Firstlinks
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Editorial

My first lesson in risk didn’t come from a finance class.

It came the day I told my parents I was abandoning a law degree in pursuit of one in English literature.

I wasn’t naive about the employment prospects. What I wanted (that I couldn’t articulate at the time), was to learn how the minds that came before me had made sense of uncertainty, ambition, fear, desire. All the things that added meaning to the otherwise mundane. Years later, when I found myself studying a postgraduate degree in finance, I realised the two disciplines weren’t as far apart as they seemed.

During those literature years, I was a William Blake devotee. Perhaps most famous for his poem "*The Tyger*", an analysis on the creation and coexistence of good and evil.

In a brutally oversimplified description, Blake rejected Enlightenment rationalism and argued that without duality, there was no progress. I think, better than anyone, he understood that the human condition was permanently at war with itself. Now, it’s unlikely Blake was an investor, but he certainly understood the role of excess and appetite.

The road of excess leads to the palace of wisdom

I recently had a stretch of time off.

Somewhere over the Pacific Ocean, after suffering from altitude-induced introspection, I called time on my thoughts and logged onto the airline Wi-Fi. I stumbled across a clip of Warren Buffett’s latest interview with CNBC. With as much gusto as a person can muster at 95, he lamented about the difficulty of finding value when “everybody is preferring gambling.”

It reminded me of something he said earlier this year, when he described the modern market as "a church with a casino attached." A rather vivid image.

There's a common observation in theology that a church is not defined by its walls, but by what people believe happens inside them. A sacred space becomes profane when the rituals lose their meaning and the congregation forgets why they gathered in the first place. What Buffett seems to be describing is the desecration of discipline, replaced by spectacle. And he might have a point.

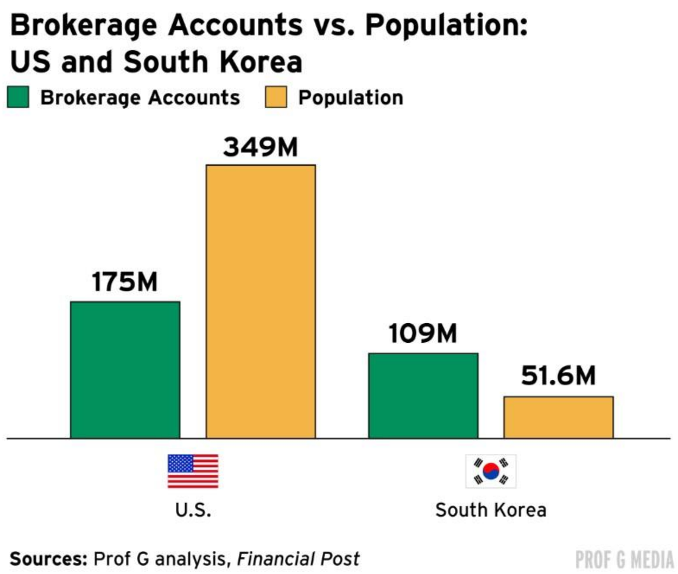
Retail participation is as high as ever. In many ways, entry to the casino has never been more brightly lit, inviting anyone with a smartphone and an impulse for financial gain. The most recent spectacle has been South Korea.

A painful lesson

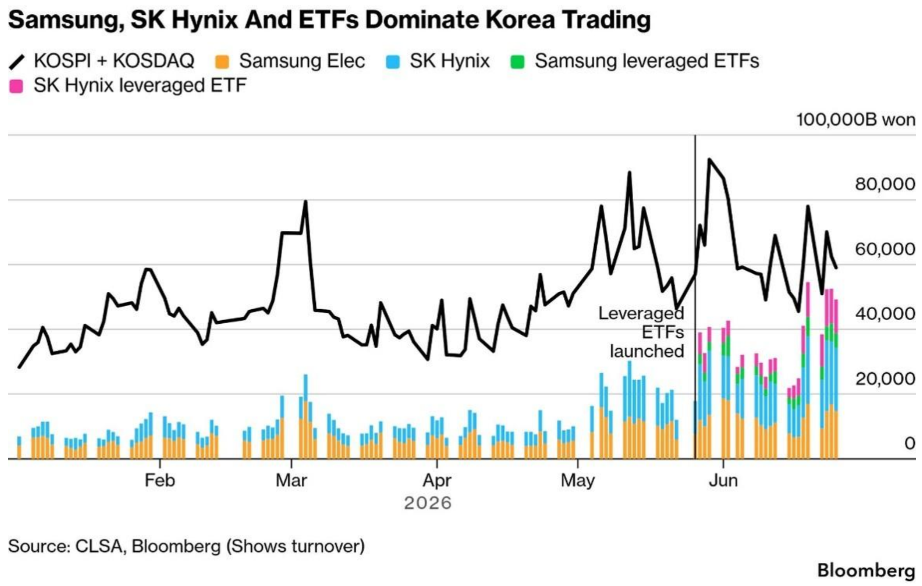
The South Korean market has just lived through one of the most violent episodes in modern financial history. Last week, the Korea Composite Stock Price Index (KOSPI) fell 44% from its June high, to then rebound 18%, marking its largest ever one-day gain.

What appeared like a booming renaissance in early 2026 has unravelled into a fragile, self-reinforcing ecosystem built almost entirely on leverage, AI hype and the fervour of retail traders who believe they've found a one-way bet.

For months, the Korean equity market had been rising on a tide of optimism centred almost entirely around semiconductor players Samsung and SK Hynix, the twin pillars of the KOSPI. Their fortunes had become synonymous with the global AI boom and traders poured into these stocks with enthusiasm. At the same time, the number of retail trading accounts in South Korea also exploded.



The real spark came in May when Korea launched single-stock 2x leveraged ETFs on Samsung and SK Hynix. Soon enough, leveraged ETFs for Samsung and SK Hynix made up 70% of stock trading value. The products sat on top of an already leveraged ecosystem, all concentrated in the same two semiconductor names.



But when sentiment finally faltered, there was an immediate and brutal unwind. The leveraged ETFs collapsed with the SK Hynix 2x product losing ~70% of its value from its peak and nearly half from its launch. Goldman Sachs estimated over 1.2 million leveraged retail trading accounts in South Korea triggered margin calls with around 30% being wiped out entirely. The violence of the crash wasn't simply the result of falling semiconductor prices. It was the consequence of a market structure that had become overly dependent on retail leverage.

There are a number of incredibly sobering stories behind the collapse. These are not abstract losses on institutional balance sheets and I take no pleasure in the demise of the optimistic. But as the saying goes, *there is no crying in the casino*. Such rules are written in advance, even if no one reads them.

The government's response was swift and unusually apologetic. Regulators admitted they had not fully considered the risks of single-stock leveraged ETFs and apologised publicly. New rules have been proposed to limit how much retail investors can allocate to such products, as well as the introduction of higher trading costs for speculative instruments. Another inquiry has been launched into the ease with which margin loans were granted through mobile apps. Much too little, too late.

And in a strange way, this brings me back to Buffett and Blake. In the Proverbs of Hell, Blake writes "*The road of excess leads to the palace of wisdom*". This was never meant to be read as an endorsement of indulgence. Blake saw wisdom as something earned only after going too far, yet Buffett proves that with experience, some learn to spot the excess long before the rest of us reach the palace.

Simonelle Mody

Also in this week's edition...

The recent pickup in inflation has reignited debate on the falling living standards in Australia. **Shane Oliver** from AMP discusses why this has happened and how we go about fixing it.

Australia's golden age of dividends may be ending. **Mark LaMonica** explores four options for an income investor's next dollar.

Recent CGT reforms tax real gains to inflation, however, they fail to index losses. **Jason Nassios** and **James Giesecke** argue this leads to inefficiencies in the tax system.

Phil Strano from Yarra Capital Management prepares investors for the increasing influence of AI funding demands on Australian bond markets.

Jason Teh from Vertium explains why active managers confronting today's markets need to bring a gun to the gun fight.

Kaye Fallick interviews a leading pension fund innovator and poses the question - *What can Australian super funds learn from the UK?*

Chris Cuffe shares what ten fund managers believe the market may be missing.

Curated by Simonelle Mody and Leisa Bell

Why have Australian living standards 'fallen' and how do we fix it?

Shane Oliver

For the last few years there has been much talk of a “cost-of-living” crisis in Australia and of “falling living standards”. This has flared up again lately with the pickup in inflation resulting in a renewed fall in real wages.

In the last week the OECD noted that: a 5% fall in real wages over the last five years was amongst the worst in OECD countries; Deloitte Access Economics noted that on its growth forecasts for the next two years Australia was heading for its worst stretch of growth below 2% since the early 1990s; and the media reported that Australia’s underlying rate of inflation was around the highest in developed countries.

This of course is a far cry from what we were used to in the decades prior to the pandemic. In the 1980s a collapse in national income following years of stagflation, i.e., poor growth and high inflation, galvanised the Hawke/Keating Labor Government to undertake supply side productivity enhancing economic reforms to get the economy back on track. These were continued in the Howard/Costello years and Australians saw rapidly rising material living standards.

This in part contributed to the IMF referring to “Australian Exceptionalism” given its strong performance compared to other developed countries and was highlighted in a 2018 cover story in The Economist magazine titled “Aussie Rules…what Australia can teach the world” and referred to “the wonder down under”.

In fact, to borrow from journalist Paul Kelly’s book, Australian Exceptionalism had by then already entered the “twilight zone” as since the late 2000s the wheels fell off the reform agenda and productivity started to suffer but it had been masked by strong export earnings so no one really worried. Since the pandemic, though, the malaise has become clearly apparent. So, what went wrong and how do we fix it?

Weaker living standards

The deterioration in living standards can be seen in various indicators. Often referred to in the last few years has been the slump in real household disposable income per capita which shows the value of incomes after allowing for tax, mortgage debt payments and inflation. It's a far broader measure of household income than just wages.

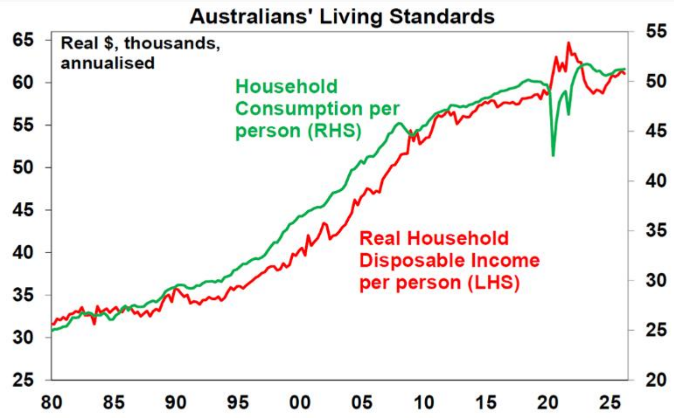
Since its high point in 2021, it fell more than 9% into 2023-24. It's still 5.6% below its high, and is now showing signs of slowing again. Of course, the slump was exaggerated because it came off the back of a surge through the pandemic due to payments like Job Keeper. But even allowing for that, real disposable income per person is up only 0.6% pa over the last decade, compared to 2.3% pa growth over the prior 20 years. And real disposable income has been much weaker here than across OECD countries, where on average it's risen above the highs reached in the pandemic.

So, what's gone wrong?

The poor performance in real household income reflects a combination of factors. First, wages have not kept up with inflation since 2021. Since the end of 2020 average consumer prices are up 25%, but average wages have only gone up 19%. So real wages have fallen 6%**.** They did start to rise again in 2024 and into 2025, but are now reversing again due to the rebound in inflation.

Second, the rise in interest rates since early 2022 saw a big rise in mortgage interest payments relative to income. There was a brief decline last year, but this is now reversing again.

Thirdly, bracket creep has driven income tax payments to a near record high as a share of income further reducing disposable income.



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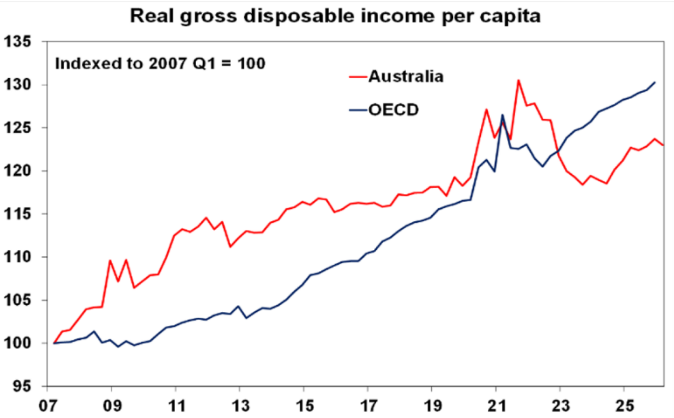

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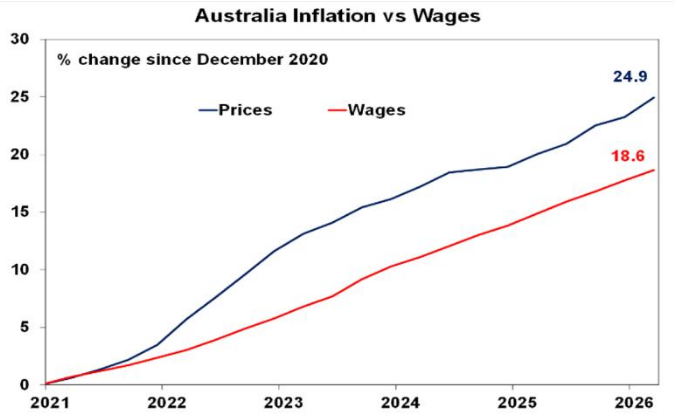

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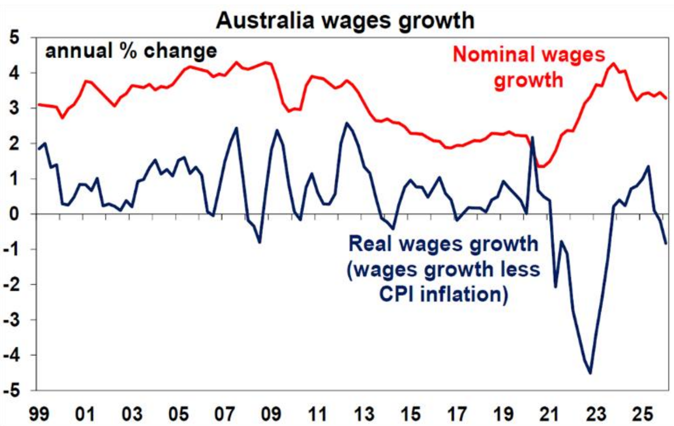
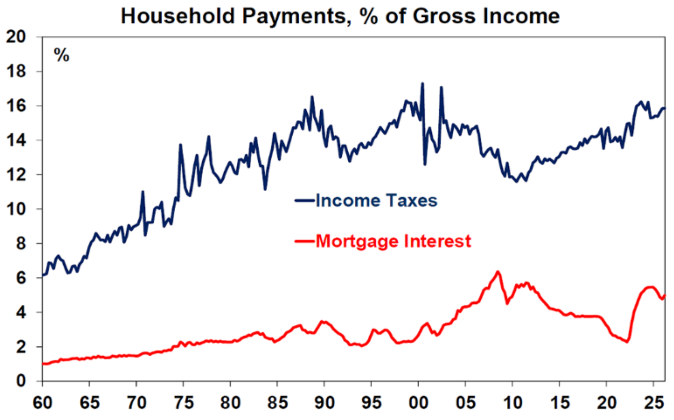


Source: ABS, AMP

The July 2024 income tax cuts provided some relief but the rising trend has resumed.

However, a more fundamental driver of the malaise is poor productivity growth. Productivity is often thought of in terms of labour productivity, i.e. GDP per hour worked. It rises when we boost our skills, use more capital like machines or AI or arrange our efforts more efficiently all of which enable us to work smarter and so produce more, which can then be rewarded with rising real incomes. While productivity growth was strong in the 1990s and early 2000s it slowed from the mid-2000s and has slowed to a crawl since 2016.



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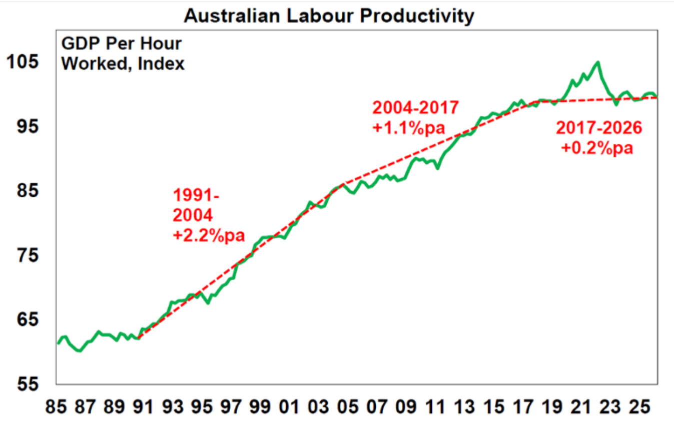
Productivity growth is the main driver of material living standards over long periods. The slowdown in productivity points to ongoing softness in per capita GDP growth…



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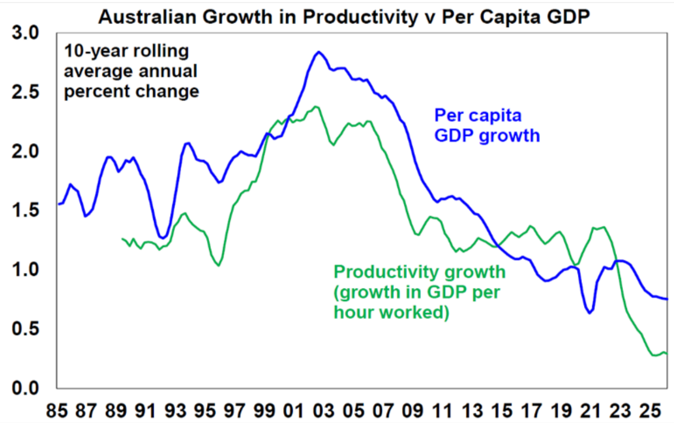
…and slower growth in household incomes and by implication consumer spending.

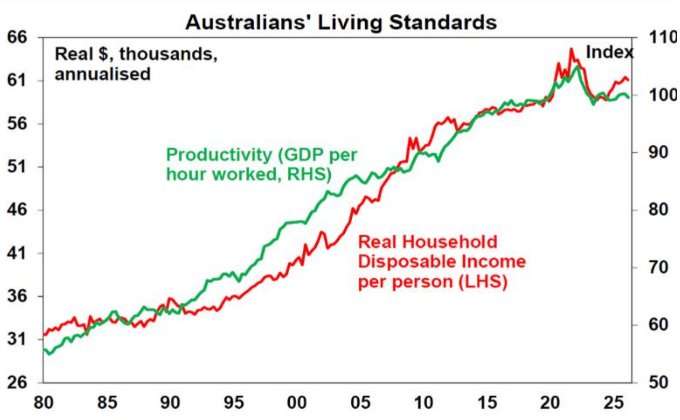


Source: ABS, AMP

We can make up for this by faster population growth, but this doesn't help living standards per person. Likewise, it can also be masked by strong commodity prices and hence national income, but medium-term threats to Chinese growth mean we cannot rely on that. Lower productivity growth makes it harder to boost the supply side of the economy to keep inflation down and results in lower real wages growth, slower growth in profits and a reduced ability for the government to provide services.

So, why has productivity growth stalled?

As noted in the introduction, after the malaise of the 1970s and a collapse in export earnings, there was a focus in the 1980s under Hawke and Keating, and then continued under Howard and Costello, on supply side economic reforms designed to improve productivity growth by making the economy more flexible and competitive, improving incentives and improving skills. This saw productivity growth



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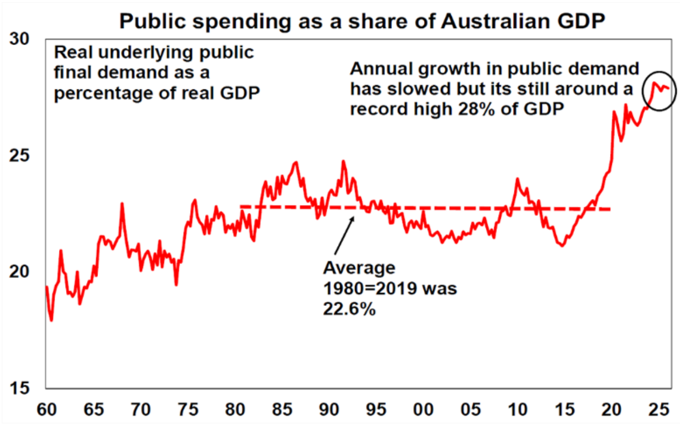
surge through the 1990s into the 2000s and expanded the capacity of the economy to grow without causing inflation.

But since then, a range of factors have contributed to slower productivity growth, including: no big new reforms since the GST in 2000 and some backsliding, e.g. with reregulation in industrial relations; very strong population growth has led to urban congestion and poor housing affordability; growth in business investment stalled in the 2010s; market concentration has increased, reducing competition; confusion regarding climate policies contributed to underinvestment in power supply and higher energy costs; and a huge expansion in public spending has taken resources from the more efficient private sector. A good example of the latter has been out of control growth in the NDIS which saw public sector employment rise dramatically over the last few years and health employment as a share of the labour force rise nearly 2 percentage points above its long-term trend.

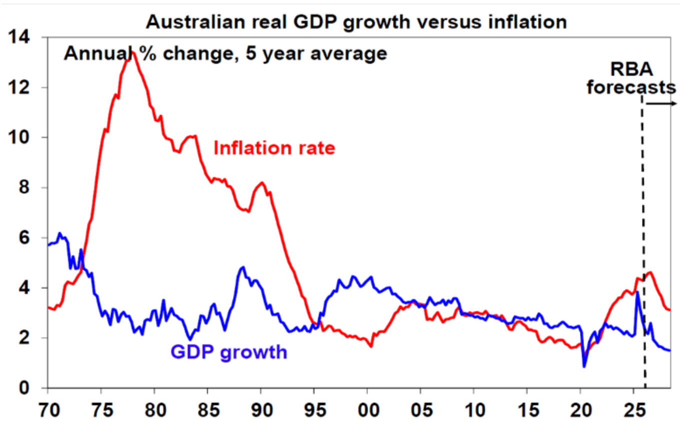


Source: ABS, AMP

The surge in public final demand – which is now running around 28% of GDP compared to an average of around 22.6% over the previous 40 years – is particularly significant as the required shift in resources from the private sector to the public sector has been bad news for productivity. That is because public (or non-market) sector productivity is invariably lower than that in the private (or market) sector and because public spending has been squeezing out private business investment, which has weakened private sector productivity.

This has meant a worse growth/inflation trade-off

The deterioration in productivity growth has effectively led to a worse growth/inflation trade off. In other words, because the economy is no longer as efficient as it uses to be in boosting the supply of goods and services to meet any pickup in demand (or spending) in the economy – as we saw last year when private sector demand picked up – an acceleration in growth is more likely to result in a higher rate of inflation than used to be the case for any given level of GDP growth. This can be seen in the next chart where the five-year average rate of GDP growth has been trending down (abstracting from pandemic distortions) but the five-year average inflation rate (the red line) has been trending up so far this decade. Of course, this is nowhere near as bad as the 1970s. However, it's still necessitating higher RBA interest rates and ultimately lower economic growth to tame inflation than would have been the case prior to the pandemic.



Source: ABS, AMP

Hence the observation by Deloitte Access Economics referred to earlier & it's also evident in the RBA's own growth & inflation forecasts.

All Australians are paying for the slump in productivity growth with weaker than otherwise living standards.

How to sustainably boost growth in living standards?

If we want to boost living standards and enable sustained real wage growth consistent with the 2-3% inflation target there are no quick fixes. At the risk of sounding like a broken record, the only sustainable way to do it is to boost productivity so we can expand the supply side of the economy and take pressure off inflation. Fortunately, there are plenty of good ideas out there, including these seven key measures:

1. Tax reform to rebalance from direct tax to a broader GST, compensate those adversely affected, index the income tax thresholds to inflation and remove nuisance taxes like stamp duty to incentivise work effort and investment and better allocate resources. The Government did move to curtail property tax concessions in the last Federal Budget but with no real cuts to income tax this was more of a tax hike than tax reform and the capital gains tax changes threaten startups and hence productivity.
2. Put a limit on the size of government spending below 25% of GDP. If we want more government services, we need to find other government spending to cut. Unfortunately, the Budget saw no significant cut to government spending.
3. Deregulate product and labour markets to remove red tape and boost labour market flexibility, for instance, to make it easier to build new homes. There was a bit of this in the last Budget but much rests with the states and the Government has ruled out industrial relations deregulation.
4. Provide more incentives to boost investment and adopt new technology. There was a bit of this in the Budget but it was modest and the capital gains tax changes are likely to be a disincentive for some.
5. Undertake competition reforms to reduce market concentration.
6. Match population growth to the ability to supply new homes and make it easier for people to live away from congested cities.
7. Reduce climate policy uncertainty and rely more on market signals as to how best to transition to net zero.

While the Economic Reform Roundtable last August and the lead up to the Federal Budget this year offered the hope of the more sustained focus on boosting productivity, this has yet to be really delivered upon.

What's stopping us?

The problem is that since the GFC, and reinforced by the pandemic, the political pendulum has been swinging in favour of bigger more interventionist government. There is now an expectation that government is the solution to most problems. The economic rationalist policies of Reagan, Thatcher, Hawke/Keating and Howard/Costello are out of fashion. Populist policies are in.

In the absence of a crisis, it's hard to see Australian governments undertaking the sort of hardnosed economic rationalist reforms required. Hopefully the "cost-of-living" crisis and the living standard malaise will start to put more pressure on for sensible reforms. We may have a way to go yet though.

Dr Shane Oliver is Head of Investment Strategy and Chief Economist at AMP. Additional contributors: Diana Mousina, Deputy Chief Economist and My Bui, Economist. This article has been prepared for the purpose of providing general information, without taking account of any particular investor's objectives, financial situation or needs.

Four options for an income investor's next dollar

Mark LaMonica CFA

Two things are needed to be a successful income investor. You must have the patience to stay the course with existing positions so income compounds over time. You must also continually focus on the best place to invest your next dollar for future income growth.

This dichotomy can be difficult to navigate. Long-standing positions with significant unrealized capital gains may still be delivering for your portfolio while not being the 'best' place to invest the next dollar.

The Australian market has delivered for income investors in the previous decades – but what if that golden age of dividends is coming to an end?

This is not a call to overhaul your portfolio. However, it is worth considering other options for investing your next dollar if you are an income investor. Here are four choices for investors who share a concern about the companies and sectors that dominate the local market.

Alternate options for income investors

The goals of income investors are not uniform. Some income investors are concerned with the highest possible current yield and some are more focused on income growth.

Where you fall on this spectrum will dictate the relative attractiveness of each of these options.

Broad exposure to the Australian market in a non-market capitalisation weighted ETF

For investors with specific goals – like generating income – a broad-based index may not deliver the desired outcome. This is the case for most global investors. But Australia is different and historically a passive approach to the Australian market worked out for income investors.

The outcomes for market capitalisation weighted indexes are heavily reliant on the largest companies. If you are worried about the largest companies, you can buy ETFs that either reduce their exposure or avoid it altogether. Two examples are the BetaShares Australian Ex-20 Portfolio Diversifier ETF (ASX: EX20) and VanEck Australian Equal Weight ETF (ASX: MVW).

As the name implies, the EX20 ETF avoids the twenty largest companies in the ASX 200 and applies individual holding and sector caps to limit concentration. The VanEck ETF has an equal allocation to the top 74 companies in the ASX 200, although the number of holdings may change based on liquidity criteria.

However, both MVW and EX20 experienced the same challenges with the June distribution with each falling 40% from the previous year.

One data point isn't a trend and I still believe reducing exposure to the largest companies is the right move for long-term income investors. But it is important to acknowledge the same challenges faced by the big miners and banks also impact smaller miners and banks. In most cases the challenge is greater given their lack of scale.

It is hard to avoid sector concentration in any diversified Australian share ETF. But given the top-heavy nature of our local market the return and income profile of MVW and EX20 will be different from the ASX 200.

There are downsides to investing in both ETFs. An investor will likely face a higher capital gains component of the distribution – especially for MVW – and a higher fee than the broad-based index. Whether that is worth it is based on your goals, your view of the Australian market and the other holdings in your portfolio.

Listed Investment Companies (LICs)

There are several structural advantages and disadvantages of including LICs as part of an income portfolio.

The company structure allows the retention of profits and provides the LIC manager with the discretion to distribute income and franking credits at a time of their choosing. This can smooth out any income cyclicality in the underlying holdings and provide a stable stream of income and franking credits to investors.

A steady stream of income is valuable to investors living off dividends – especially in challenging times. For example, during the pandemic many LICs were able to maintain a degree of dividend stability even as many companies were suspending or cutting dividends.

The following chart shows the percent change in distributions / dividends for three major LICs compared to the Vanguard Australian Shares ETF.

Holding	2019	2020	2021	2022	2023
Vanguard Australian Shares (ASX: VAS)	0.26%	-46.70%	82.34%	85.29%	-45.40%
Australian Foundation Investment Company (ASX: AFIC)	33.33%	-25.00%	0.00%	0.00%	4.17%
Argo Ord (ASX: ARG)	4.76%	-9.09%	-6.67%	17.80%	4.55%
WAM Capital Ord (ASX: WAM)	0.00%	0.00%	0.00%	0.00%	0.00%

Another advantage is LICs can provide franking credits from a variety of assets and not just Australian shares. A LIC that invests in global shares can still have franking credits because the LIC is an Australian company which makes profits and pays taxes in Australia.

The closed end structure of a LIC has advantages and disadvantages. The LIC share price is set by supply and demand from investors and can deviate meaningfully from the value of the underlying assets. There is no mechanism to keep the net tangible assets ("NTA") in line with the LIC price like an ETF or a fund.

This adds another element to the total return for a LIC investor. Not only does the skill of the manager matter in the capital growth of the LIC but also the behaviour of other LIC investors. Many LICs trade at a discount to the NTA but they could just as easily trade at a premium if investor demand for LICs increased.

The closed structure does provide freedom for the manager, which is one reason I would consider a LIC while avoiding other active strategies. The capital raised from investors is ring fenced and isn't impacted by investors moving into and out of the fund. This is something a manager of an open-ended managed fund must deal with which can restrict their freedom of action and lead to short-term behaviour.

The challenge for LIC investors is evaluating the skills of the LIC manager. This matters because a skilled manager can avoid companies with poor dividend prospects. But it can be difficult for an individual investor to assess the skills of a manager as the only tools available are the historical track record and marketing material.

Individual shares

Part of the reason I became an income investor is because it is more straightforward. Achieving financial freedom by hitting some arbitrary level of wealth was abstract. Generating enough passive income to pay for my life was clear.

In my opinion, picking individual shares for income is more straightforward than finding shares with a total return objective. That doesn't make it easy – but I think it is easier. You still need to evaluate a business because without earnings there are no dividends. But you don't have to try and figure out how investors will react to different scenarios.

There is no need to worry about catalysts, sector rotations, sentiment or expectations. You just look for companies that will likely make more money in the future and have a track record of returning it to shareholders. There are fewer variables that impact success when you narrow your focus to income.

There are other advantages to investing in individual shares with an income focus.

Behavioural risk is lower if you focus on dividends and place less emphasis on price movements.

Companies that pay dividends are generally more mature, stable and financially healthy, which makes it less likely they will go out of business. This limits downside risk.

Many dividend paying companies are boring which means you don't have to evaluate cutting edge technology and the shifting competitive environments of new industries. You still need to understand the dynamics of the industry for a dividend paying share…but some industries are more complex to evaluate than others.

When you hold individual shares you can pick the timing of capital gains. You have more transparency into why income levels are changing. You don't have to pay any fees. You get complete control over your positions which means you can avoid sectors and companies that don't have attractive prospects for dividends.

There is one big disadvantage. Picking individual shares is more challenging than buying a diversified ETF. Managing a portfolio of individual shares takes more time and effort.

Picking individual shares isn't about having a high IQ or special talent. It just involves some effort to gain knowledge and evaluate companies. Some people prefer to focus on other aspects of their lives – financial and otherwise. I personally gravitate towards individual shares but you can still be successful avoiding them and for many people that is a sensible choice.

Covered calls

The ‘best place’ to invest the next dollar is dependent on what you are trying to accomplish. For some income investors ‘best’ may be the highest yielding investment. For others it is all about income growth.

I’m in the income growth camp, and I wouldn’t consider a covered call strategy at this point in my life. But I do see why it is attractive to some investors and could see myself potentially using it in a limited way in a few decades.

A covered call strategy is a technique used to generate additional income from a portfolio of shares. The effectiveness in generating additional income is offset by limits on capital gains.

If you are considering investing in a covered call ETF I would encourage a detailed review of how they work – I wrote one here. But the summary is the ETF holds a group of shares and sells call options.

In exchange for the cash, the ETF gives the buyer of the call the right, but not the obligation, to buy the shares at a price above the current price of the shares.

If the shares rise in value the upside is capped because they are purchased by the holder of the call option. If the shares fall in value the ETF goes down in price. The trade-off is income consisting of the dividends from the shares and the cash from the call options.

There are also tax considerations as this strategy has the potential to generate significant capital gains.

The performance of a popular ETF

I will use the BetaShares Australian Top 20 Equities Yield Maximiser Complex ETF (ASX: YMAX) as an example.

Investing $10,000 on 1 August 2021 at the open price of $8.35 would result in 1197.50 units. Slightly less than five years later the units closed at $7.46 on 22 July 2026. The $10,000 investment would now be worth $8,933.35. But the income generated over that period is an impressive $3,704.82.

The total annual return over the past five years is 6.49%. That compares to a 7.91% annual return for BetaShare’s Australia 200 ETF (ASX: A200). But those annual returns assume distributions are reinvested.

If you are not reinvesting the distributions – and I assume many people in this product aren’t – things don’t look quite so good.

Each investor will have to decide if this trade-off is worth it. When you invest in the share market you benefit from the asymmetric nature of returns – a share can only go down 100% but has an unlimited upside. A covered call ETF is different as higher levels of income are exchanged for capped upside and the same downside of the overall market.

Final thoughts

Yesterday I got $536 closer to going to Africa. Last week I got $140 closer to financial independence. This is life as an income investor. In an account I use to fund travel the most recent dividend from Cisco will help pay for a trip next year. In another account I bought an ETF which should pay $140 in distributions next year – and hopefully will pay a growing stream of income for the rest of my life.

Income investing isn't a get rich quick scheme and it isn't about investing in the companies on the front page of the paper – hence my call for patience and a non-consensus approach.

There are many tools that income investors can use and each has a unique set of advantages and disadvantages. The job you are trying to do will dictate which combination of tools works best.

To be a successful income investor requires the same framework as any other investment strategy.

Start with clearly defining what you are trying to accomplish – is income growth or high current levels of income the best way to support your life?

Establish criteria for making the inevitable trade-offs involved in investing and select the right investments for you based on your goals, your temperament and your knowledge and skills.

Once the framework is in place, focus on consistently applying your strategy over the long-term.

Mark LaMonica, CFA, is Director of Personal Finance at Morningstar Australia.

Completing the reform of CGT: tax real losses like real gains

James Giesecke, Jason Nassios

The Commonwealth Government's Capital Gains Tax (CGT) reforms begin with a sensible principle: tax real financial gains rather than inflation. To advance this principle, Parliament passed the Treasury Laws Amendment (Tax Reform No. 1) Act 2026 in June, which will see changes to the CGT from 1 July 2027. Under the current system, individuals generally pay tax on half of nominal capital gains on assets held for over a year, while the new system will introduce indexation based on the Consumer Price Index (CPI), with a minimum 30 per cent tax on gains.

CGT can be an important element in a tax system by helping reduce exploitable loopholes. Without CGT, taxpayers may be incentivised to package income as capital appreciation, for example through retained earnings. Taxpayers with identical real incomes can face different tax bills simply because they receive income in different forms. This can lead to higher tax rates generally to make up the difference.

CGT, however, should reflect a taxpayer's genuine increase in purchasing power. This requires taxing real gains rather than inflationary gains, which is where the recent tax reforms come in. However, the new tax reforms only go halfway to meeting this overarching principle. Under the measures proposed, gains are fully indexed, but losses are not. According to our new research, this change in design could impose higher taxes on directly held assets than the design it replaces.

With a further technical bill later this year, there is time to make changes to better reflect the underlying principle behind these reforms. This would mean indexing capital gains for inflation, while also recognising real capital losses where assets have not kept pace with inflation.

Why taxing real gains implies recognising real losses

Real gains and real losses are the same economic object, just from opposite perspectives. Under a CGT that taxes real gains in asset values, assets that outpace inflation generate taxable income, and assets that lag inflation generate losses to recognise. If this symmetry is broken, the tax base no longer properly measures real income, and the tax system creates costly distortions.

The new CGT design does just this. It will mean that over time, every directly held asset will fall into one of three tax zones. If its value ends above the indexed cost base, the resulting real gain is taxed. If its value falls below the original purchase price, only the nominal loss is recognised as a capital gains offset against the asset's full real loss. Between these outcomes sits a middle band of assets that have risen in nominal terms but failed to keep pace with inflation. On these assets, the investor suffers a loss in purchasing power just as real as the gain in purchasing power generated by assets in the first zone. But the tax system recognises no loss.

Consider a simple example. An investor buys three assets, A, B and C, for $10,000 each. After five years of 3% annual inflation, the inflation-adjusted cost base of each asset is $11,593. Assume the assets are now worth $19,619, $10,031, and $5,129 respectively. Hence, in total, the portfolio is worth $34,779, exactly equal to its inflation-adjusted cost base. In real terms, the investor has made no gain. Yet, under the new CGT system, the investor is taxed on a gain of $3,155. This reflects the real gain on asset A, less only the nominal loss on asset C. The real loss on asset B, and the inflation component of the loss on asset C, are ignored. At the top marginal tax rate, the taxpayer faces a $1,483 CGT liability, despite no real gain. This example shows how the system taxes upside without treating downside outcomes equally. The result is that investors can face CGT bills even when they have earned no real gain overall.

The economy comprises millions of assets, many directly held, and individual investors typically hold portfolios of assets. At both the national and individual levels, the new CGT design creates a system under which upside outcomes are taxed on full real gains, while real losses on downside outcomes are recognised only partly, or not at all. Expected tax therefore rises with the spread of outcomes across assets, even when the portfolio yields no real gain.

Comparing CGT systems

Our paper studies a diversified share portfolio whose value, on average, merely keeps pace with inflation. This is a portfolio with no real gain and hence, in principle, there is nothing to tax.

The table below reports expected tax liability under the current and new CGT systems, generalising impacts over investment holding periods longer than 5 years under 3 per cent inflation and no real capital growth. Under the current system, an investor on the top marginal tax rate faces an expected CGT liability of 13.8 per cent of the portfolio's final value after 30 years, purely for standing still against the CPI. Over long periods of time, this liability approaches 23.5 per cent. That is the defect that indexation is meant to fix.

Holding period	Current system: nominal gains, 50% discount	New system: indexed gains, unindexed losses
10 years	6.0% (62 basis points/year)	7.5% (78 basis points/year)
20 years	10.5% (55 basis points/year)	14.3% (77 basis points/year)
30 years	13.8% (49 basis points/year)	19.9% (74 basis points/year)
50 years	18.1% (40 basis points/year)	28.4% (67 basis points/year)

But under the new system, the same investor faces an expected burden of 19.9 per cent at the 30-year horizon: around six percentage points of total accumulated value more than under the system being replaced. In annual terms, this is a tax drag of about 74 basis points, compared with 49 basis points under the current system.

A symmetric real gains tax would collect nothing from this portfolio, because there is no real income to tax, while still taxing genuine real gains where assets grow faster than CPI.

Creating a fairer, symmetric CGT system

Why might policymakers resist symmetric treatment of real losses? A potential objection is that recognising indexed losses might encourage taxpayers to realise losses and defer gains. The pre-1999 Australian regime restricted loss recognition partly for this reason. However, capital losses are already quarantined against capital gains, limiting this possibility. While anti-avoidance concerns deserve attention, they must be weighed against the efficiency costs created when losses are not treated in the same way as gains.

Our research focuses on the tax penalty created by treating gains and losses differently. But the costs of the new system extend beyond this. Lock-in is likely to worsen. Taxpayers with long-held assets and large accrued gains now face tax on disposal at the higher of their marginal rate and 30 per cent, which will create distortions that are difficult to quantify but potentially large in their impact on economic efficiency. Investors may hold portfolios that are poorly suited to their evolving circumstances because rebalancing is costly; business founders may stay on as managers beyond the point at which transfer to new owners would be efficient; and shareholders in established companies that might be more efficiently managed via takeover could require higher premiums before selling.

The regime is also likely to push asset ownership into more institutionally mediated forms. Companies and superannuation funds retain their existing CGT treatment, while direct personal holdings face the new regime. This is itself an economic distortion. However, it also means fewer individual investors participating directly in asset pricing and capital allocation, and a narrower channel via which the ultimate owners of capital hold management to account.

Compliance costs are also likely to rise. Investors will need to keep records of the purchase price, cost base changes and inflation adjustments for every CGT asset. For assets held when the new system begins on 1 July 2027, they may need valuations at that date (so that prior gains can be taxed under the old system and subsequent gains can be taxed under the new system) or opt for apportionment between the two systems when CGT is triggered. Hence, many investors will need to maintain records that work under both the old and new rules. For many households, direct asset ownership will be unattractive.

The reform correctly recognises that inflationary gains are not income. A similar logic, which has been missed, is that inflationary losses must not be ignored. With a further technical bill later this year, there is an opportunity to align the treatment of capital gains and losses with the effects of inflation.

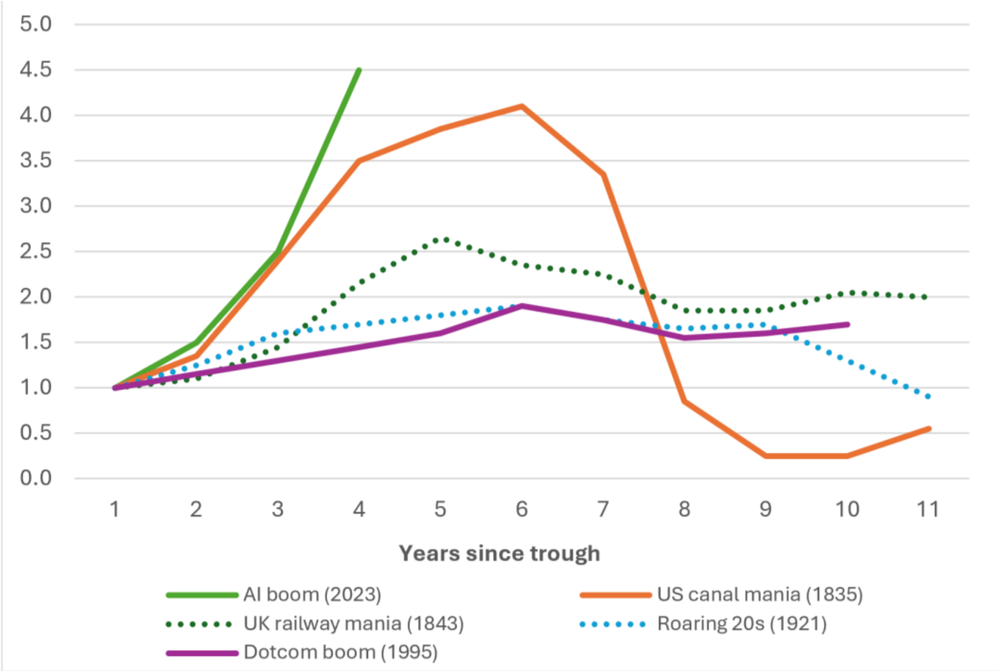
James Giesecke is a Professor; and Jason Nassios is an Associate Professor and Deputy Director (Engagement and Impact) at the Centre of Policy Studies, Victoria University. This article was originally published by The Policymaker, a digital publication of the Australian Public Policy Institute, and is republished with permission.

Blockbuster AI debt issuance coming to a bond market near you

Phil Strano

With its capital expenditure cycle in full swing, AI investment in fixed assets is up ~4.5x in three years. Outside of war times, this growth in fixed assets has no precedent, easily eclipsing the US canal mania of 1835 and sits well above last century's dotcom boom (Chart 1).

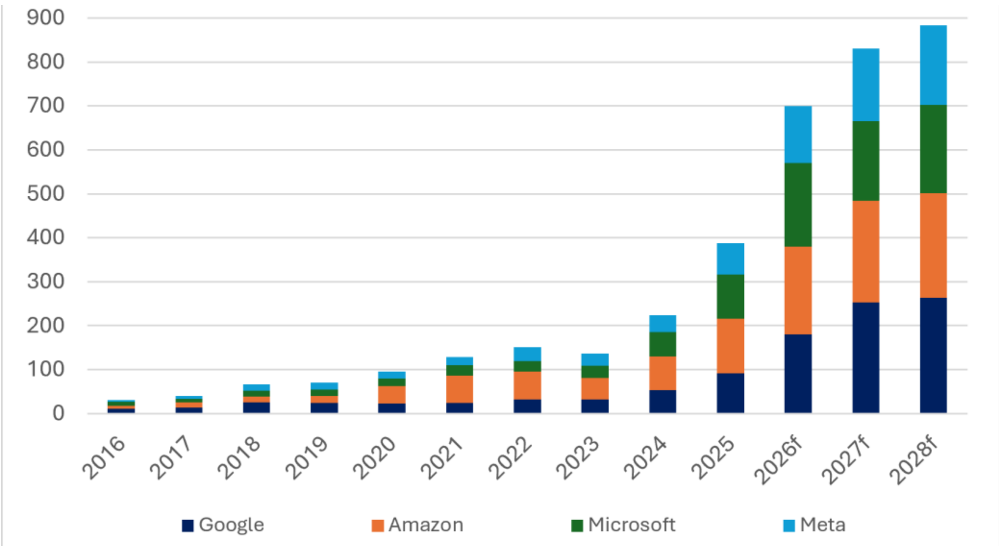
Chart 1. AI build-out is eclipsing previous investment booms (Index, pre-boom trough = 1)



Source: ASR, Jul 2026.

Among the hyperscalers (Google/Amazon/Microsoft/Meta), annual capital expenditures are expected to continue rising to an estimated $US900 billion in 2028 (Chart 2). If you include related investments from the likes of OpenAI, Oracle, SpaceX, Anthropic etc., estimated AI capital expenditures easily exceed $US1 trillion p.a.

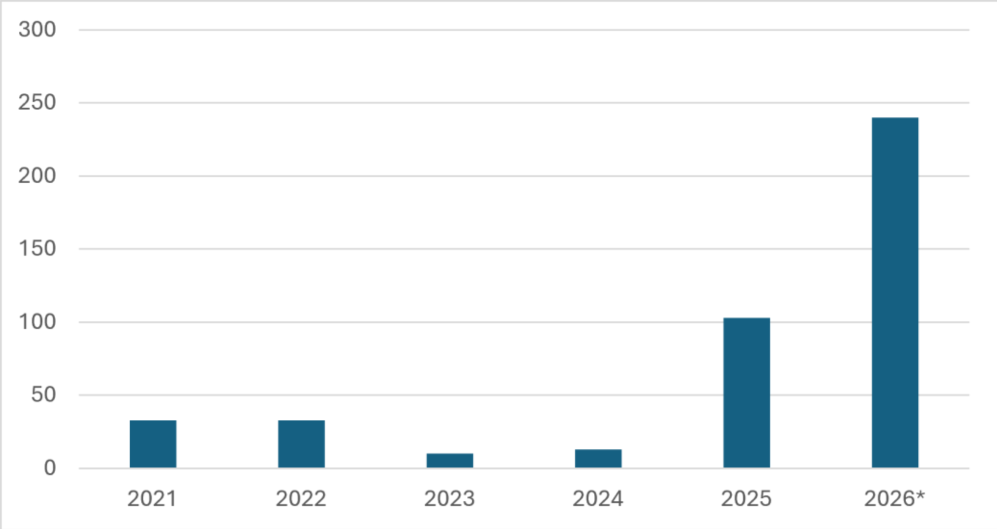
Chart 2. Full steam ahead for hyperscaler capex (actuals and forecasts ($USbn))



Source: YCM, Bloomberg, Jul 2026.

With recurring cashflows totally insufficient, capital expenditures are now being increasingly funded with debt. Up to July 9th of this year, investment grade (IG) bond issuance from Google, Amazon, Meta, Nvidia, Oracle and SpaceX was ~$US240bn, comfortably more than double the total for 2025 and still with ~six months left in the year (Chart 3).

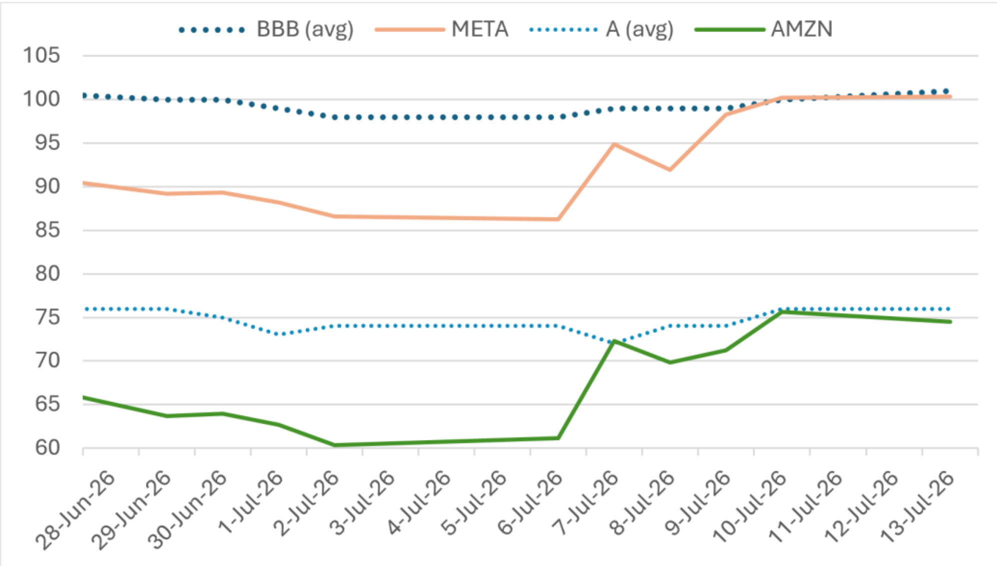
Chart 3. Debt funding now increasingly part of the AI funding plan (AI-related IG Bond Issuance ($USbn))



Source: YCM, Dealogic, 9 Jul 2026.

The significant increase in bond issuance, primarily in the US market, is already creating indigestion, leading to hyperscaler spread underperformance. Albeit still officially rated in the double A rating bands, Meta and Amazon are respectively pricing like US triple B and single A rated corporates (Chart 4).

Chart 4. AA rated Hyperscaler 2036 bonds now pricing like single A and triple B credits (2036 $US bonds - credit spreads vs. averages, bps)



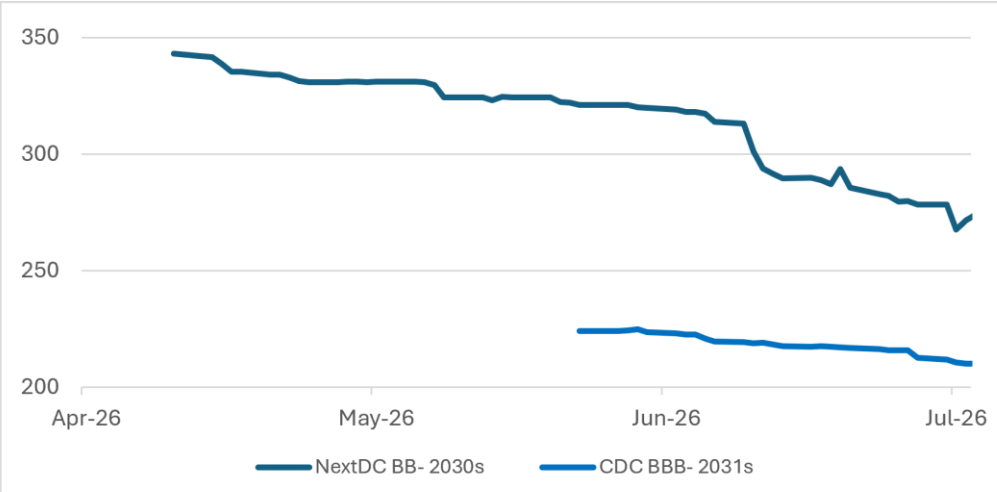
Source: YCM, Bloomberg, Jul 2026.

With additional debt funding required and the US IG market already saturated, blockbuster AI issuance is unquestionably coming to a bond market near you. However, the sheer scale of debt required will result in global benchmark pricing across all markets including Australia. Thus, if Meta is pricing as a triple B corporate in the US, the same will apply across all major markets (EUR, $A, GBP and CAD etc.).

To date, AI bond issuance in Australia has been confined to data centre developers NextDC (NXT) and CDC Data Centres (CDC). In the 1H26, both entities issued subordinated bonds/notes while CDC is currently marketing new senior $A bonds. While AI spread widening is not currently impacting $A bond markets, in our view it's only a matter of time before our market reflects global benchmarking.

Having not invested in sub-investment grade NXT subordinated notes at issue [due to insufficient return for the risk](), these securities now look extremely expensive at an even narrower ~275bps credit margin. By contrast, IG rated CDC has not rallied as much, offering more value protection from the AI-related spread widening to come (Chart 5).

Chart 5. Australian data centre bond spreads holding up for now (NXT and CDC subordinated bonds – credit spreads (bps))

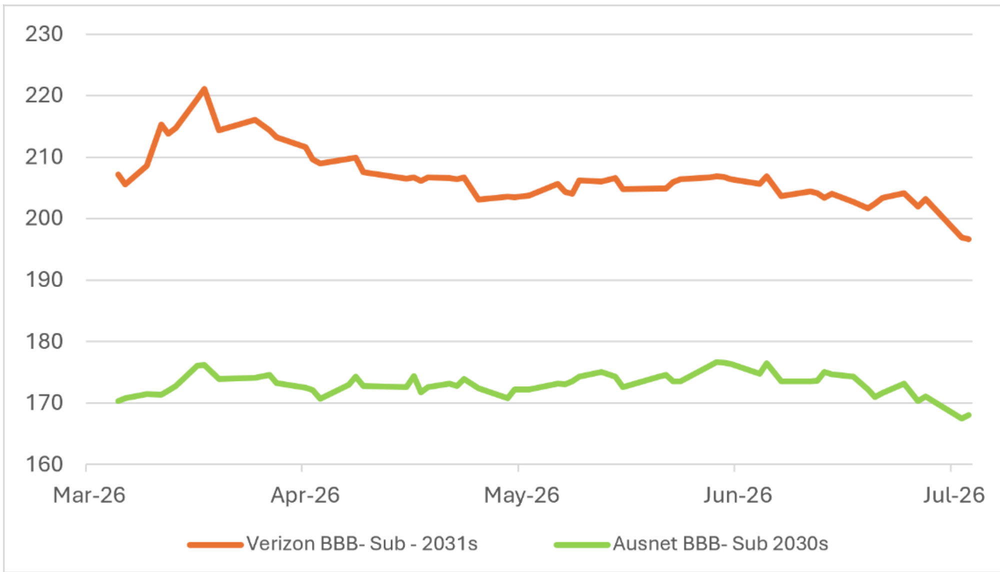


Source: YCM, Bloomberg, Jul 2026.

Judging by the latest US bank earnings results, the AI boom is driving revenue growth across equity and debt capital markets. Eager to participate in this growth, domestic banks are champing at the bit to attract more AI issuance into $A markets. Hyperscalers have never issued bonds in Australia, with first-time issuers normally required to conduct a domestic roadshow to execute successfully. We hear there is reluctance to commit the time required for a successful debut deal in Australia.

Like Verizon (VZ), who issued $A BBB- rated subordinated bonds in March 2026, there seems to be a preference for same day deal announcement and execution among the hyperscalers. Having not issued in Australia for some time, the VZ method resulted in poor deal execution, wider pricing and weak secondary market performance: the 2031 VZ subordinated bonds were issued ~40bps wider of similar rated Ausnet 2030s and have traded substantially wider, with most domestic investors not participating (Chart 6).

Chart 6: Verizon's bonds flawed deal execution results in underperformance (Verizon and Ausnet Subordinated Bonds - Credit Spreads (bps))



Source: YCM/Bloomberg – July 2026.

Either the hyperscalers will be happy to pay a significant spread premium for the privilege of accessing the required $A volume in a ~12-hour window or they will alternatively commit to market convention for debut issuers. We expect to find out soon enough.

Given the gargantuan sums involved, it is inevitable that the $A market will see more AI-related issuance with hyperscalers playing a more prominent role. Consistent with global benchmarking, we also expect spread widening to be associated with increased AI issuance. Finally, we remain convinced this period of AI investment will follow a similar path to that of the European telcos of the early 2000s, with average hyperscaler sector credit ratings in coming years migrating lower from double A to triple B. Across our funds, we will be ensuring any investment in AI bonds offers sufficient spread premia to compensate for lower future credit quality.

Overall, expected AI volatility and higher outright yields will create opportunities for active managers to generate additional attractive and defensive income. The actively managed Yarra Enhanced and Higher Income Funds are ideally placed - generating income in the range of 6.5-7.5% p.a. from highly diversified IG quality portfolios.

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

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Active managers: Bringing a gun to the gunfight

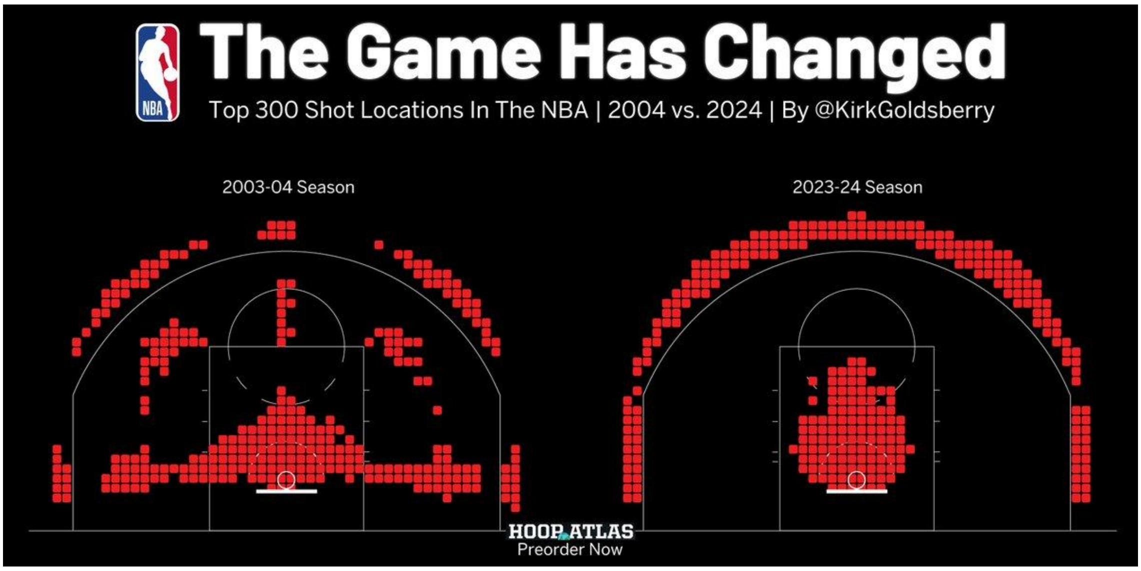
Jason Teh

In "Are Active Managers Bringing a Knife to a Gunfight?" I argued that the rise of passive investing has handed price-setting to sophisticated systematic players, and that discretionary active managers must evolve. Markets are not the only place this has happened. Professional basketball, Formula 1 and chess were all reshaped by data over the past two decades, and each has something to teach active managers facing the same shift.

The NBA: asymmetric mathematics

For decades, shot selection was a matter of feel. Guards and forwards worked the mid-range, the zone between the key and the three-point line, taking jump shots based on spacing and personal comfort. Camera-tracking technology ended that. Once analysts could calculate the expected value of every square foot of the floor, the mid-range jump shot was the least efficient play in the sport.

Kirk Goldsberry's shot charts capture the shift. Map the league's top 300 shot locations in 2003-04 and the mid-range is dense with activity. Map the same thing in 2023-24 and it has been hollowed out. The volume migrated to two zones: at the rim, and behind the arc.



Source: @kirkgoldsberry

The two zones win for different reasons, and the mid-range loses on both counts. Using recent league averages, the maths is revealing:

- At the rim, shooters convert around 66%. Two points a time, that is 1.32 points per shot (66% x 2).
- From mid-range, accuracy falls to about 41%. Still two points, so 0.82 points per shot (41% x 2).
- Behind the arc, accuracy drops further to roughly 36%. But the shot pays three, lifting the return to 1.08 points per shot (36% x 3).

The mid-range sits between the other two on the floor but finishes behind both on the maths. The rim wins on accuracy, the arc wins on payout, and the shot in the middle wins on neither. A lower accuracy shot can still be the better shot if it pays enough, which is the logic the hedge fund manager Paul Tudor Jones built a career on.

"Five to one means I'm risking one dollar to make five. What five to one does is allow you to have a hit ratio of 20%. I can actually be a complete imbecile. I can be wrong 80% of the time, and I'm still not going to lose."
- Paul Tudor Jones

This is the first lesson. Being right more often is not what separates the best. Citadel is one of the most successful hedge funds ever built, yet its top portfolio managers are correct only 54% of the time. Accuracy is not what sets them apart. Position sizing and portfolio construction turn a hit rate slightly above 50% into strong, consistent returns.

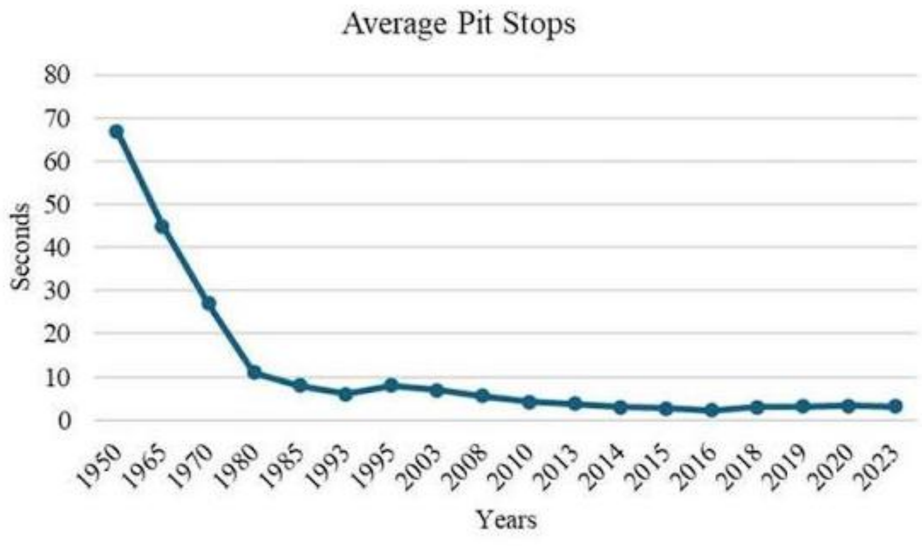
Formula 1: the infrastructure behind the driver

If basketball shows what an optimised strategy looks like, Formula 1 shows the infrastructure required to execute one.

An F1 driver is the ultimate discretionary manager, turning the wheel and managing risk in real time. But the driver does not operate on intuition. He sits at the tip of a computing ecosystem. Before a race weekend, simulation engines run millions of permutations across tyre degradation, track temperature, fuel weight and safety car probability, mapping the physical limits of the car.

During the race, hundreds of sensors feed telemetry to a pit wall that resembles mission control. The driver does not change tyres on a hunch about the asphalt. He receives an instruction because a model just recalculated the optimal pit window against live competitor data.

The pit stop itself makes the point. Through the 1990s and 2000s a stop took eight to ten seconds, most of it spent pumping fuel. When refuelling was banned in 2010, the tyre change became the only variable, and the entire engineering effort turned to shaving it. Times fell to around three seconds within a year, and the record now stands at 1.80 seconds, set by McLaren at the 2023 Qatar Grand Prix. That was not achieved by telling mechanics to move faster. It was unlocked by embedding sensors in the wheel guns, feeding an automated system that triggers the green release light the millisecond the job is mathematically complete. The modern pit stop is a software loop executed by human hands.



Source: L. Belkovics, K. András and I. Takács, "The Technological Innovation of Pit Stops in Formula 1," 2024 IEEE 22nd Jubilee International Symposium on Intelligent Systems and Informatics (SISY), Pula, Croatia, 2024, pp. 101-106.

Markets have run the same compression. A result used to reprice over days while analysts interpreted it. Now the systematic players read the announcement and reprice the stock before a fundamental manager has finished the first page. The reaction has become its own software loop, run at machine speed.

This is the second lesson. The pit crew did not get faster by trying harder. They got faster by measuring the task and stripping out everything a machine could do better. The same is true in markets: you cannot out-react a machine, so the edge moves upstream, to understanding the forces acting on a price before the catalyst hits and surviving the move when it comes. Reading how earnings drive company value is only one of those forces. Understanding the others requires quantitative machinery that can stress test a portfolio across environments, the way an F1 car is simulated across weather conditions. Navigating machine-driven factor rotations on intuition alone is driving in the wet without radar.

The rise of the centaur

Basketball showed a strategy solved by maths, and Formula 1 the machinery to execute it. Chess put a name to what both were really doing: combining human and machine. In 1997, world champion Garry Kasparov lost a match to IBM's Deep Blue supercomputer. Everyone took it as proof the machine had won. Kasparov asked a different question. If a machine could beat the best human alive, what could a human and machine do together? The pairing became known as a centaur, half human, half machine.

The proof came at the 2005 PAL/CSS Freestyle tournament, where two amateur Americans running three ordinary computers beat both grandmasters with supercomputers and the machines alone. The winning ingredient was neither the strongest human nor the strongest machine, but the best process for combining them. Chess has since moved past this. The engines no longer need humans, because chess is a closed, unchanging system. Its rules are fixed, so a machine that has mastered it never falls behind. Markets are not. What worked last year may stop working this year. Regimes turn over, and the model tuned to the last environment is the most exposed to the next. The judgment never fully transfers to the machine.

That is the choice active managers face. The apex predators are already centaurs, human oversight wired to systematic machines. The manager who still runs on fundamental research alone is the last standalone grandmaster in the room. Survival does not mean out-computing the predators. It means keeping the one edge they lack, deep conviction on individual businesses, and wiring it to enough systematic risk infrastructure to stop being run over by the forces they set in motion.

The reverse is also true. Even the purest machine still answers to a human. Renaissance is the most successful quant fund ever built. When its models bled 20% in three days during the 2007 Quant Quake, Jim Simons considered pulling the plug. The firm had to decide: let the models run or override them and cut risk. They let them run, and Medallion finished the year up around 85%. Even at the apex of quantitative sophistication, the machine could measure the loss but not decide what it meant. That call belonged to a human.

Adapting to the modern arena

The mid-range shooter and the refuelling-era pit crew have one thing in common. They no longer exist. Once an arena has been mapped and quantified, there is no going back, and the competitors who refused to adapt disappeared with them.

Survival does not belong to the manager who tries to out-calculate the machines, nor to the one who trusts them blindly. It belongs to the centaur: fundamental conviction wired to systematic risk and factor infrastructure, with the judgment to know when the model has stopped describing the world. Stephen Curry still has to shoot. Lewis Hamilton still has to drive. Jim Simons still had to decide when to trust the machine. A model is built for one world, and it cannot tell you the moment that world has changed. That judgment is the one thing the machine cannot hand back.

To bring a gun to the gunfight, you must let the data build the weapon and keep a human to aim it.

Jason Teh is the founder and Chief Investment Officer of Vertium Asset Management; and a Portfolio Manager at Clime Investment Management Limited, a sponsor of Firstlinks. This article is general in nature and does not constitute or convey personal financial advice. It has been prepared without consideration of anyone's financial situation, needs, or financial objectives. Before acting on the areas discussed and contained herein, you should consider whether it is appropriate for you and whether you need to seek professional advice.

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What Australian super funds can learn from the UK

Kaye Fallick

Robert Cochran tells me that it all started with a big blue bus.

Well, not quite.

One of the UK's top pension funds started much longer ago, in 1815 in the Royal Exchange coffee rooms in Edinburgh. It was the time of the Enlightenment and a much stronger mastery of numbers. Gathered in the rooms were the money men of the day. They had been taking a keen interest in a global first-ever pension system, one for the retired ministers of the Church of Scotland and their families.

Over coffee and conversation, the decision was made to also do something for the widows of men who'd died fighting for Queen and country in the Napoleonic Wars.

These widows were not little old ladies in frumpy gowns. Their average age was 26 and they would have been condemned to a life of poverty if not for this innovative solution. Thus was born the Scottish Widows Pension Fund.

Fast forward to 2026 and Scottish Widows, now sitting within the Lloyds Banking Group, is one of the largest funds in the UK. Last year, Robert Cochran was awarded the title of Pensions Marketer of the Year and his colleague, Head of Pensions Policy, Pete Glancy calls him a 'master' of engagement.

So naturally I was curious to see if Robert would be prepared to share his 'secret sauce' with an Australian audience. And he was, answering questions including:

- What is engagement?
- Why does it matter?
- And, most importantly, how does a fund go about increasing it?

Some background

Some days in Australia it seems as though fund member engagement is a bit like the weather. Everyone seems to want to talk about it, yet no one ever seems to do anything.

Now that's a bit harsh, but engagement has become a bit like black puffer jackets in a Melbourne winter – everywhere to be seen - but it remains an ill-defined, elusive target. Funds are, quite rightly, highly focused on the need to observe the Retirement Income Covenant (RIC), part of which, according to the Australia Prudential Regulations Authority (APRA) requires:

"Tailoring guidance and support for members by delivering retirement-focused communications, education, and guidance to assist members navigate the transition to retirement."

Yet despite all this attention, there is still remarkably little agreement about what engagement actually means, how it should be measured, and where responsibility for improving it sits.

Some challenges may be bigger than any individual fund. For example, what if there were an agreed industry-standard retirement calculator that combined super, Age Pension entitlements, work income, private assets and lifetime income streams? Such tools already exist in various forms, but a single trusted version might reduce duplication and confusion.

Against that backdrop, let's find out more about the magic that Robert Cochran uses to motivate his members.

Making pensions more exciting

Of the 10 million or so members of Scottish Widows, half are in workplace pensions and the majority have been automatically enrolled as a work pensions customer since auto enrolment was introduced in the UK in 2012.

Robert's responsibility as Scottish Widows Workplace savings, innovation and engagement specialist, is to help people who are automatically 'in' the system to look forward to a good retirement. To better understand their needs in 2015 he did something unusual – and very clever.

That's where the big blue bus comes in. Realising that the gateway for members was their employers, Robert wanted to make the concept of a pension more exciting. So in partnership with Pension Geeks, Scottish Widows ran a double-decker bus on Pension Awareness Day, inviting workers to visit the bus, have a coffee and ask their most pressing questions.

Pension Day grew to Pension Week before becoming Pension Month. And what Robert learned from the miles travelled and hours of discussions was that the language of pension entitlement and decumulation could be boiled down to three critical needs:

- What have I got?
- Is it enough?
- What can I do with it?

As more workers started to join the Pension Month conversations, the company bought their own retirement vehicles with fold-out classrooms to cater for the extra numbers. The Scottish Widows information sessions are now digital, with over 100,000 members joining the sessions in 2025 alone.

The key learning for Robert was the need to simplify the language of retirement:

"Through getting out and meeting so many people – whether digital or face-to-face – I was gifted about 6500 questions. These are the words our members use. So let's use their language. And of course it was challenging from a compliance point of view, but it was necessary to simplify the language in order to make it easy for these members to engage."

The power of comparison

Another innovation has been the Scottish Widows Pension Mirror. It provides an age filter that guesses the age of the member from their selfie and asks if they would like to know the average pension savings for someone of the same age. Averages are supplied by data from the Office for National Statistics. The user can also ask how much older or younger people might have.

According to Robert, this tool has been enthusiastically adopted, *"…because it meets an age-old human concern – how do I compare?"* The proof is in the pudding as it's now been used over one million times and won 18 industry awards across Europe.

What does good engagement look like?

When asked to define strong engagement for a member of his fund, Robert replies that it means the customer knows:

- How much they have
- Whether they are on track for retirement
- What the recommended actions are for their situation
- Whether the anticipated retirement amount matches what they will need
- Whether they feel in control of their financial future

The holy grail for Robert is the download of the company app. To date, Scottish Widows has had one million registrations, and they are pushing to increase this number further. Says Robert:

"When a member logs in, they see immediately what they have, required actions and a bright red action button. We have an engagement secret weapon too – Lloyds has over 28 million customers and they log into their online banking on average 26 times a month. If these customers also have a Scottish Widows pension, we show them that pension value right next to their bank account, it's just another tile and it takes all the friction out of knowing your current pension balance.

"We are very tech-focused. Gamification is really important, to the extent that we have our own gaming team in Dundee, where the original Grand Theft Auto (one of the biggest gaming franchises) was conceived. If someone enters our pension app they will spend four minutes if it's gamified, compared with 40 seconds if it's not.

"Lloyds Bank is in the top 15 banks in the world for use of AI. We've started to introduce AI Agents into the app operating within the regulated boundaries. The brilliant thing is we have all these genuine questions people ask us – those 6500 recorded questions from last year have been fed into the agent alongside the answers – it's learning just how our customers speak and how our products work".

Another feature is the willingness to tailor communications to different audiences, using team members who genuinely understand the communities they're speaking to.

"We need to go where people are, talk the way people talk. Authenticity is key. People are using social media for all sorts of searching and in the UK we saw 118 million searches on TikTok for the word 'pension' last year – it's a genuine resource. Short items get people interested. Simple measurements matter most – have they downloaded our app and used it? Have they come back again? If so, you can then nudge them to take next steps."

It's taken Robert's team five years to achieve one million registrations on the app. Each month since there have been over two million log ins, and they hope to double that number over the next year.

On a separate note, next year the British government will introduce Pension Dashboards which means members will see all their pension savings in one place, so the question 'what have I got?' will be much better answered by technology.

What can Australia learn?

Before we finish, I ask Robert to share his thoughts on the Australian super system and where we are at when it comes to engaging members. He replies that he thinks we've done a good job on the accumulation side, but notes the size of our super savings pot is huge – but largely due to the high mandatory employer contribution of 12%. In the UK it's 8%, and that includes an employee's own contribution as well.

"Australia has got people in – in a way the government has given them a free kick – but I'm not sure that funds have yet developed the robust engagement that will see their members retire well."

What do you think?

I tried out the Pension Mirror and got an age three years younger. I then went and put some makeup on and came up 10 years younger. Love it! Either way, the average savings by age were much lower than those in this country. But what a great tool to get people exploring and comparing their own retirement savings progress.

Interested in learning more about the Scottish Widows use of AI, gamification or their key metrics in a recent retirement report? They're all covered as different topics in the Scottish Widows Workplace Savings podcast series.

Kaye Fallick is an independent retirement commentator and author, www.kayefallick.com. This article is general information and does not consider the circumstances of any person.

What the market may be missing in FY27

Chris Cuffe

Every year, we spend considerable time reviewing our underlying managers, not simply looking at returns, but assessing how they think, where they find opportunity and whether they remain disciplined through changing market conditions.

Following the end of FY26, we asked ten of our underlying managers a simple question: ***What are you seeing today that the broader market may be missing?***

While their portfolios differ significantly, what stood out was how often their answers converged. Across growth managers, value managers, small-cap specialists, quality investors and activist managers, views generally converged around the following:

- valuation matters more than ever;
- opportunities are emerging beyond Australia's largest companies;
- passive investing is creating pricing distortions;
- volatility is creating opportunities for active managers; and
- patient stock selection will become increasingly important through FY27.

This paper brings together those insights and highlights why we believe a diversified portfolio of specialist active managers remains well positioned for the opportunities ahead.

What are managers seeing for FY27

The past financial year was one of the most unusual in recent history. While the S&P/ASX 300 delivered another positive return, the headline index masked an increasingly concentrated market, heightened stock-specific volatility and widening valuation gaps across sectors. Passive investment flows continued to favour Australia's largest companies, while many quality businesses outside the ASX 20 traded at historically attractive valuations.

1. Active management is becoming more valuable

One of the strongest themes from our managers was the growing opportunity for active investors.

After several years where passive investing dominated fund flows, managers increasingly believe those flows are creating pricing distortions across the Australian market. Rather than reflecting company fundamentals, many share prices are now being driven by index weightings and ETF flows.

As passive capital continues concentrating in Australia's largest companies, active managers see increasing opportunities to identify businesses trading well below intrinsic value.

Our managers are seeing:

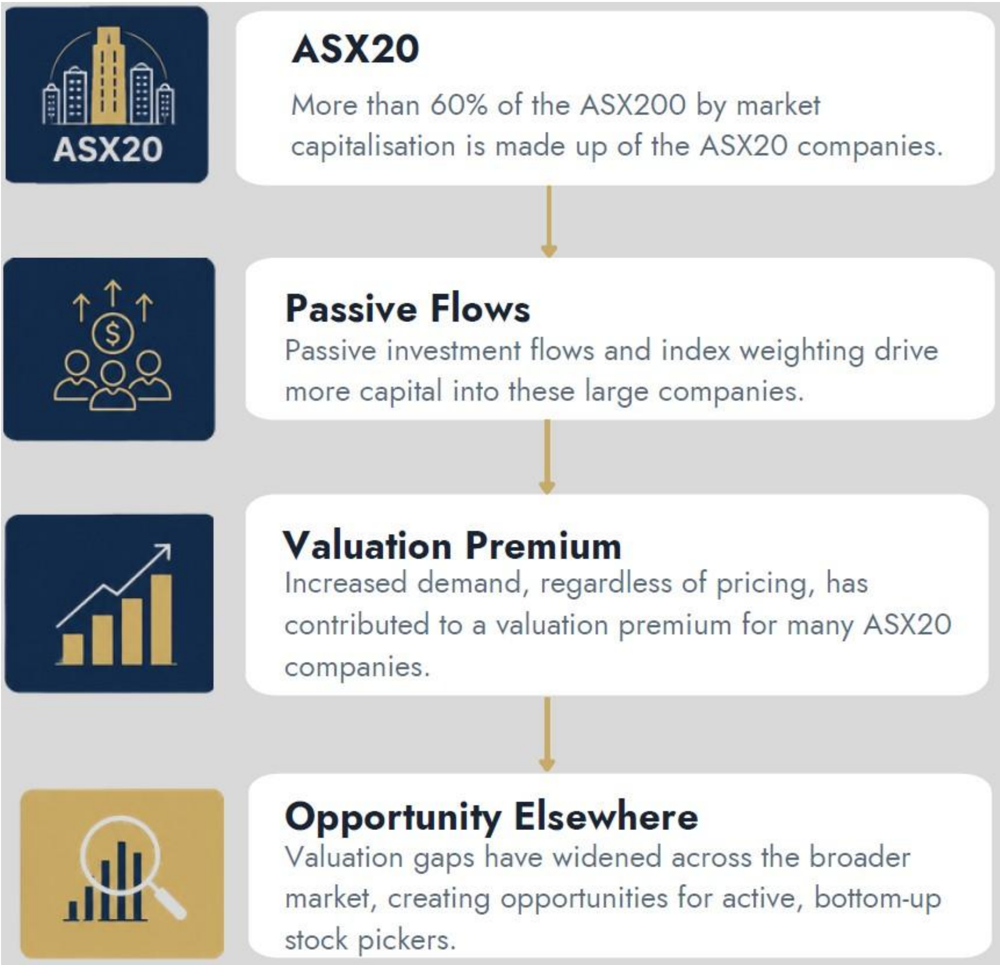
- Greater stock dispersion
- More valuation anomalies
- Increasing concentration risk
- Better opportunities outside the benchmark

2. Opportunity exists beyond the ASX20

If there was one message repeated throughout the interviews, it was this: The biggest opportunities are increasingly outside Australia's largest companies.

Several noted that the ASX20 now represents around two-thirds of the ASX200 by market capitalisation, resulting in greater concentration risk for passive investors.

Many believe valuations across the largest companies, particularly the major banks, remain stretched, while quality businesses further down the market offer stronger earnings growth at significantly lower valuations.



3. Valuations matter again

Managers repeatedly observed that FY26 wasn't simply about earnings. It was about valuation.

- Quality healthcare has de-rated despite resilient long-term earnings.
- Software de-rated.
- Banks became increasingly expensive.
- AI winners attracted enormous capital.

Many quality companies traded well below intrinsic value despite continuing to deliver solid earnings.

Table: Where active managers are finding value today

Healthcare	• Large sell-off despite long-term quality; valuation becoming attractive. • AI-driven healthcare innovation with significant long-term growth potential. • Structural demographic growth and attractive long-term outlook **Examples:** CSL, Regis Healthcare, Healius, Artrya, 4DMedical, PYC Therapeutics
Software & Technology	• Attractive earnings growth at more reasonable valuations. • AI and digital infrastructure continue to drive long-term demand. • Market has become increasingly selective, rewarding profitable growth. **Examples:** Life360, Block, Megaport, Technology One, Codan
Large Caps	• Valuations don't fully reflect long-term earnings potential. • Short-term market concerns have created buying opportunities. • High-quality businesses with resilient cash flows and global growth exposure. **Examples:** The Lottery Corporation, James Hardie, CSL, BHP, BlueScope
Small & Mid Caps	• Benefiting from AI, electrification and infrastructure investment. • Strong earnings outlook supported by structural growth. • Less researched than large caps, creating greater alpha opportunities. **Examples:** SKS Technologies, Southern Cross Electrical Engineering (Scee), Wagners, Codan, Aurizon
Growth Companies	• Consistent earnings growth with expanding market opportunities. • Valuation resets have created attractive entry points. • High-quality management teams with long growth runways. **Examples:** Tyro, Life360, Block, Evolution Mining, Megaport

4. AI isn't one investment theme

Perhaps the most fascinating observation was that managers are investing in AI very differently. Few are attempting to own AI directly. Instead, they are investing across the broader ecosystem - from the infrastructure powering AI to the businesses benefiting from increased productivity and digital adoption.

- Artificial Intelligence: OpenAI, Anthropic, Microsoft
- Date Centres: NextDC, Megaport
- Power: NexGen
- Copper & Resources: BHP, IGO, PLS Group (Pilbara Minerals), Firefly Metals
- Contractors: SKS Technologies, Mineral Resources, MAAS
- Software: Life360, Block, Technology1
- Healthcare/Medicine AI: EchoiQ, Artrya, 4DMedical

5. Volatility is creating opportunity

While markets appeared relatively calm at the index level, individual companies experienced enormous swings. Several ASX20 companies suffered one-day share price declines of between 10% and 40%. Rather than fearing volatility, our managers increasingly view it as a source of opportunity.

A common conviction

While each of our underlying managers invests with a different philosophy, their outlook for FY27 was remarkably consistent. Markets remain highly concentrated, passive investing continues to influence pricing, and short-term volatility is creating wider gaps between share prices and underlying business value. Rather than viewing this as a challenge, our managers believe it is creating one of the most attractive environments for active stock picking in recent years.

While markets will continue to be driven by short-term headlines, long-term investment success comes from owning exceptional businesses at sensible valuations. That remains the common conviction across our managers as we head into FY27.

Chris Cuffe is Portfolio Manager of the charitable trust Third Link Growth Fund and of the Australian Philanthropic Services Foundation General Portfolio. Chris is involved with many other groups as a director, chairman and investment professional. This article is general information and does not consider the circumstances of any person. The views expressed are his own and they are not personal financial advice.

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