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Editorial

If there’s one industry that attracts an unusual number of snake oil salesmen, it’s probably this one.

Spending some time around markets eventually reveals the economist who knows what’s coming next, the fundie who has discovered a secret that somehow remains hidden from every other investor on the planet.

In most professions, expertise can be observed directly. We assume the surgeon knows more about surgery than we do and the pilot knows more about flying. Investing is different. It may be one of the few areas where a healthy dose of scepticism is necessary to succeed.

However, I do believe there are a handful of exceptions to this.

For me, Warren Buffett is one of them. But it’s not just due to his extraordinary track record.

It’s that he occupies a peculiar position in this industry. As one of the most successful practitioners of the game, he has spent decades telling people not to play it the same way he does.

Most financial figures are sellers of some description, whether it’s a newsletter, a new fund or at the very least, a world view. And before throwing stones from a glass house, I should acknowledge the irony here. My career exists within this very realm.

The point isn’t that selling ideas is inherently bad. It’s that authority is often derived from the ability to persuade people that you know something most don’t.

Buffett's authority stems from almost the opposite impulse.

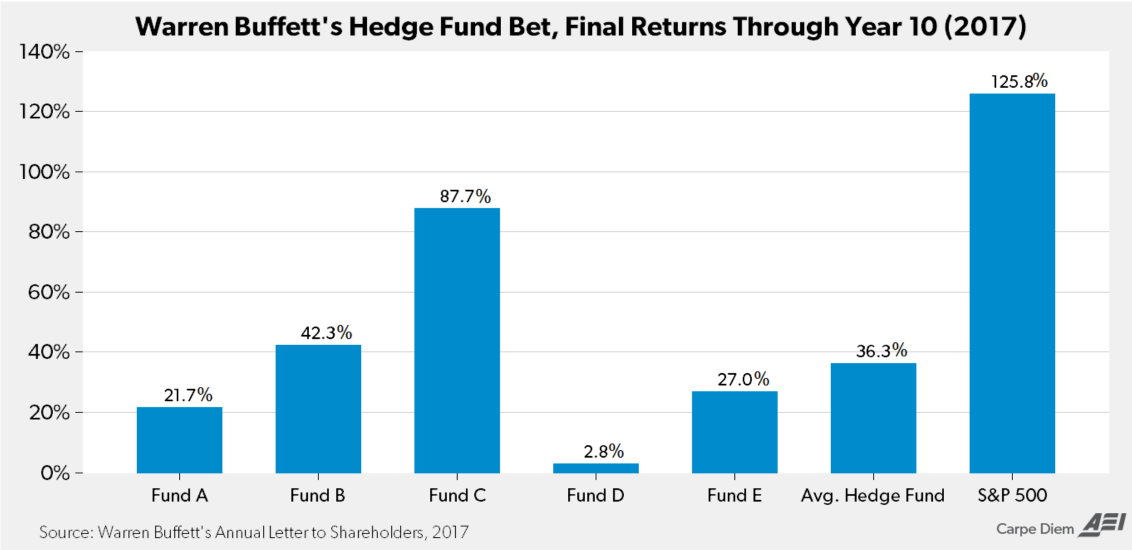
How many Michelin-starred chefs would tell people they could make the same dish at home, for a fraction of the cost? There's an almost self-negating quality to Buffett's credibility.

Below are some of my favourite takes from him.

"By periodically investing in an index fund, for example, the know-nothing investor can actually outperform most investment professionals."

Coming from one of history's most successful active investors, the statement borders on paradox.

In 2008 Buffett famously made a $1 million bet that an S&P 500 index fund would outperform most investment professional's picks over a 10-year period. And indeed, he was right. Ted Seides, co-founder of Protégé Partners, accepted the challenge and handpicked five hedge funds he believed would outperform the S&P 500 over this period. The performance gap was certainly something.



This exercise wasn't intended to be an obituary for active management. Rather, it was an exercise in humility for an industry that has long projected an image of delivering superior returns through complex strategies, demanding higher fees.

"The goal of the non-professional should not be to pick winners – neither he nor his 'helpers' can do that – but should rather be to own a cross-section of businesses that in aggregate are bound to do well. A low-cost S&P 500 index fund will achieve this goal."

I believe the 'helpers' he refers to here are "those who profit from giving advice or effecting transactions". I imagine many readers have successfully invested in individual companies for decades and have the results to show for it.

But no matter your persuasion, the ability to consistently identify winning stocks over decades is extremely difficult, even with professional help. The argument is ultimately about probability rather than possibility.

"The most important quality for an investor is temperament, not intellect."

Buffett's point challenges the common perception that investing is primarily an intellectual exercise. It also echoes Peter Lynch's observation that the most important organ in investing is the stomach, not the brain.

Lacking a 'superior' intellect is not the barrier many make it out to be. Long-term success is often determined more by the ability to remain disciplined and stick to a sensible process through periods of uncertainty.

Every generation produces its own collection of gurus, visionaries and occasionally outright charlatans. However, the promise of exceptionalism always gives way to the decidedly unglamorous virtue of common sense.

Simonelle Mody

Also in this week's edition...

Rachael Rofe is back to discuss a win for testamentary trusts and deceased estates, as questions on death and divorce rollovers remain unresolved.

Average super balances are often a misleading benchmark. **Shani Jayamanne** examines her own retirement goal and why comparing averages may lull Aussies into a false sense of security.

Most people spend decades planning how to retire but fewer plan for what comes next. **The Retirement Researcher** proposes some aspects you might not have considered.

Russel Chesler from **VanEck** explains why the primary risk in small cap investing is hidden in plain sight.

SMSF investors remain concentrated in shares, cash and property. **Nick Kelly** argues there may be a missing piece.

Conventional investing wisdom tends to focus more on rules for accumulation. But what about the other side of the equation? **Trevor Schmid** shows why the buy-and-hold method has no landing gear.

Why have active managers struggled as passive investing has surged? **Larry Swedroe** examines the broader implications for investors.

Curated by Simonelle Mody and Leisa Bell

Testamentary trusts have secured the CGT exemption

Rachael Rofe

Treasury’s latest exposure draft landed on 4th August, and gives genuine testamentary trusts and deceased estates an important exemption from the proposed 30% minimum tax on capital gains.

That is the good news.

The less good news is that two of the most obvious problems, namely what happens when assets move on death or on divorce, have been identified, discussed, and left for another day.

In tax policy, this is known as progress.

The death and divorce problem Treasury is trying to solve

The first tranche of the CGT reforms applies from 1 July 2027. It replaces the general 50% CGT discount for individuals and trusts with cost-base indexation, and introduces a 30% minimum tax on capital gains.

For assets already owned at 1 July 2027, the law divides the gain into two periods: the gain accruing before that date, and the gain accruing after it. It does this through a deemed sale and reacquisition. The gain or loss arising at that point is deferred until a later realisation event.

That is reasonably elegant, until the asset moves without being sold. In estate planning, that happens often.

Death and divorce: not fixed yet

Treasury expressly acknowledges the difficulty where an asset is transferred between separating spouses under the relationship-breakdown rollover, or from a deceased estate to a beneficiary.

Neither transaction is a genuine economic realisation. The separating spouse has not cashed out, and the executor distributing an estate asset has not sold it. But as drafted, the rules treat each transfer as a realisation event. The deferred gain crystallises and CGT falls due on the notional gain, even though no money has changed hands. Treasury agrees that these transfers should not trigger the deferred gain.

Agreeing with the problem and legislating the solution remain two separate stages of government. The Explanatory Memorandum says further complexity arises because the asset, and presumably the deferred gain attached to it, moves to another taxpayer. The necessary amendments will be dealt with in a future tranche.

The same death and divorce problem runs through both reforms in this bill, and only one of them has been fixed. In the negative gearing rules, the tranche lets a surviving spouse, a surviving co-owner or a family-law transferee inherit the owner's status, and with it the negative gearing exemption. That problem is solved. In the capital gains rules, the same drafters left it for another day. That problem has only a promise.

So on capital gains, death and divorce have a favourable policy statement, but not yet an operative rule. The fix already exists in the same bill for negative gearing, so it should not be far behind for capital gains.

For now, an adviser cannot confidently say how the deferred gain will follow the asset, who will ultimately be taxed on it, or what happens if there is more than one rollover before the asset is sold.

The clear win for testamentary trusts

The draft provides that qualifying capital gains attributed to an individual beneficiary of a testamentary trust, deceased estate or special disability trust will be excluded from the beneficiary's minimum-tax capital gains amount.

In plain terms, the gain will not automatically be pushed up to the new 30% minimum rate.

For testamentary trusts, the exemption is connected to the existing section 102AG rules. Broadly, the gain must come from property transferred from the deceased estate, or from investments, reinvestments, accumulations or profits derived from that estate property.

This is not a general exemption for anything placed inside a trust created by a will. The gain must be connected to the deceased estate. That is sensible. It protects ordinary testamentary trusts without turning them into tax-free storage for unrelated family assets. The draft also contains integrity rules aimed at arrangements designed to move property through an estate mainly to obtain the exemption.

Who sells the asset, and when

For the purposes of understanding the exemption, it is important to distinguish between two roles. The executor administers the deceased estate. The trustee administers the testamentary trust once the assets are held in it. A beneficiary of the will takes what the will provides. A beneficiary of the trust takes what the trustee distributes. Different people, at a different stage.

The draft covers both deceased estates and testamentary trusts, so the exemption is available at each stage. If the executor sells an asset inside the estate and attributes the gain to a beneficiary of the will, the gain is exempt from the 30% minimum floor. If the trustee sells an asset inside the trust and attributes the gain to a beneficiary of the trust, the result is the same.

The floor applies only when the individual sells the asset in their own name, after it has left the estate or the trust. The exemption belongs to the gain realised inside the structure. It does not follow the asset to the beneficiary. A later sale in the individual's own name is fully exposed.

The same question therefore arises at both stages, for two different people.

The executor should understand what the beneficiary is likely to do with the asset. If the beneficiary is likely to sell it, and the asset carries a taxable gain, the executor should consider selling it inside the estate, where it is not subject to the 30% minimum, and distributing the net proceeds. That can produce a better result than distributing the asset in specie to a beneficiary who then sells it and meets the 30% minimum. Distributing the asset itself carries little tax at that point, because the beneficiary takes on the deceased's cost base, but the beneficiary then meets the floor on a later sale.

The trustee faces the same choice for a beneficiary of the trust, but distributing the asset out of the trust is more costly. It can be a CGT event in its own right, and duty may arise depending on the state and the terms of the trust. Where the beneficiary wants cash, selling inside the trust and distributing the proceeds is usually the better course.

None of this means every asset should be sold inside the estate or the trust. Where the beneficiary wants to keep the asset, they should receive it, and there are sound reasons to distribute in specie: ownership, control, foreign residency, or the terms of the will. But the timing is now a tax decision, and it rests with whoever holds the asset: the executor at the estate stage, the trustee at the trust stage.

Before an asset is distributed, the question is who should sell it, and when. The answer carries a material tax cost.

It also makes the case for flexible drafting. The trustee should have the power to sell, appropriate, distribute assets in specie and stream capital gains, so the trustee is not confined to one course when the time comes.

Two trust tax regimes, because one was apparently not enough

There is also a risk of confusion between this reform and the separate proposed 30% minimum tax on discretionary trust income.

This draft deals with the minimum tax on capital gains from 1 July 2027. The separate discretionary-trust proposal deals with trust income from 1 July 2028.

Both contain proposed protections for genuine testamentary trusts, but the tests are not the same. The CGT exemption in this draft focuses on whether the gain is derived from deceased-estate property. It does not contain the separate proposed rule restricting the beneficiaries of certain future testamentary trusts to individuals and tax-exempt entities.

Advisers may therefore apply two different versions of "genuine testamentary trust" to the same structure: one for income, another for capital gains.

Nobody said tax reform had to be user-friendly.

The deceased's paperwork may live forever

The draft also introduces continuity rules for inherited assets. For relevant purposes, an executor or beneficiary receiving a post-CGT asset will generally be treated as having acquired it when the deceased acquired it. Similar rules apply to the deceased's interest passing to a surviving joint tenant.

This is necessary to divide gains accruing before and after 1 July 2027, and to calculate indexation. It also means the asset's history survives the owner.

Executors may need original purchase records, evidence of capital improvements, details of prior rollovers, historical ownership information, and in some cases residency records. A date-of-death valuation may no longer tell the whole story.

The practical estate-planning advice is unglamorous but important: keep the records. The tax cost of an asset may now depend on documents created decades before the beneficiary sells it.

Where this leaves us

This tranche is a win for testamentary trusts. It recognises that estate-derived capital gains should not automatically face a 30% floor merely because they arise through a testamentary structure.

But it also makes trust administration more consequential. Selling an asset inside the estate or the trust may produce a different outcome from distributing it before sale. And the law dealing with transfers on death and divorce remains unfinished.

None of this is law yet. The exposure draft is open for consultation until 31 August 2026, which is the moment to press Treasury on the death and divorce gap, rather than wait for the next tranche.

For now: testamentary trusts have secured the CGT exemption. Death and divorce have secured an acknowledgement and the promise of another tranche.

Rachael Rofe is an estate planning and wealth transfer lawyer who works across giving in every form it takes: to community, to family, across life and on death. Her focus sits where tax, asset protection and values meet. She also reads exposure tax reform legislation like this one so you don't have to.

How much super should you have?

Shani Jayamanne

I recently wrote an article about why your super isn't going to be enough. Part of the reason that you're likely underestimating how much you need in superannuation is that it's based on a best guess or other people's circumstances. Most people don't come up with a personalised estimate based on the vision you have for your retirement or your likely future expenses.

This is understandable. It is a difficult task to imagine how much you'll need in the distant future. It is multiple decades for some of us. For instance, I have around three decades before I hang up my keyboard.

Just because something is difficult doesn't mean it isn't worthwhile. As you move through life you can refine your goal as retirement gets closer. Creating an initial estimate and refining as you have more clarity is much more helpful than relying on articles showing average super balances by age.

The average super balance for a particular age is particularly disconnected from what an individual should have in super. It does not reflect any of your circumstances or whether you're on track to have a comfortable retirement. I run through an exercise to estimate how much I should have in each decade, and the disparity with the average super balance, and the recommended balance from ASFA.

Age	Year	Average balance by age	ASFA balance for a comfortable retirement	Purchasing power in today's dollars	My balance to stay on track with my goals
35	2028	$85,100.00	$118,000.00	$287,700.00	$304,000.00
40	2033	$118,700.00	$178,000.00	$469,000.00	$569,000.00
45	2038	$151,900.00	$239,000.00	$676,000.00	$942,000.00
50	2043	$190,500.00	$313,500.00	$918,600.00	$1,469,000.00
55	2048	$234,700.00	$399,000.00	$1,204,300.00	$2,211,000.00
60	2053	$263,400.00	$496,500.00	$1,544,800.00	$3,256,000.00
65	2058	$285,800.00	$604,500.00	$1,954,300.00	$4,729,000.00

Source: APRA, ASFA and author's own calculations

I encourage you to go through this exercise yourself. It's important to spend some time thinking about the variables that go into the calculation.

My circumstances

I have estimated that I need an average of $75,000 in today's dollars per year in retirement. This is a goal with two pathways. One path – the one I will explore today – I have purposely kept separate with my husband's. I know I want to enjoy my retirement with him, and we will have a much more comfortable retirement with our combined balances. However, it is important to me that I maintain financial independence and have enough to support myself regardless of what happens in the multiple decades until retirement.

I have assumed in this scenario that my mortgage is paid off. Using the 4% rule, the balance I will need for my portfolio is $1,875,000 in today's dollars (a future value of $4,485,195 in 2058).

Age
33 years old, with 32 years until fully accessing superannuation. These are the funds that I will use at age 65 when I am able to fully access my superannuation and set up a pension.

It does not include my Transition-To-Retirement plans or structuring. I have a separate financial goal with investments outside of superannuation to assist with transitioning out of full-time work prior to 65. This is supplemental to the $75,000. Think about your goal and when you are likely to access your retirement savings.

Retirement balance
$221,000. This is my superannuation but include any other accounts that will contribute to your retirement.

Contributions to superannuation per year (employer and salary sacrifice):
$27,000, or $23,000 after the 15% contributions tax. This will be all contributions to superannuation, after tax.

Projected returns in superannuation
Based on my asset allocation I'm estimating a projected return of 7.1%, after the 15% tax on earnings.

Inflation rate
Inflation should be included in any estimate of retirement needs. The inflation estimate doesn't require a perfect inflation rate. It is about making a reasonable assumption about how your spending is likely to change over the long-term. Your retirement spending will look different from your spending today, and the inflation rate applied to the broader economy may not perfectly reflect your personal experience.

That is why I think it is more useful to focus on the big picture rather than constantly adjusting your retirement target every time the latest inflation number changes. A forward-looking assumption, such as Morningstar's 2.8% long-term inflation assumption, gives you a consistent starting point for thinking about what your future expenses might look like.

My approach calculates your inflation rate based on your personal circumstances instead of an aggregate basket. However, my 'basket' is going to look very different in retirement than it does now. For example – my largest expense – housing – will hopefully be reduced to just maintenance costs as I would've paid off the mortgage.

When your personal inflation rate will matter most is when you are managing your portfolio in retirement. Many of us are living for as long as our working lives when we retire. Your spending of your portfolio will directly impact the way you should manage capital, and the returns that you need to manage longevity risk.

Other considerations

Age pension
For my retirement, I want to and expect to be fully funded. Understand whether this will form part of your retirement income. MoneySmart's calculator will be able to help you.

Spouse
I've excluded my husband's retirement funds from this goal, but it is a personal decision. You may be in

a position where there is an age gap between spouses and when superannuation can be accessed. Account for this in your calculations, and how much income is needed from each account.

Changes to circumstance

It is likely that there will be changes to your income over such a long period of time. It is important to account for career breaks where possible and adjust your goal accordingly. I have chosen not to include any salary increases in my calculation until they are realised. I then adjust my goal based on these increases if they happen.

Common ways retirement needs are calculated

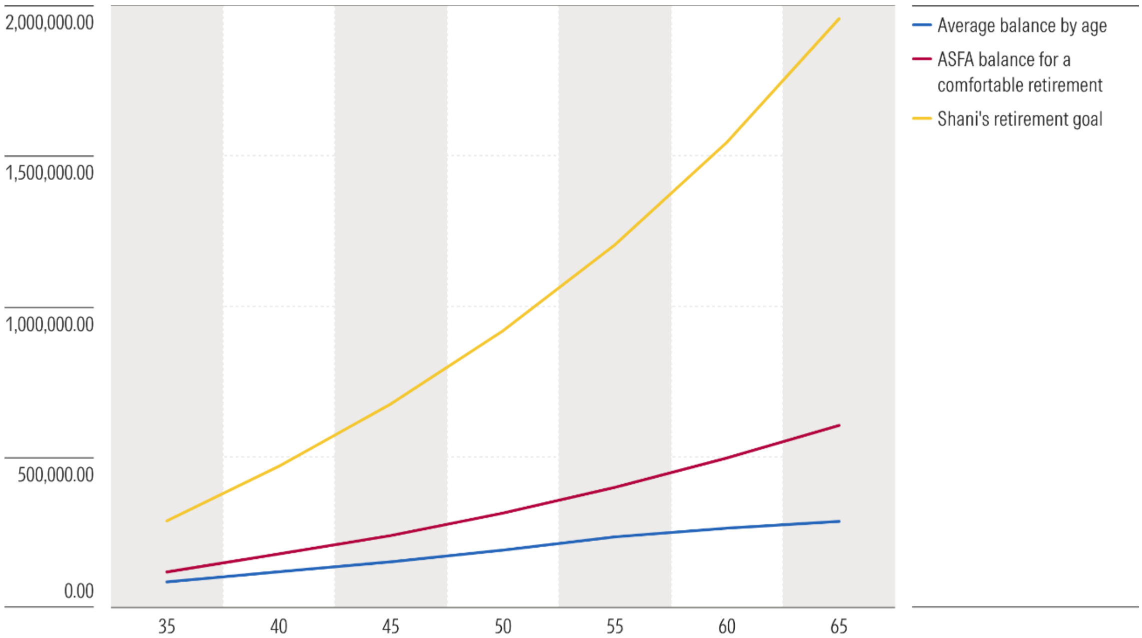
There are a few ways that Aussie investors track progress. Back of the envelope checks may be inadequate and contribute to retirement shortfalls. For this piece I'm going to focus on two common methods investors use as a point of comparison:

1. Looking at the average balance for their age and using that as a guide. Many people think they are fine as long as they keep up with the age-based bracket amounts as they age. Women are retiring with $380,000 on average.
2. Looking at what the industry says. ASFA's retirement standards says a comfortable retirement can be achieved with $630,000 for a single person who owns their own home.

There are issues with these sense checks. None take you or your circumstances into account. The average balance check meaningfully underestimates what many people will need for a comfortable retirement.

Comparison can also leave you discouraged and confused given the different measures of retirement progress. The purpose of measuring what you need in retirement is to give you an actionable goal that informs your decision making. This goal can be adjusted as your circumstances in retirement become clearer. The important thing is that it is specific to you and not based on measures that have nothing to do with your actual spending needs.

Difference in goal balance compared to common methods to estimate retirement needs



Final thoughts

The average balance for your age might give you a point of comparison, and industry benchmarks can provide a useful sense check, but neither tells you whether you are building enough to fund the life you want.

Working backwards from your retirement income goal gives you something much more useful: a target that is based on your circumstances, your spending and the time you have to get there. My target is likely to change as my circumstances do, and yours will too. I may earn more, spend differently, or decide that my retirement looks different from what I imagined at 33.

I have a number that gives me direction, but I know it will change. For me, that means checking in at different points throughout my working life and asking whether my balance, contributions and investment strategy are still moving me towards the retirement I want. That is far more actionable than simply asking whether my super balance is above average.

Shani Jayamanne is Director, Investment Specialist, at Morningstar Australia.

Retiring from work is easy, retiring into life is harder

Retirement Researcher

Most retirement planning conversations revolve around the financial side of the equation. People spend decades focusing on how much they need to save, when they can afford to retire, how their portfolio should be invested, and whether their assets will support the lifestyle they envision. Those questions matter, but many retirees discover that the financial transition into retirement is only part of the challenge.

The more difficult adjustment is often psychological. After spending decades operating within structured routines and careers that shaped their schedules, relationships, identity, and sense of purpose, retirement can create an unexpected feeling of uncertainty. Even people who are financially prepared sometimes struggle once the structure and meaning that work provided begins to disappear. That reality catches many people off guard because most of us spend years preparing financially for retirement while spending very little time thinking about how we actually want to live once we get there.

The retirement fantasy

Many people approach retirement with a long list of things they plan to finally do once work is over. They want to learn piano. Write a book. Travel the world. Volunteer. Learn a language. Join clubs. Pick up golf. Spend more time on hobbies that were always pushed aside because life was too busy. The problem is that retirement does not magically change who we are.

If someone has spent the last 30 years saying they want to write a book but never once made time to sit down and write, it may be unrealistic to assume the motivation suddenly appears at age 65. The same thing happens with instruments, hobbies, exercise routines, and many of the other aspirations people associate with retirement.

That does not mean these goals are impossible. Some retirees thrive in this stage of life. But there is an important difference between something that sounds appealing in theory and something you genuinely want to build into your daily life. Retirement has a way of exposing that difference.

Many people are drawn to the image of retirement activities without fully understanding the reality behind them. Someone may love the idea of traveling constantly, only to discover they actually enjoy being home after a week or two away. Others become fascinated with RV life until they experience the logistics, maintenance, and stress that come with it. Some retirees imagine themselves spending every day golfing, only to discover that what felt relaxing on vacation begins to feel repetitive when it becomes the centre of daily life.

This is one reason why it is dangerous to postpone your entire future life until retirement officially begins.

Start building retirement before you retire

One of the best ways to prepare for retirement is to begin experimenting with your future life while you are still working.

If you think travel will become a major part of retirement, start taking longer trips now. See how you feel after spending extended time away from home. Learn what type of travel you actually enjoy rather than relying on assumptions. It is common for some people to discover they love the adventure of constant movement, while others prefer shorter trips with longer stretches at home.

If you want to volunteer in retirement, get involved before you retire. Build relationships within organisations now instead of assuming those connections will instantly appear later.

If writing, painting, music, or other creative activities matter to you, carve out time for them today. Even if it is only a few hours per month. If you struggle to prioritize those activities now, retirement alone may not suddenly change that dynamic.

The point is not to fully recreate retirement while you are still working. The point is to test whether these activities genuinely energize you enough to become part of your life once work is no longer filling most of your day. Retirement should not be the first time you experiment with the life you hope to build.

If you are within a year of your target retirement date, the One Year Out Workshop walks through the practical steps to take now, from testing your interests and building routines to coordinating the financial and non-financial pieces of a smooth transition.

Work provides more than income

One reason retirement can feel emotionally difficult is because work provides many benefits beyond a paycheck. Careers create structure and routine, provide social interaction, intellectual stimulation, accountability, and momentum. Work gives people a sense of progress and creates a reason to wake up in the morning and a framework that organises daily life.

For many professionals, careers also become intertwined with identity. One of the first questions people ask when meeting someone new is, “What do you do?” Over time, people begin to associate their value, contribution, and sense of self with their profession. Then retirement arrives and much of that disappears almost overnight. The meetings stop, the inbox slows down, and the schedule opens up. Relationships with coworkers naturally fade over time, while the sense of urgency that once drove daily life gradually disappears.

Recent retirees often report that one of the strangest realisations is that weekdays no longer feel different from weekends. The structure that once divided time into productive days and recovery days disappears, and some people begin to feel adrift without fully understanding why.

Others discover that many of their friendships were tied more closely to the workplace than they realised. Conversations and social interaction that once happened naturally throughout the day suddenly require intentional effort.

At first, that freedom can feel exciting. But eventually, some retirees begin to feel untethered. Days lose structure. The calendar empties. Without realising it, many people drift into routines that feel passive rather than fulfilling.

This is where retirement can become psychologically challenging. Humans generally need purpose and engagement. We need things that challenge us, connect us to other people, and create a sense of contribution. Retirement does not eliminate those needs. In many ways, it makes them more important.

The risk of too much freedom

There is an assumption that freedom automatically creates happiness. In reality, unlimited unstructured time can become surprisingly difficult to manage. Ironically, the same freedom people spend decades pursuing can eventually become uncomfortable when there is no structure left to shape daily life.

People often imagine retirement as permanent relaxation, but most individuals eventually need more than leisure alone. Vacations are enjoyable partly because they are temporary. Retirement is different. It is not a two-week break from life; it is an entirely new phase of life that may last 20 or 30 years.

Without intentional planning, some retirees begin to feel isolated or disconnected. Others lose motivation because there is no longer an external structure shaping their days. Some even experience anxiety or mild depression despite being financially secure. Retirement can feel surprisingly lonely for people who spent decades surrounded by coworkers, clients, and constant interaction. This is why the non-financial side of retirement deserves serious attention.

A successful retirement usually requires replacing many of the benefits work once provided. That may include creating routines, maintaining social connections, pursuing meaningful projects, continuing education, volunteering, mentoring, or staying physically active. The goal is not simply to stay busy but to remain engaged.

Retirement does not have to mean stopping work completely

Another misconception is that retirement must be all or nothing. For many people, continuing to work in some capacity can significantly improve retirement satisfaction. The difference is that work becomes optional instead of necessary.

Some retirees transition into consulting, teaching, board service, mentoring, seasonal work, or passion projects. Others reduce hours and continue working because they genuinely enjoy the intellectual stimulation, relationships, and sense of contribution their work provides. In many cases, this type of gradual transition works better emotionally than abruptly stopping everything overnight.

There is also an important psychological difference between having to work and choosing to work. Financial independence creates flexibility. It allows people to shape work around their lives rather than the other way around. For some, complete disengagement from work creates more stress than continuing to contribute in a limited and intentional way. Many people do not actually miss the stress of their careers. They miss feeling useful, challenged, connected, and mentally engaged. There is nothing wrong with continuing to work if it adds meaning and structure to your life.

A different way to think about retirement

One of the most important aspects of retirement planning has very little to do with money. The real challenge is figuring out what will give your life meaning once work is no longer at the centre of it. For some people, that may involve family and grandchildren. For others, it may involve travel, volunteering, teaching, faith communities, creative pursuits, or remaining professionally engaged in a more limited capacity.

But those things rarely develop automatically once retirement begins. The retirees who seem to transition most successfully are often the ones who begin building that life well before their final day of work. They cultivate interests, relationships, routines, and a sense of purpose long before retirement forces the issue.

Financial planning remains important, but retirement is ultimately about much more than replacing a paycheck. A successful retirement is about building a life you genuinely want to wake up to once work is no longer deciding how your days will be spent.

Retirement Researcher is a leading educational resource focused on retirement income planning. Founded by Dr. Wade Pfau Ph.D., CFA, RICP, Retirement Researcher provides research-based educational content to help individuals navigate the financial decisions that come with retirement.

This article is based on an episode of the Retire With Style podcast. Explore more research-based articles and subscribe to receive future retirement insights at www.retirementresearcher.com.

***Disclosure:** This article is for educational and informational purposes only and does not constitute personalized financial, tax, or legal advice. The "One Year Out Workshop" referenced above is a paid educational program offered by Retirement Researcher.*

Right asset class, wrong index: the trap in Australian small caps

Russel Chesler

Most Australian equity portfolios are, in effect, a concentrated bet on 20 companies. The small cap allocation that would offset it is often the piece investors leave until last – and when it is made, it is frequently made through a broad index.

That matters more than usual right now. Australian small companies have outperformed the S&P/ASX 200 over recent months as markets have wound back expectations of further RBA tightening, and small caps have historically been among the most rate-elastic segments of the market.

But getting the asset class call right and the implementation wrong is an expensive way to be correct. Around 60% of the S&P/ASX Small Ordinaries Index by weight sits in companies with negative trailing earnings. The question for investors is therefore not whether to hold small caps, but which ones - and on what terms.

The macro environment is becoming more supportive

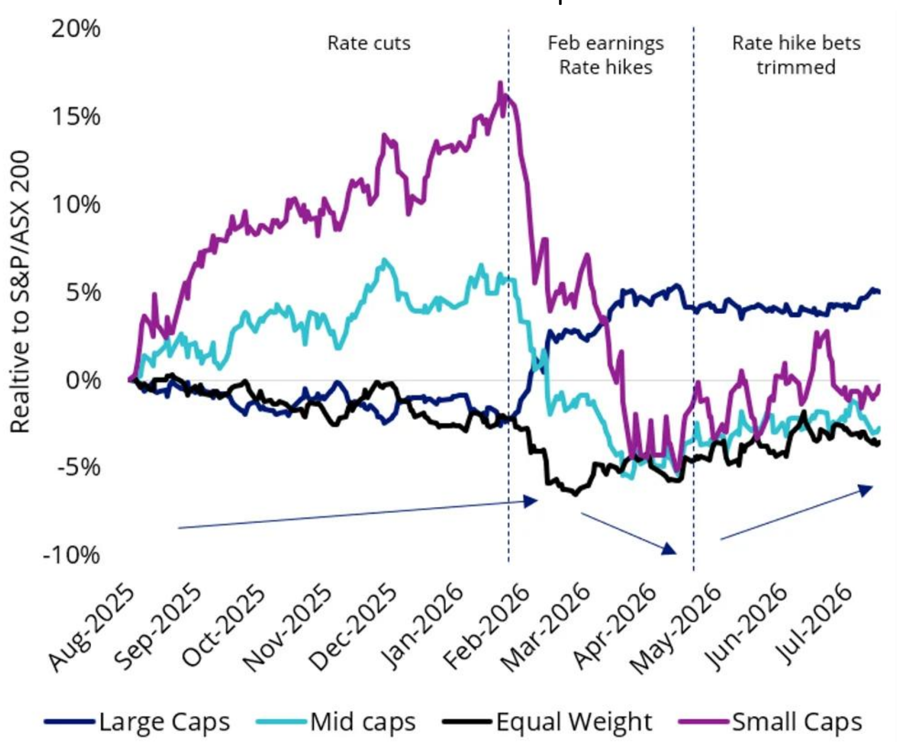
Australian equity portfolios remain heavily concentrated in large-cap companies, with the majority of capital allocated to the S&P/ASX 200. While these businesses form the core of the market, they represent only a fraction of Australia's listed companies and leave many portfolios underexposed to the broader opportunity set available across small caps.

For investors seeking genuine exposure to the Australian economy, breadth matters. Small companies provide access to businesses earlier in their growth journey, operating in sectors and industries that are often underrepresented in the large-cap universe. An allocation to small caps can therefore broaden portfolio diversification and introduce additional sources of earnings growth that may not be available through large-cap exposures alone.

Recent market conditions have also become more supportive. Australian small companies have outperformed the S&P/ASX 200 over recent months as investors have wound back expectations for further Reserve Bank tightening. While monetary policy remains restrictive, many investors are increasingly treating the current cash rate as close to, if not, the peak of the cycle.

Historically, Australian small companies have been among the most elastic to interest rate movements. This means that a downward shift in interest rate expectations may bode well for small caps.

Chart 1: Australia size relative performance



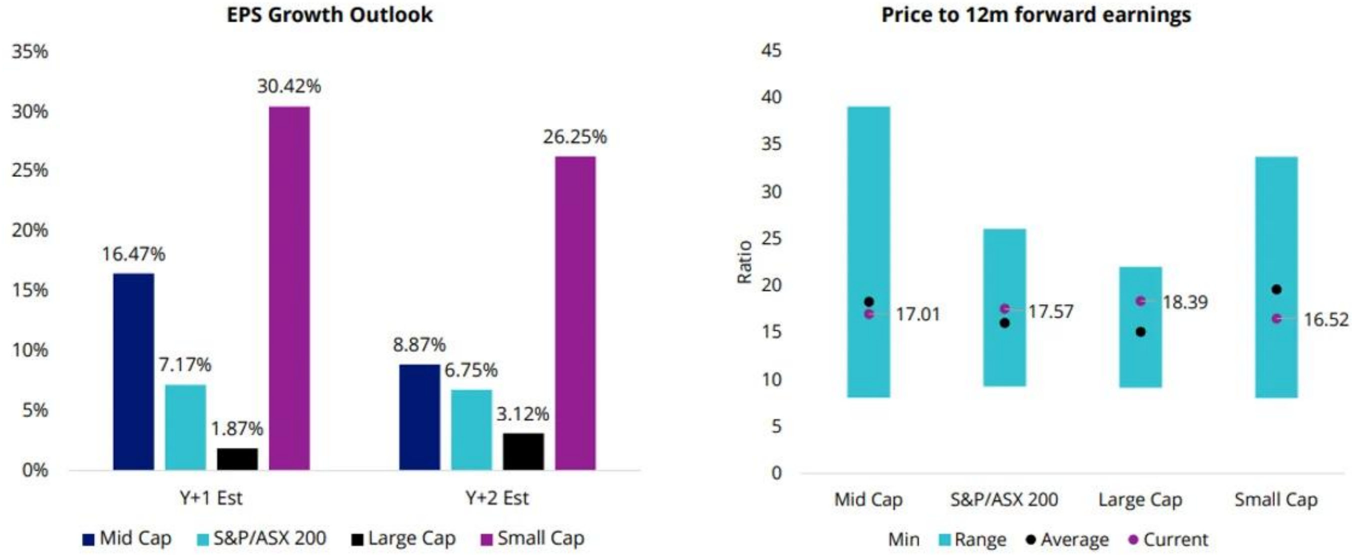
Source: As at 30 June 2026. Small Cap is ASX Small Ords Index. Mid Cap is ASX Mid 50 Index. Large Cap is ASX 20 Index. Equal weight is MVIS Australia Equal Weight Index. Performance in AUD. Past performance is not indicative of future performance. You cannot invest in an Index.

Why GARP matters today

Lower interest rate expectations are only part of the investment case. What makes today's environment particularly compelling is that Australian small companies continue to offer some of the strongest earnings growth prospects in the market, while still trading on reasonable valuations relative to other market segments.

As the charts below show, small caps are expected to deliver the highest earnings growth over the next two years despite trading on a forward earnings multiple that remains below large- and mid-cap peers.

Chart 2: Australian small caps offer superior EPS growth potential and less demanding valuations



Source: FactSet. VanEck. Bloomberg. As at 30 June 2026. Large cap is S&P/ASX 20 Index. Mid cap is S&P/ASX Midcap 50 Index. Small Cap is S&P/ASX Small Ordinaries Index. Average is calculated as the 10 year historical average, using month end figures. These are estimates only. Past performance is not indicative of future performance.

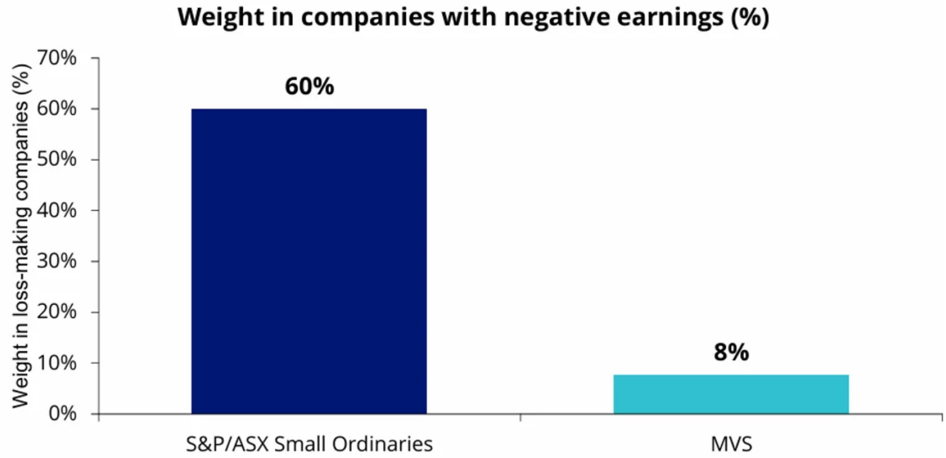
Don't just spray and pray

When capital was cheap, businesses with limited earnings or significant funding requirements could continue raising capital to support growth. As financing costs increased, investors shifted their focus to profitability, cash generation and balance sheet strength.

This is particularly relevant in Australian small companies, where a significant proportion of the investment universe remains unprofitable or reliant on external funding. Investing in a broad small-cap index fund means owning the entire market, including many of these businesses.

The chart below illustrates the impact of this approach. While the S&P/ASX Small Ordinaries Index currently allocates around 60% of its weight to companies with negative earnings, VanEck's Australian Small Companies Masters ETF (MVS) reduces that exposure to just 8%.

Chart 3: MVS' weight in companies with negative earnings vs Small Ordinaries Index



Source: VanEck, FactSet, as at 30 June 2026. Negative trailing Annual EPS, 98% coverage. This subject to change.

This is why a GARP approach becomes particularly relevant.

GARP seeks companies capable of delivering sustainable earnings growth without paying excessive valuations. In today's environment, that means businesses with strong balance sheets, consistent cash generation and attractive returns on capital. Small cap companies that fit this profile outperformed last year during the RBA's short easing cycle.

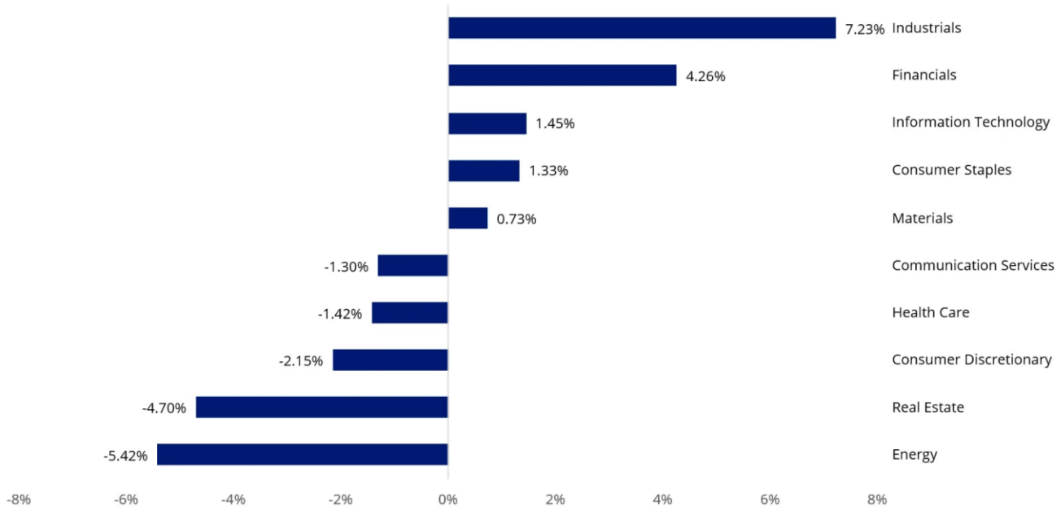
The transition from cheap capital in 2021 to sharply higher interest rates in 2022 was a powerful reminder that not all growth is created equal. When capital was cheap and readily available, businesses with limited earnings could continue funding growth through debt and equity raisings. As interest rates rose sharply and financing conditions tightened, investors became far more selective.

Companies with strong balance sheets, consistent cash generation and attractive returns on capital generally proved more resilient as financing conditions tightened. This is precisely the type of company a GARP approach seeks to identify.

Why VanEck's small cap strategy is overweight industrials

The current largest active overweight by sector in MVS is industrials.

Chart 4: MVS Index vs S&P/ASX Small Ordinaries Index sector weights



Source: VanEck, FactSet, as at 20 July 2026. You cannot invest directly in an index.

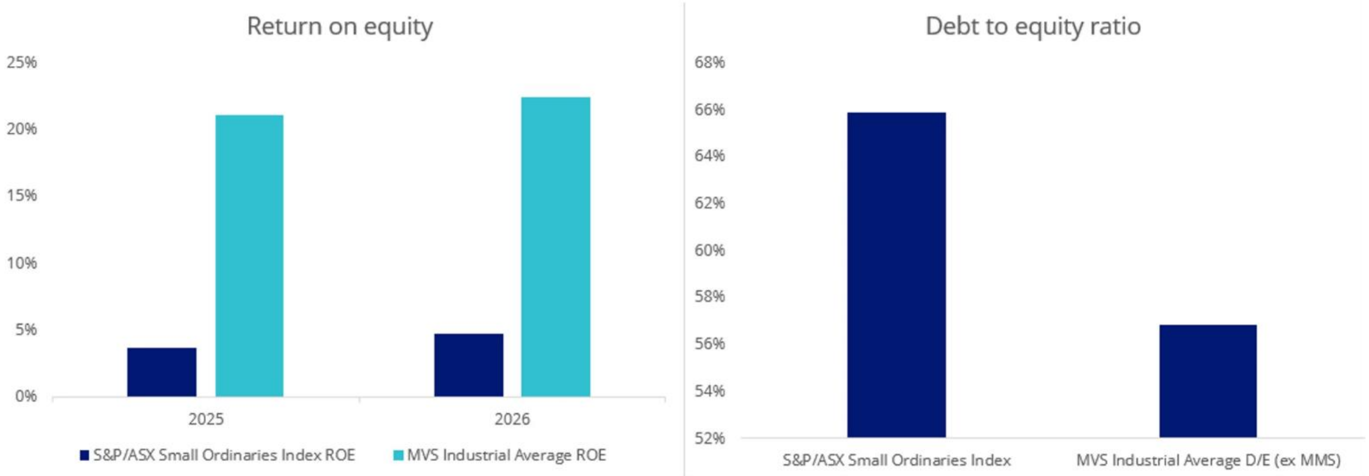
While industrial companies are often viewed as cyclical businesses, much of MVS' exposure is concentrated in specialist firms that support critical infrastructure across mining, utilities, transport and energy markets.

Rather than relying solely on new construction activity, these businesses derive a significant proportion of earnings from recurring maintenance and sustaining capital expenditure. Infrastructure owners cannot indefinitely defer maintaining essential assets, providing greater revenue visibility through the cycle.

Many also operate relatively light leverage business models, allowing them to generate attractive returns on equity without relying on elevated financial leverage.

This is reflected in the portfolio's underlying fundamentals. As the chart below shows, MVS' industrial holdings have generated materially higher returns on equity than the broader Australian small-cap benchmark while maintaining lower debt-to-equity ratios.

Chart 5: Industrials with a GARP bent have generated higher ROE and lower debt to equity than the Small Ordinaries Index



Source: Bloomberg, as at 30 June 2026. Past performance is not an indicator of future performance. You cannot invest directly in an index.

Note that McMillan Shakespeare (ASX:MMS) was excluded from the industrial debt-to-equity chart because their business is an annuity generator, meaning their debt-to-equity ratio is significantly higher than the rest of the sector.

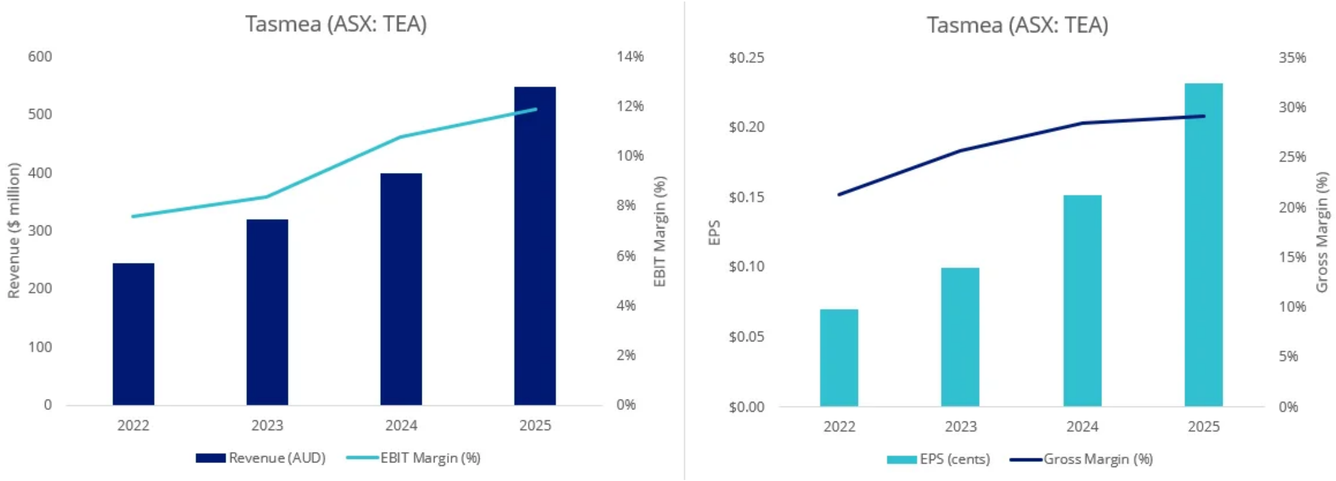
The process in action

Tasmea (ASX:TEA) and SRG Global (ASX:SRG) demonstrate the type of businesses identified by MVS's methodology. Together, they contributed approximately two percentage points to the fund's active outperformance over the past quarter.

Both provide essential maintenance, engineering and infrastructure services across mining, utilities, transport, energy and industrial markets. Around 80% of earnings come from recurring maintenance or sustaining expenditure, providing greater revenue visibility and reducing reliance on new construction activity.

Tasmea's revenues increased from approximately $245 million in FY2022 to $548 million in FY2025, while EBIT margins have expanded significantly in the last three years. This growth has been supported by repeat customers and increasing exposure to data centres, battery storage and energy services. Its more recent results also show strong revenue and operating cash-flow growth.

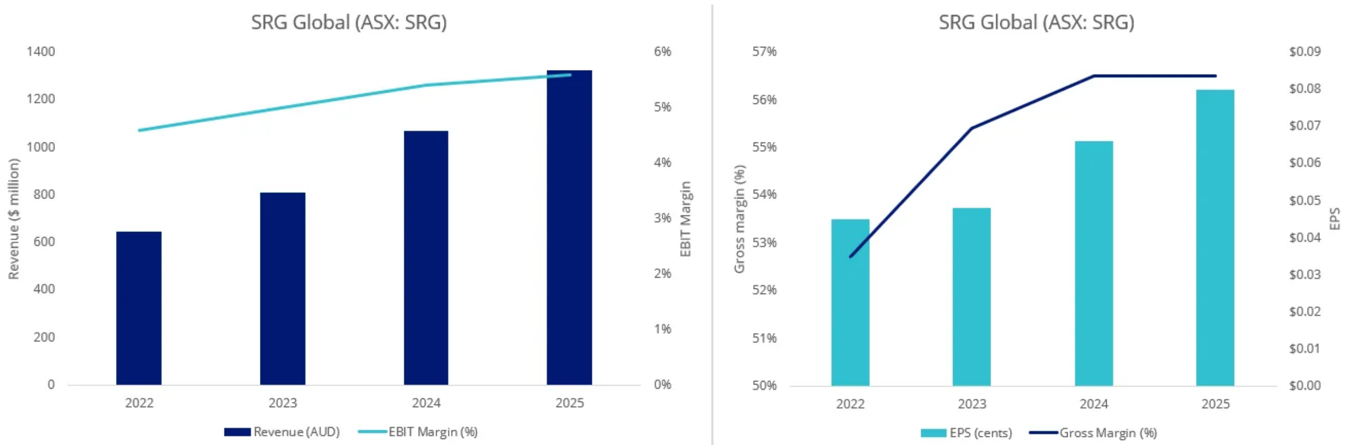
Chart 6: Tasmea's performance over last four years



Source: Bloomberg, as at 30 June 2025. Past performance is not an indicator of future performance. Not a recommendation to act.

In FY2025, SRG Global's EBITDA increased 29% and its EBIT rose 43%. Its $3.6 billion work-in-hand provides multi-year visibility across infrastructure, water, defence, transport and energy-transition markets. More recent figures also show continued double-digit revenue and operating-profit growth.

Chart 7: SRG Global's performance over last four years



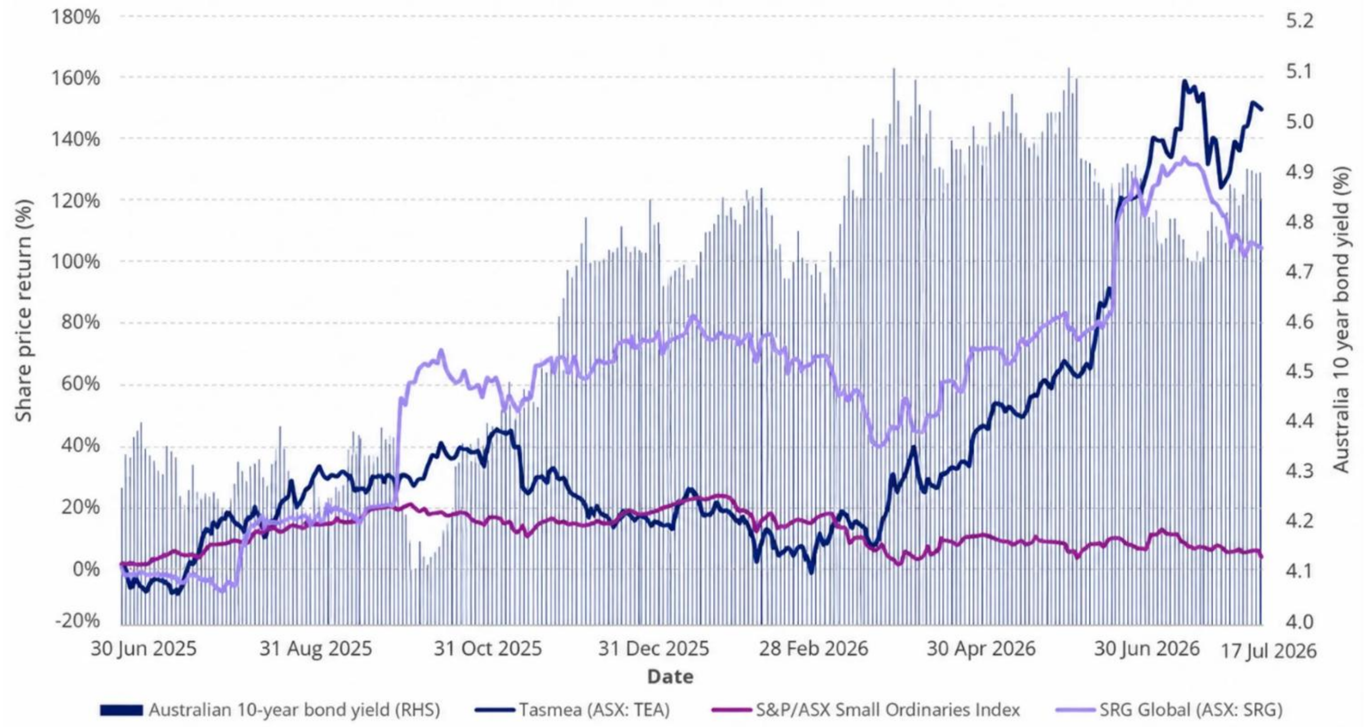
Source: Bloomberg, as at 30 June 2025. Past performance is not an indicator of future performance. Not a recommendation to act.

Importantly, both businesses have grown revenue without sacrificing operating profitability.

Resilient through higher rates

Despite the significant run up in Australian bond yields over the last 12 months, Tasmea and SRG Global materially outperformed the S&P/ASX Small Ordinaries Index. Both continued growing earnings and generating cash, demonstrating the value of recurring revenue, disciplined capital allocation and resilient operating models in a higher-rate environment.

Chart 8: SRG Global and Tasmea outperformed despite of rapidly rising bond yields



Source: Bloomberg, as at 17 July 2026. Past performance is not an indicator of future performance. You cannot invest directly in an index.

MVS's industrials overweight reflects these qualities: stronger capital efficiency, lower leverage and exposure to essential services expenditure. Tasmea and SRG Global demonstrate why selectivity matters.

We believe when financing conditions tighten, businesses with resilient earnings, recurring revenues and disciplined capital allocation are often the ones best placed to outperform.

Russel Chesler is Head of Investments and Capital Markets at VanEck, a sponsor of Firstlinks. An actuary with over 30 years' experience in financial services, Russel is responsible for managing VanEck's passive solutions.

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Are these assets the missing piece in Australian portfolios?

Nick Kelly

While Australian super funds typically hold meaningful allocations to real assets, many self-directed investors remain concentrated in listed shares, cash and property.

According to the latest figures, as at December 2025, around 73% of all self-managed super fund (SMSF) assets were held in just five asset classes: listed shares (27%), cash and term deposits (17%), unlisted trusts (12%), non-residential property (10%) and limited recourse borrowing arrangements (7%) (Source: ATO).

While that concentration has worked well through a long bull market in equities, it also means many portfolios are heavily exposed to the same set of risks. Though no asset is entirely immune to the broader economic cycle, real assets introduce differentiated return drivers that can help create portfolio resilience when traditional asset classes face drawdowns.

So, how should investors approach an allocation to real assets?

What are real assets?

Real assets are tangible, physical assets with intrinsic value derived from their utility.

What distinguishes real assets from listed equities and bonds is the source of their returns. While public market prices can be significantly influenced by investor sentiment in the short term, mature real asset valuations are typically linked more closely to the income generated by the underlying asset.

A toll road collects fees, a warehouse collects rent and a water entitlement generates lease income.

In infrastructure and real estate, these cash flows are often secured through long-term contracts and are structured to provide strong inflation protection. Inflation linked leases, for example, are far more common in the real estate market now than they have been historically.

Why the attention now?

Large institutional investors have long allocated to private markets, including real assets, seeking diversification, inflation protection and exposure to sources of return that differ from listed equities and bonds.

One objective of these allocations is to reduce dependence on public equity and bond market returns, although outcomes vary by institution and market cycle.

Retail and wholesale investors, by contrast, have remained heavily concentrated in listed equities and bonds, largely because access to private and real asset markets was historically restricted to large institutional investors that have the scale, patience and governance to invest in these asset classes. Compared with many institutional portfolios, adviser-directed and self-directed portfolios often have less exposure to private markets and real assets, remaining structurally under-diversified.

Real assets help bolster portfolio diversification because their return drivers are genuinely different from those of listed equities and bonds. They allow investors to access a different set of structural premia, such as inflation-linked cash flows, the illiquidity risk premium and others.

Furthermore, because they are operationally intensive physical assets, their performance is highly dependent on manager skill, which can have a significant impact on an asset's return profile.

These asset classes are also benefiting from powerful structural tailwinds: in 2026, institutional investors have been targeting real assets that benefit from secular themes such as digitalisation, decarbonisation and demographics.

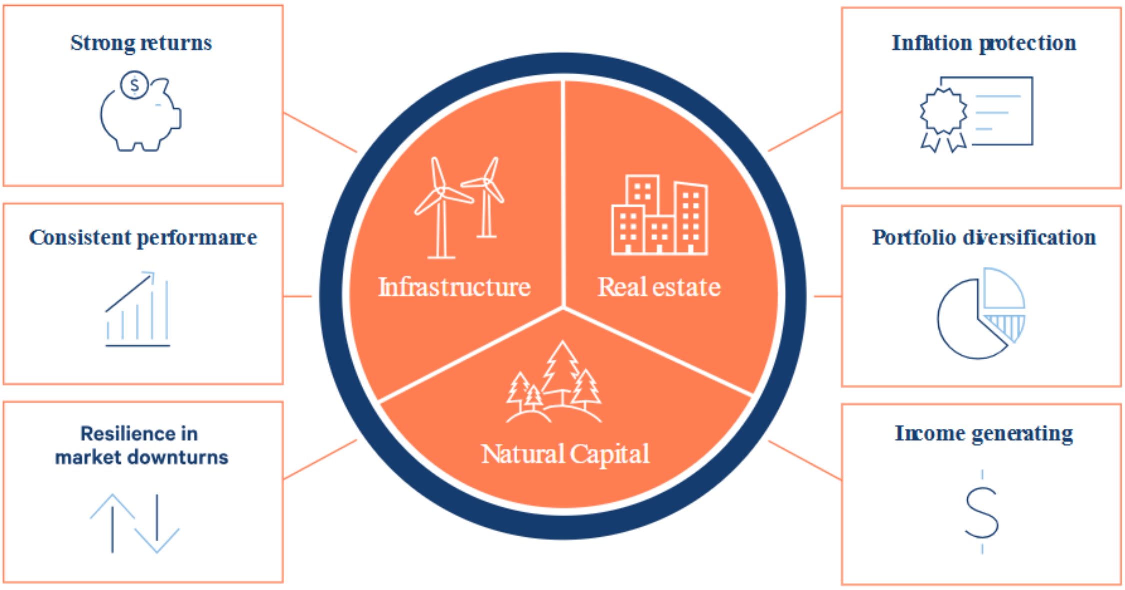
A key example is the surge in investment in renewable energy generation, energy storage and transmission infrastructure to ensure reliability and decarbonisation as the coal fleet exits (Source: Palisade Impact).

The role of real assets in portfolios

Real assets earn their place by delivering key benefits to a portfolio, as shown in the figure below.

- <u>Income Generation</u>: many strategies generate a reliable yield from rents or usage fees, which can be attractive for investors transitioning towards drawdown or needing a reliable source of income.
- <u>Inflation Protection</u>: many regulated and contracted assets, together with assets under long-term leases frequently embed inflation-linked pricing, so revenues rise with inflation rather than being eroded by it.
- <u>Portfolio Diversification</u>: because returns differ from those of listed equities and bonds, some real asset sectors have historically exhibited lower correlations with public markets.

Figure 1: How can real assets optimise an investor's portfolio?



Source: Wilson Asset Management

A modest but deliberate allocation to real assets may improve the resilience and durability of an investment portfolio.

The risks

While the benefits of real assets are compelling, investors must be aware of the structural trade-offs involved:

- Liquidity: Unlisted real assets cannot be sold at the click of a button; vehicles typically offer periodic, capped withdrawals, and investors should treat the allocation as long-term capital. This reflects the underlying asset types, such as airports, office buildings, laboratories and farms, which are significantly harder to sell than listed equities and bonds.
- Valuations are less frequent and rely on appraisals rather than live market pricing, which dampens reported volatility, but means values can lag listed markets.
- Gearing can amplify both returns and losses, so the level and structure of borrowing matter (including any duration mismatch between the asset type and debt financing).
- Fees are generally higher than for listed products, and in fund-of-funds structures investors should understand the total cost across both layers. Transparency is therefore critical.
- Manager skill and asset selection drive outcomes far more than in efficient listed markets; as competition has pushed up pricing, choosing skilled value-adding managers who can develop and operate assets is essential to generating returns. Dispersion between strong and weak managers in private markets is significantly wider than in public equities (Source: [JP Morgan]).

Navigating structural dispersion in private markets

The point about manager skill deserves more than a passing mention, because it is a defining feature of real assets and a key driver of dispersion across the asset class. Figure 2 illustrates the clear dispersion between top and bottom quartile manager returns for private real estate compared with public real estate.

More recently, this dispersion has been driven by a divergence in sector performance. Globally, traditional assets such as standard office towers and high-street retail have struggled under higher interest rates, repricing and structural vacancy, while sectors aligned with durable demographic and digital demand, such as logistics, data centres, student accommodation and healthcare property, have continued to deliver income growth.

Given the dispersion of returns across managers, manager selection can be a significant determinant of long-term outcomes.

Figure 2: Range of outcomes across private managers and public managers

Source: Blackstone

Five questions to ask before allocating

For investors and advisers approaching real assets, we think there are a few questions to ask managers before investing in the asset class. This list is not exhaustive:

1. What is the underlying exposure? Which sectors, geographies and asset types does the manager invest in and do they match the diversification you are seeking? Does the investment duplicate existing exposure or fill a gap in the portfolio?
2. How is income generated and how durable is it? Is the income contracted, regulated, inflation-linked or market-dependent?
3. How often are assets valued, and by whom? Independent, frequent valuations are preferable to infrequent, internally determined valuations.
4. What liquidity is available? Understand the fund's withdrawal terms and assume that you may need to hold the investment through a full cycle.
5. How is the manager constructing the portfolio? Asset sizing and deliberate diversification across different asset types with distinct economic drivers, matter far more than any single asset's individual appeal. For example, within real estate, diversification across office, retail and industrial assets is critical. Office exposure is largely tied to employment and unemployment trends, retail assets provide exposure to discretionary spending and industrial property is supported by structural economic and GDP growth drivers.

Concluding thoughts

Real assets have long played an important role in institutional portfolios and are becoming increasingly accessible to individual investors and SMSFs.

While they are not a substitute for equities or bonds, they can broaden the opportunity set available to investors seeking diversification, income and inflation protection. The challenge is to balance those benefits against the trade-offs of liquidity, fees and manager selection risk.

For long-term investors, real assets deserve serious consideration as a distinct and durable diversifier.

Nick Kelly is a portfolio manager of WAM Alternative Assets (ASX:WMA) and the recently launched Wilson Asset Management Real Assets Fund (ASX:WRAF), which provides exposure to an actively managed portfolio of Australian and global real asset strategies across real estate, infrastructure and natural capital.

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The biggest risk that buy-and-hold investors ignore

Trevor Schmid

Every piece of investing wisdom you have ever absorbed is an instruction for going up. Let winners run. Time in the market beats timing the market. Don't just do something, sit there. Ignore the noise and hold. They are all rules for accumulation: rules for the long climb, when the only job is to stay invested and let compounding do the work. Not one of them tells you how to get off. Not one tells you how to land.

That gap matters the moment your money has a deadline. In many cases, investing aims at a number you must hit by a date: the lump sum that clears the mortgage, seeds the business, covers the school fees, or meets a settlement date you have already signed. A goal with a date attached is a different problem from a goal without one, and the rule that builds the portfolio is precisely the wrong rule for landing it.

What buy and hold quietly assumes

Buy and hold rests on an assumption almost nobody says out loud: that you have time to recover. A 30% fall is survivable, even welcome, when you have a decade for the market to climb back and for new savings to buy in cheaply. Eventually, the market recovers. Across rolling 20-year periods, a fully invested share portfolio has historically never finished underwater (US data, after inflation). The catch hides in two words: 'historically' and 'eventually'. A deadline deletes both. It fixes the date you must sell, and the market does not consult your calendar.

Here is the part the maxims skip. If you hold a lump sum and neither add nor withdraw, the order in which good and bad years arrive makes no difference to your final balance. The arithmetic simply multiplies out: a strong year followed by a weak one lands exactly where the reverse does. So where is the danger? Not in the sequence. It is in the single fact that you do not get to choose which year is your last. The deadline chooses, and hands you whatever the market is doing that day. Worse, your portfolio is at its largest just as the deadline arrives, so a bad year at the end is a bad year applied to the most money you will ever have. If you are still contributing, sharper again: the balance peaks exactly where a fall does most damage.

$237,000 on one ordinary year

Take a growth-tilted portfolio of $400,000 with a seven-year goal of $700,000. A steady 8.3% would land it almost exactly on target, with nothing to spare, which is the whole appeal of growth assets. Now suppose it does better, like a strong run of 12% a year for six years lifting it to $789,500, comfortably ahead of the goal with a year still to go. On paper, the investor is home.

Then year seven delivers a 30% fall. Severe, but not exotic, with share markets producing drops of that order in 2008, in early 2020, and across 2022 for anything growth-heavy. The $789,500 becomes $552,700. At the deadline. A portfolio that was $89,500 ahead of its goal finishes $147,300 short: a swing of almost $237,000 in twelve months, with no year eight in which to recover. The investment thesis may be perfectly intact. The arithmetic of the goal is not.

Year seven delivers	Buy and hold	Glide path
Market falls 30%	$552,700	$701,000
Market rises 12%	$884,300	$831,300

A $400,000 portfolio targeting $700,000 over seven years, compounding at 12% for six years. 'Glide path' moves 25% to cash at 24 months out, 60% at 12 months; cash earns 4%. Source: author's calculations.

Let the calendar outrank the thesis

The institutions solved this long ago, and named it for what it resembles. A target-date fund runs a 'glide path': it begins almost entirely in shares and, as the target date nears, automatically winds risk down toward cash and bonds. So the landing never rides on a single year. As the deadline approaches, the calendar, not the thesis, sets the asset mix.

The do-it-yourself version is a written, dated schedule, fixed before you need it and followed regardless of how the market (or your conviction) looks on the day. The schedule behind the table above: 24 months out, move a quarter to cash; 12 months out, take it to 60%, and hold that to the deadline. The percentages matter less than the commitment. The purchasing stays flexible; you buy when the opportunity and the conditions align. The derisking does not, it runs on schedule whatever the market is doing. Flexibility lives in the buying decision; protection lives in the timetable.

This overrides every accumulation instinct, which is the point: thesis discipline says 'hold' at exactly the moment the goal says 'sell'. Build the rule to resist yourself under pressure, because near a deadline the urge to wait just a bit longer is the most expensive instinct you own.

The cost of the parachute

The sharper objection is Paul Samuelson's: time diversification is a fallacy, and if shares suit you for 40 years, they should suit you equally for one month. But Samuelson was pricing risk appetite. A date you cannot move is not a preference; it is a liability.

None of this is free either, and the practical objection is a good one. Going to cash early forgoes the very compounding that makes growth assets worth holding. In the far more common case where the deadline lands in an ordinary or good year, the glide path simply costs money. In the example above, about $53,000 of upside surrendered in the year the market rose. Over long horizons, time in the market beats nearly every attempt to sidestep its bad days.

The glide path is not a market call. It is not trying to beat buy and hold, or the crash; it lands on the goal, clearing $700,000 by about $1,000. It is insurance. Like all insurance it loses a little most of the time and earns its keep in the one outcome you cannot survive. You pay a known, modest premium: forgone upside. To remove an unknown, unsurvivable risk: arriving at a fixed date with too little and no time left. That trade only makes sense for the slice of capital tied to a hard number and a hard date. The rest of the portfolio can stay fully invested and let its winners run.

The discipline that grows a portfolio and the discipline that lands one are not the same, and the second is the one almost nobody writes down. Every maxim you trust is built to keep you in your seat. A deadline turns staying in your seat into the risk. So decide now, in writing, the date the calendar takes over from the thesis. The market will not do you the courtesy of crashing in a convenient year, and a plan made under pressure at the worst possible moment is not a plan. It is a hope.

Trevor Schmid has more than 20 years' experience across superannuation and financial advice and holds growth shares of the kind described here. The schedule and percentages above are illustrative, not a recommendation, and moving to cash can trigger capital gains tax. This article is general information only and does not consider anyone's objectives, financial situation or needs.

How passive investing is driving the decline of active fund alpha

Larry Swedroe

An overwhelming body of academic research demonstrates that the past performance of actively managed mutual funds does not provide valuable information as to future performance. For example, Eugene Fama and Kenneth French, authors of the 2010 study "Luck Versus Skill in the Cross-Section of Mutual Fund Returns," found that fewer active managers (about 2%) were able to outperform their three-factor (beta, size, and value) model benchmark than would be expected by chance.

However, believers in active management were offered hope with the 2009 study by Martijn Cremers and Antti Petajisto, "How Active Is Your Fund Manager: A New Measure That Predicts Performance," published in *The Review of Financial Studies*. The authors concluded: "Active share predicts fund performance: Funds with the highest active share significantly outperform their benchmarks, both before and after expenses, and they exhibit strong performance persistence."

Active share is a measure of how much a fund's holdings deviate from its benchmark index, and funds with the highest active share tend to have the best performance. Thus, while there's no doubt that, in aggregate, active management underperforms and the majority of active funds underperform every year (and the percentage that underperform increases with the time horizon studied), if an investor were able to identify the few future winners by using active share as a measure, active management could be the winning strategy.

This raises an interesting question: Has the secular shift toward passive investing – index funds and exchange-traded funds have grown from about 19% to over 50% of equity fund assets since 2010 – changed how active funds perform, and if so, through what mechanism? Hannah Unterberg attempts to answer that question in her June 2026 paper "Passive Flows, Active Woes: Passive Investing and the Decline of Active Mutual Fund Alpha."

What the paper examines

Unterberg studied US domestic-equity mutual funds and ETFs from 1984 to 2024, using CRSP fund data merged with Thomson Reuters holdings data. She found that active performance has deteriorated sharply as the relationship between active share and performance didn't just weaken after 2010 – it flipped entirely. Her explanation is a flow-driven mechanism: When investors pull money from active funds and into index funds, the active managers are forced to sell down their existing (often concentrated, off-benchmark) positions, while passive inflows buy mechanically in benchmark weightings regardless of price. This creates lopsided demand – selling pressure on stocks that active managers like, buying pressure on stocks they don't hold – and that pressure shows up directly in fund returns.

Key findings

1. Active fund alpha roughly doubled in its underperformance after 2010. Using the Carhart four-factor model, average net alpha for active funds fell from negative 0.72% annually (1984–2009) to negative 1.82% annually (2010-24).

2. The active-share premium reversed. Before 2010, high-active-share funds beat low-active-share funds by 0.85% annually (gross, four-factor). After 2010, high-active-share funds *underperformed* low-active-share funds by 1.11% annually.

3. Flow-induced demand explains the reversal. Unterberg finds:

- Before 2010, active share *positively* predicted future flow-induced demand: Active funds benefited from flows.
- After 2010, active share *negatively* predicts flow-induced demand: The more a fund deviates from its benchmark, the more adverse flow pressure it faces.
- When flow-induced demand is added as a control in return regressions, the negative active-share coefficient becomes statistically insignificant. In other words, controlling for flow pressure largely *explains away* the post-2010 active-share underperformance. Manager skill has not deteriorated, market structure is the cause of the decline.

Investor takeaways

Active share is no longer a reliable positive signal. A measure that was a useful predictor of outperformance through the 2000s now correlates with *underperformance* in the current environment. Investors and advisors who are still using active share as a simple screen for skilled managers should be aware that the historical relationship has not just weakened, it has reversed.

This is a story about demand mechanics, not eroding manager skill. That distinction matters for how investors interpret active fund track records. Underperformance driven by structural flow pressure is a different phenomenon than underperformance driven by managers losing their edge – and it has different implications for whether skilled stock-picking still has value once the flow headwind subsides or reverses.

Implications for market efficiency

Unterberg's findings suggest capital reallocation toward passive vehicles is large enough, and the supply of price-elastic capital willing to absorb it is limited enough, that flows themselves move relative prices in economically meaningful and *persistent* ways. That has a few implications worth sitting with.

1) **Price discovery may be getting less efficient at the margin for stocks where active and passive ownership diverge most.** If the buying/selling pressure described here doesn't fully arbitrage away over a three-year horizon, prices for some securities are, at least temporarily, being set as much by mechanical flow as by anyone's assessment of fundamental value.

2) I**t complicates simple "passive investing makes markets more efficient because it pushes out unskilled active managers" narratives.** The paper directly tests and rejects the idea that a shrinking active sector should mechanically improve the performance – and by extension, the price discovery quality – of the managers who remain. The *source* of the contraction matters: Managers exiting on

account of flow-driven redemptions face a different competitive landscape than managers exiting because of genuine underperformance.

Unterberg's paper offers a useful reframing of the question: Why did the historical edge associated with high active share evaporate – and reverse – just as passive investing became the dominant force in equity markets? The answer she provides isn't that "active managers got worse." It's that the market's plumbing changed. Reallocation from active to passive funds creates structural, asymmetric demand that disproportionately penalizes exactly the kind of benchmark-deviating bets that used to define skilled active management.

Concluding thoughts

For evidence-based investors, this is a reminder that performance predictors aren't static laws of nature – they're conditional on market structure, and that structure has shifted meaningfully over the past 15 years. It's also a useful caution against treating "passive investing makes markets more efficient" as an unconditional truth. The mechanism documented here suggests that, at least for the segment of the market most exposed to active-to-passive flow rotation, the opposite may currently be true.

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.

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