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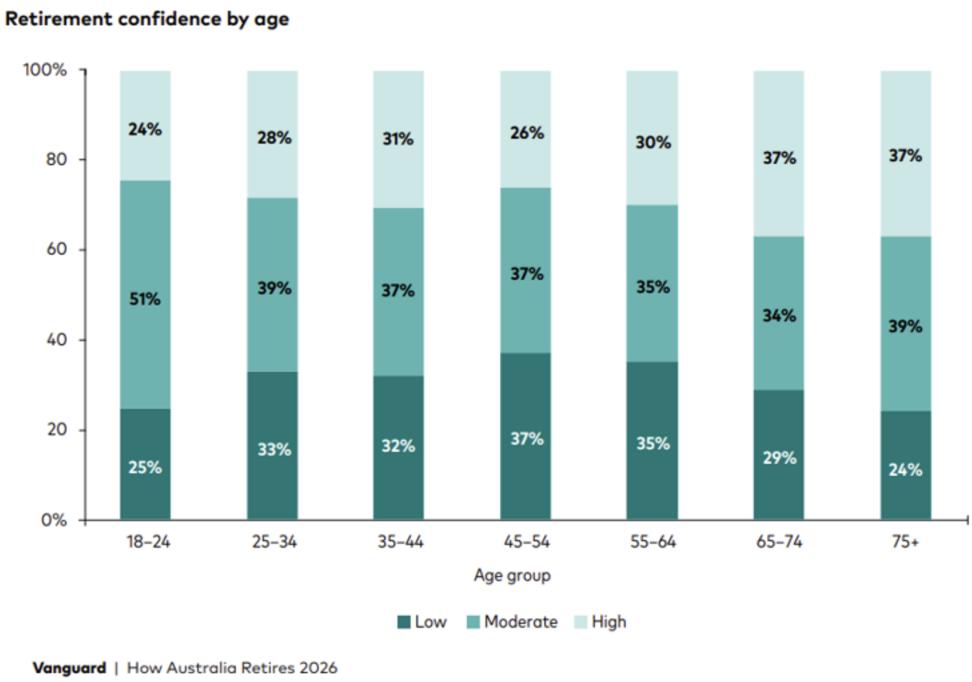
Editorial

Australians appear to be far more pessimistic about retirement before they get there, than after they arrive.

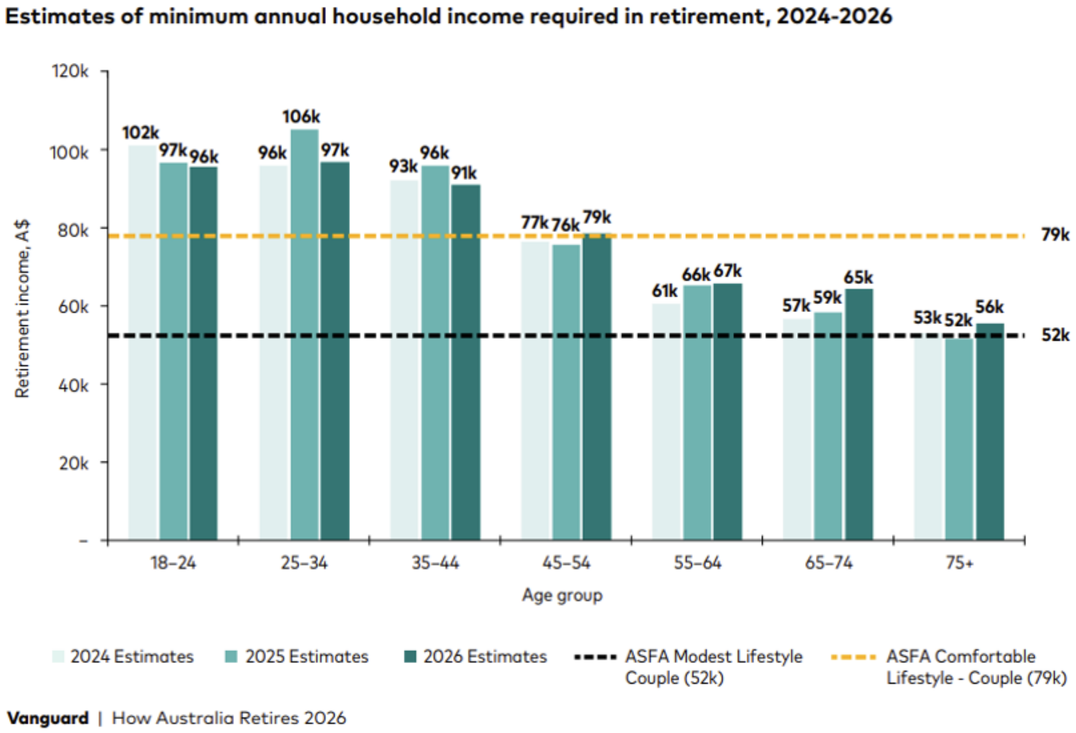
The latest findings from Vanguard reveal that retirees were considerably more likely to express positive sentiment toward retirement than working-age Australians. In some respects, retirement may turn out better than many people fear.



The report suggests this might reflect the advantages many existing retirees enjoy, such as greater accumulated savings, lower levels of debt and clearer retirement plans. That is hardly surprising, but is this gap is misplaced pessimism or a genuine structural shift?

Higher expectations

Working-age Australians increasingly believe retirement will require exceptionally high income levels, exceeding $90,000 per year for a household among younger cohorts. Meanwhile, today's retirees report far lower income needs. For context, the ASFA Retirement Standard estimates the cost of a comfortable retirement as $55,923 per year, or around $1,071 a week.



One could argue that social perceptions of retirement have shifted from achieving financial security to achieving something closer to financial abundance. Though I don't believe the story is simply one of unrealistic expectations.

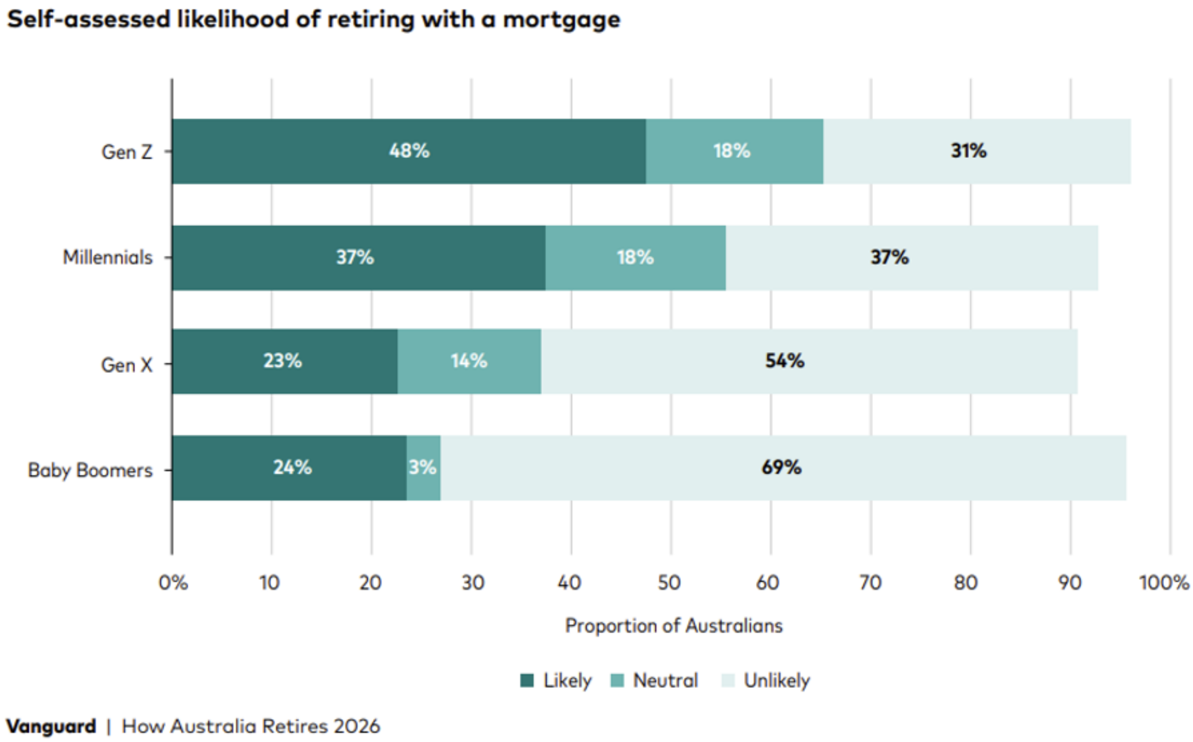
The role of housing debt

To some extent, younger Australians may be justified in their concerns. Around 61% of respondents identified having little or no debt as an important contributor to retirement confidence. But many younger Australians are unlikely to have the same starting position as current retirees.

Where previous generations viewed retirement as a period free from major financial obligations, younger Australians increasingly expect those obligations to follow them into retirement itself. To me, this is the more consequential notion buried in the survey.

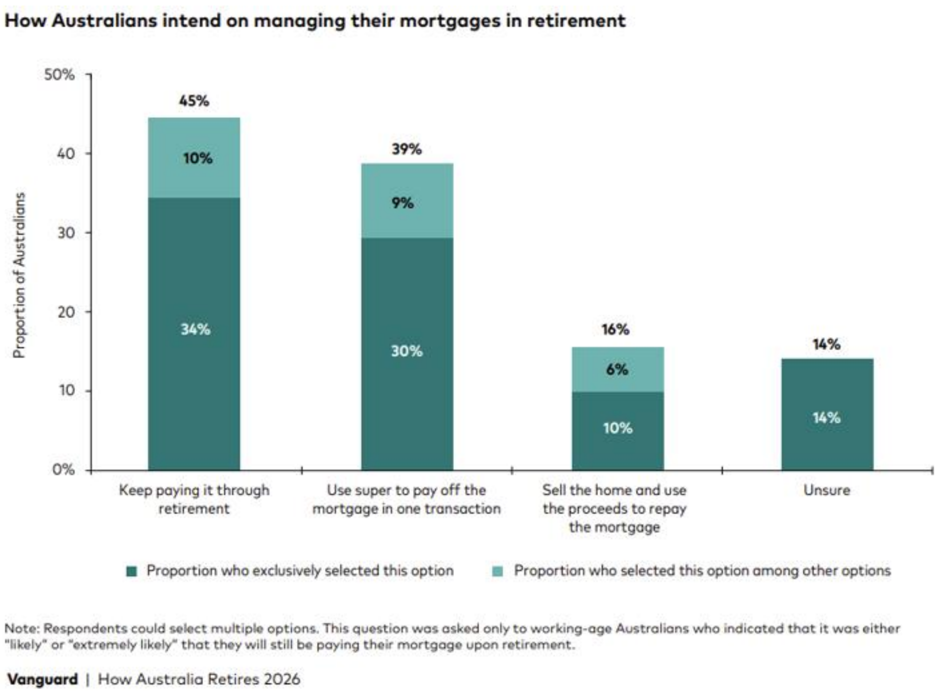
For decades, Australia's retirement system has rested on the implicit assumption that retirees own their homes outright, but this appears to be increasingly fragile.

Nearly half of Gen Z respondents and over a third of Millennials expect to retire with a mortgage. Many also expect to continue paying down debt during retirement or to use superannuation to extinguish it. If these expectations prove correct, it will represent a profound change in the way retirement is funded and experienced.



Among those who believe they will retire with a mortgage, almost 40% expect to use their super to pay off that debt as part of their transition into retirement.

This may seem perfectly rational as eliminating debt before or at the beginning of retirement can dramatically improve cash flow and financial security. Yet it also highlights a shift in the role of superannuation itself. A vehicle for generating income may increasingly become a way to repair household balance sheets.



More broadly, it raises questions about how retirement adequacy should be measured. Two retirees with identical balances can face vastly different realities if one owns their home outright while the other is still servicing debt.

There is also a wider policy implication. For years, the assumption has been that compulsory super would lessen dependence on the Age Pension. Yet if a growing share of retirement savings is diverted toward mortgage repayment, the outcome may be more complex than anticipated.

While converting superannuation into home equity may improve Age Pension eligibility, it also leaves retirees with less capital available to generate income. Either way, the assumptions underpinning much of our retirement planning warrant a closer look.

Simonelle Mody

Also in this week's edition...

Testamentary trusts have survived the trust tax. **Rachael Rofe** is back to reveal a hidden technical detail that could still force many families to rethink wills.

Shani Jayamanne models how the recent tax changes complicate the task of rebalancing your portfolio.

Ashley Owen shares a chart that reveals how population growth is masking Australia's productivity problem.

Despite eyewatering returns from mega-caps, **Robert M. Almeida** and **Ross Cartwright** discuss why tomorrow's winners may not be today's index leaders.

Sometimes the important information in an earnings result isn't the number itself. **Jarrad Stuart** explains why an earnings beat might reveal about future returns.

Michael Hallinan details a rarely discussed detail buried in SMSF structures could dramatically change who wears the cost when something goes wrong.

Buying global shares means making a bet on both the companies and on the Australian dollar. **Trevor Schmid** shows how the second bet cost investors 8.5% in the last financial year.

Curated by Simonelle Mody and Leisa Bell

Testamentary trusts survived the trust tax. The drafting battle has just begun.

Rachael Rofe

In July I wrote about Treasury's consultation paper on the proposed 30% minimum tax on discretionary trusts, and the direction it set for testamentary trusts. The paper promised an exemption from the minimum tax and left the mechanics for later. Later has arrived. The exposure draft legislation is out, and it does two things a discussion paper could not.

It shows how Treasury means to build the exemption. And it opens a question the paper was free to leave alone, because a paper can be silent where legislation has to commit to words. Those words now point in two directions at once.

The policy battle is over. Testamentary trusts have survived the 30% minimum trust tax. A testamentary trust is the discretionary trust your will creates when you die, long used to shield an inheritance from creditors, bankruptcy and family breakdown, and to let income reach children and grandchildren at ordinary tax rates. The drafting battle is the one to watch now, and it turns on a single question the draft does not cleanly answer: who is allowed to be a beneficiary?

Three tests

The exemption is not a single tick. Income escapes the minimum tax only where three requirements are met.

First, the trust must arise under a will, a codicil, an intestacy or a court order in a deceased estate. A trust set up between living people does not qualify, however it is dressed up.

Second, the income must come from the estate: assets that came from the deceased, or assets bought with them, including whatever those assets have since been reinvested into. Unrelated wealth tipped in later falls outside the exemption.

Third, for testamentary trusts that come into existence on or after 1 July 2028, the income must reach an individual or a tax-exempt entity, such as a charity. That date is not the date you sign your will. A testamentary trust comes into existence when you die, so a will signed today will be judged against this third test if you live past 1 July 2028, which most people signing a will now will.

For an ordinary testamentary trust, the first two look after themselves. The trust is made by a will, and it holds what the estate left behind. The third is where the draft stops being routine, because it raises a question the consultation paper never had to answer: who counts as a beneficiary?

The fork in the draft: Who counts as a beneficiary?

Everything now turns on that third requirement.

Most testamentary trusts are drafted with deliberately wide beneficiary classes. Alongside children and grandchildren, they routinely name a spouse, family companies, other discretionary trusts and related entities. That width is not exotic. It has been standard practice for decades, because it lets the trustee deal with circumstances no one can map at the time the will is signed. The broader the class, the more room the trustee has to provide for people who may not even have been born when the will-maker died.

The draft puts that width in question, and it can be read two ways.

The operative provision, the words of the proposed law itself, looks to the beneficiary who actually receives the income. On that reading, a company or a trust sitting in the class does no harm by itself, as long as the income from the trust is only paid to an individual or a tax-exempt entity. Most existing wills would need no change, and the trustee would simply have to watch who receives distributions. The exemption also applies income-by-income, not at total trust level. Pay income to a company and the 30% applies to that slice alone; the rest of the trust, and the income that goes to individuals or charities, stays exempt. Nothing is tainted by association.

The explanatory memorandum, the companion document that says what the law is meant to achieve, reads wider. Its language can be taken to mean that a testamentary trust set up after 1 July 2028 must be capable of benefiting only individuals and tax-exempt entities, whether or not a company ever receives a cent. On that reading, the mere presence of a company or a taxable trust in the class is fatal to the exemption, even where it is paid nothing.

The distance between those two readings is enormous. On the first, this is an administration issue: mind the distributions after death and carry on. On the second, it is a drafting issue on a national scale, because a wide beneficiary class is not the exception in testamentary trust wills. It is the standard.

The second reading would produce a result that is hard to defend. People who paid for careful estate planning years ago would be told to amend documents that were perfectly sound when they were drawn. Some of them can no longer amend anything, having lost capacity in the meantime. They did the right thing while they could, and their families would be left with fewer options because the rules moved underneath them. Lawyers would certainly be busy. Whether that is fair is another question.

Treasury should say plainly which reading it means before the legislation is settled. The difference between regulating who receives income and regulating who could potentially receive income looks small from Canberra. For the thousands of families with testamentary trust wills today, it is the difference between doing nothing and redrawing everything.

Old machinery, new job

The draft reaches for section 102AG, and that choice tells you how the whole exemption is meant to work. Section 102AG is the long-standing rule that lets children take income from inherited assets at ordinary rates rather than penalty rates. Rather than write a fresh carve-out, Treasury has given that machinery a second job: deciding whether testamentary trust income escapes the new minimum tax. Old machinery, new job.

There is good sense in that. The regime rests on ideas advisers have worked with for years, not a fresh test with no history behind it. It also signals what the coming arguments will cover, because they are the arguments the excepted income rules have always thrown up: where the assets came from, how the income is traced, and whether the arrangement is truly testamentary.

That choice is also what puts teeth in the second requirement. The exemption is not a blanket pass for anything held in a trust made by a will. Income traceable to estate assets, or to what those assets have since been reinvested into, can qualify. Unrelated assets tipped in later do not, and the draft backs that with tracing rules and anti-avoidance provisions aimed at property pushed through an estate mainly to reach the exemption. That distinction, subtle as it sounds, is the whole game.

So, should you redraft your will?

Redraft, perhaps not.

The better question is whether your will would still work under either interpretation. For many families, that can be assessed long before any decision to amend documents needs to be made.

The Government wants the reforms enacted this year, potentially as soon as the Parliament's mid-October sittings.

For families with testamentary trust wills, that means the period of uncertainty is likely to be relatively short. In most cases there is little value in rushing to amend documents before the final position is known. What does make sense is understanding whether your will could be affected by the outcome. If the legislation ultimately adopts the narrower reading of the operative provisions, many existing wills may require no change at all. If it adopts a broader restriction on beneficiary classes, some families may need to act promptly. Knowing which camp you fall into means you are ready to respond once the legislation is settled.

There is also a broader point. Most wills are reviewed far less often than people imagine. The will that felt comprehensive when it was signed in 2012 may have been written before the family business was sold, before the investment portfolio grew, before grandchildren arrived, or before relationships within the family changed. Life has a habit of moving on while documents stay where they were left.

That is why the sensible response is neither panic nor procrastination. Understand whether the legislation could affect you and use the opportunity to make sure the rest of your estate plan has kept pace with your life.

If you do not currently have a testamentary trust in your will, there is another message in the draft legislation. In preserving the exemption, the Government has effectively confirmed the continued role of testamentary trusts as one of the most effective tools available for passing wealth between generations. That should not be overlooked.

Where this leaves us

The consultation paper told us testamentary trusts would keep their place. The exposure draft tells us how. By tying the exemption to section 102AG, Treasury has protected these structures and imported decades of settled thinking about tracing and the source of assets. That part is good news.

The remaining uncertainty is narrower, but important. The draft has not yet definitively answered whether the new rules focus on who actually receives income from a testamentary trust or whether they also restrict who can be included in the beneficiary class itself. For many existing wills, that distinction will determine whether nothing changes or whether amendments become necessary.

That question is unlikely to remain unresolved for long given the Government wants the legislation enacted this year.

The argument about whether testamentary trusts survive has already been won. The argument about how they are drafted will soon be settled.

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.

This article is general information only. It is not legal, tax or financial advice, and you should obtain advice specific to your circumstances before acting. The legislation discussed is in exposure draft form and may change.

The new capital gains tax trap for your portfolio

Shani Jayamanne

Rebalancing has been one of the simplest rules in investing. Set your target asset allocation, let your portfolio move away from it as markets rise and fall, then periodically sell what has done well and buy what has lagged.

It sounds almost mechanical and this is why it works. Setting a structure instead of leaving buying and selling to chance can improve outcomes. If you want a portfolio with 70% growth assets and 30% defensive assets, you sell enough of your growth investments when they reach, say, 75%, and put the proceeds into defensive assets.

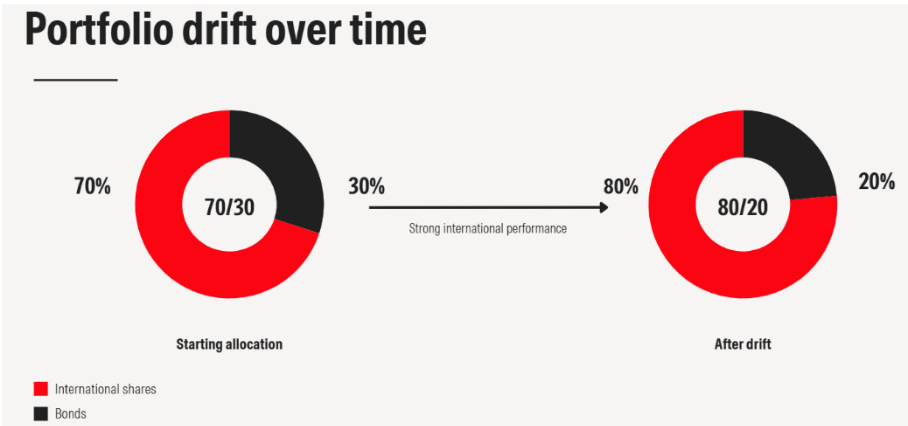
The result is a risk-considered portfolio that remains aligned to the asset allocation required to achieve your goals. This is not an exercise free of consequence. Selling appreciated investments will create a tax bill for most.

As we move from the 50% capital gains discount after 12 months to a minimum 30% tax rate, rebalancing becomes more expensive. The new tax environment favours those that are in it for the long haul. The nuance is that investors in it for the long haul will likely pay more for the benefits of rebalancing.

I look at the real cost below, and alternatives to the approach.

The hidden cost of rebalancing

Consider an investor that has a 70/30 split between international shares and bonds. Over a year, international shares perform strongly and the portfolio becomes 80% international shares and 20% bonds.



The textbook rebalancing move is straightforward: sell some international shares and buy bonds. The international share allocation has generated a large unrealised capital gain, and selling crystallises that gain.

Under the current system, if the assets are held for 12 months, the capital gain may be reduced by the 50% CGT discount. The system in place from 1 July 2027 operates on an indexation method. Selling assets frequently to maintain asset allocation percentages in your portfolio will have larger consequences.

Let's go through an example. You had $10,000. You invested 70% of your portfolio in Betashares Asia Technology Tigers ETF (ASX ASIA) and 30% in Ishares Core Composite Bond ETF (ASX IAF) on 24 August 2025. One year later, you have a portfolio worth $14,137.45, with ASX ASIA returning 58.82% for the period. This position has grown to 80% of your portfolio, and you want to return it to 70%. The sale would look as follows under the two tax regimes.

Sale of $1309.70 to bring ASIA holding back to 70%.

	Pre-1 July 2027	Post 1 July 2027
Time held	1 year	
Unit purchase price	$12.42	
Unit sale price	$19.57	
Units sold	66.9241	
Total capital gains	$478.51	
Discount method	50% capital gains	Indexation (2.5%)
Discount amount	$239.25	$20.78
Tax at 47% Marginal Tax Rate + 2% Medicare Levy	$117.23	$224.29
Tax as a percentage of gain	25%	47%

A sale like this at each rebalancing interval makes a meaningful difference to your portfolio outcomes over the long term.

This may change the mindset from 'how do I reduce risk in my portfolio?' to 'what will it cost to fix it?'. It may encourage investors to leave portfolios alone for longer while they drift further away from the target asset allocation.

When tax efficiency starts driving portfolio decisions

There is nothing wrong with considering tax when managing investments. In fact, tax is an important part of an investor's total return. I've written about tax alpha here.

The danger comes when tax efficiency becomes the objective rather than one of many considerations in a broader investment plan. An investor might look at a portfolio and conclude that selling an overweight asset is too expensive because of the capital gain and leave the portfolio as is which may lead to a worse long-term outcome.

The good news is that selling isn't the only way to bring a portfolio back towards its target. Here are a few ways to temper risk in your portfolio without resorting to what may be an expensive sale.

Ways to rebalance without selling

Using new money

One of the simplest alternatives is to use new money. Suppose an investor wants a 70/30 portfolio but it has drifted to 75/25 because shares have performed strongly. Rather than selling shares, the investor could direct new contributions towards defensive assets until the allocation moves closer to the target.

This is particularly useful for investors who are still accumulating wealth and regularly adding money to their portfolios. It is not as useful for investors in retirement.

Redirecting portfolio income

The same principle can apply to dividends, distributions and other portfolio income. Instead of automatically reinvesting every dollar into the asset that generated it, investors can direct that cash towards whichever part of the portfolio is underweight. It is a form of rebalancing that doesn't necessarily require selling.

Rebalancing across accounts

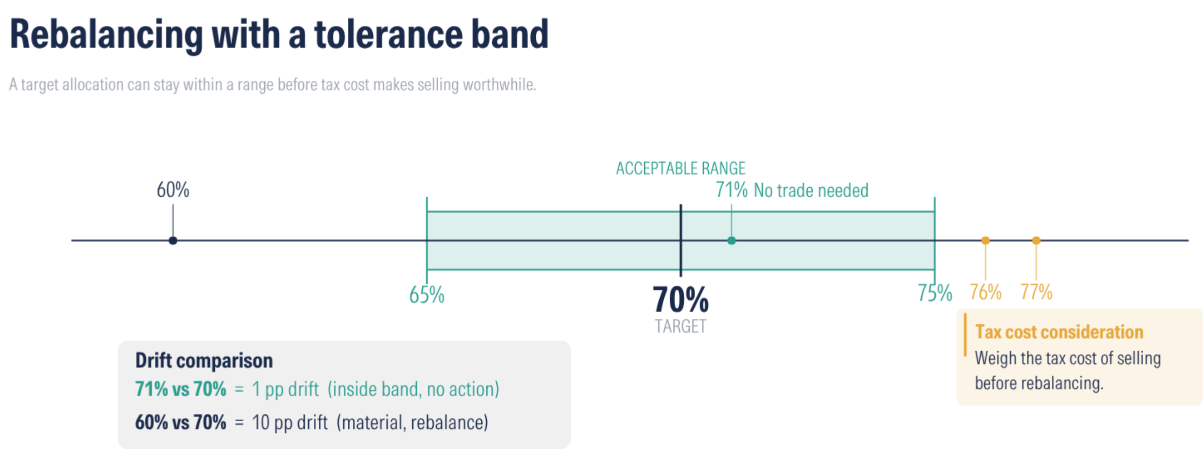
It is common for investors to undertake 'mental accounting'. Assigning particular investment accounts to certain goals and not taking a step back to look at their portfolio holistically. I am guilty as sin on this count.

For investors with investments held in different structures, there may be opportunities to make allocation changes where the tax consequences are more advantageous. Superannuation, for example, operates under its own tax rules, so the most tax-efficient way to change an overall investment mix may not involve selling assets in a taxable investment account. This is where portfolio management involves more than looking at an individual brokerage account.

It may be worth looking deeper at where in an overall portfolio a change can be made, including the structures that hold each asset class. Generally, it is worth holding growth assets where capital gains may be incurred in more tax effective accounts such as superannuation, with defensive assets held in less tax effective environments.

Rebalancing bands may become more important

Another approach is to stop thinking about rebalancing as something that happens at a particular time of year. Instead, investors can establish a range around their target allocation. For example, an investor might decide that a 70% allocation to growth assets is acceptable if it fluctuates between 65% and 75%. For investors with longer time horizons, this range may be even broader.



There is no need to sell simply because the portfolio moves from 70% to 71%. If it reaches 76% or 77%, the investor may decide the deviation has become large enough to justify the tax cost of selling.

The bigger the unrealised gain, the more valuable it is to tolerate some portfolio drift. That doesn't mean every investor should have enormous tolerance bands. A portfolio that is 60% growth assets instead of 70% is materially different from one that is 71% instead of 70%. The appropriate threshold will depend on your time horizon and capacity for risk.

Selective selling

Even when selling is necessary, you don't necessarily have to sell the asset with the largest overall gain. A portfolio can contain multiple parcels of the same investment purchased at different prices.

One parcel might have a substantial unrealised gain while another parcel has a smaller gain. Selling the parcel with the smaller gain may achieve much of the same portfolio adjustment with a smaller immediate tax consequence. Keep good records for the ATO.

One strategy that may be used in conjunction with a professional accountant may be to choose selective parcels based on future income tax assessments. If you are close to retirement, older parcels with large gains could be deferred, with the CGT discount being grandfathered for holdings prior to 1 July 2027. This will not cover gains past 1 July 2027, but will mean the bulk of these parcels are not subject to the minimum 30% tax.

Capital losses can also be used as an offset. An investor who has realised or carried forward capital losses can use them to their advantage, subject to the tax rules.

The risk of becoming too tax efficient

There is a paradox here. One of the biggest benefits of the Australian tax system has historically been that investors can defer tax on unrealised capital gains. You don't generally pay CGT simply because an investment has gone up in value.

That creates a powerful incentive to hold investments rather than constantly trading them. There is a point where avoiding tax becomes counterproductive. Imagine an investor owns an asset they no longer want, but they refuse to sell because it has a large capital gain.

This may be seen as tax efficient, but the opportunity cost is high if the investment no longer fits their risk profile, asset allocation or financial goals. The net funds could be put to better use.

The same is true at the portfolio level. An investor who has gradually become significantly more exposed to shares because shares have outperformed may be taking considerably more risk than they intended. Avoiding a tax bill doesn't make that additional risk disappear. It simply means the investor is paying for tax efficiency with a different currency - portfolio risk.

Rebalancing is not dead – it may still be the answer

For some investors, paying the tax bill will still be the right decision. Consider someone approaching retirement whose portfolio has become substantially more aggressive after a strong run for shares. They may have accumulated a large unrealised capital gain and selling some of those investments could trigger a significant tax liability.

If the alternative is entering retirement with substantially more investment risk than they can afford to take, the tax bill may be a price worth paying.

The same applies to investors whose circumstances have changed. A portfolio constructed for someone in their 30s may no longer be appropriate when they are in their 60s. A portfolio built around a particular financial goal may need to change once that goal is approaching. It may mean that when the goal appears, the portfolio is in the wrong place to actually use the funds sacrificed for said goal.

Tax should influence the implementation of that change. It shouldn't necessarily determine whether the change happens.

Think about the portfolio, not the tax bill

The biggest lesson from the CGT changes may have less to do with tax and more to do with how investors think about their portfolios. The changes have disappointed many investors, but instead of structuring around the changes, ask a more useful question – what portfolio gives you the best chance of achieving your financial goals?

It may mean using some of the alternative methods to 'rebalance' your portfolio, or it might just mean biting the bullet. Rebalancing is simply a tool that keeps your portfolio on track, and the tax changes make that tool more expensive to use. It does not make the tool obsolete.

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

Population growth masks Australia's productivity problem

Ashley Owen

Recent national accounts confirmed a disturbing reality for Australia: immigration-led population growth but flat-lined living standards.

Australia's economic growth has been increasingly reliant on ***population*** growth rather than real reforms to improve ***productivity*** and ***living standards***. This is not a new trend. It has been deteriorating for several decades through governments of all types.

Growth in a country's overall economic pie comes from two main sources:

a) growth in ***population*** (more people producing, earning, and spending the same per person as last year); and
b) growth in output, income, and spending ***per person*** – which drives growth in living standards

Australia has (and has had for two centuries) the highest population growth rate of any country outside of Africa, and is still the most sparsely populated country on earth (even if you include just the arable land)! See - [Australia's extraordinary population-led growth].

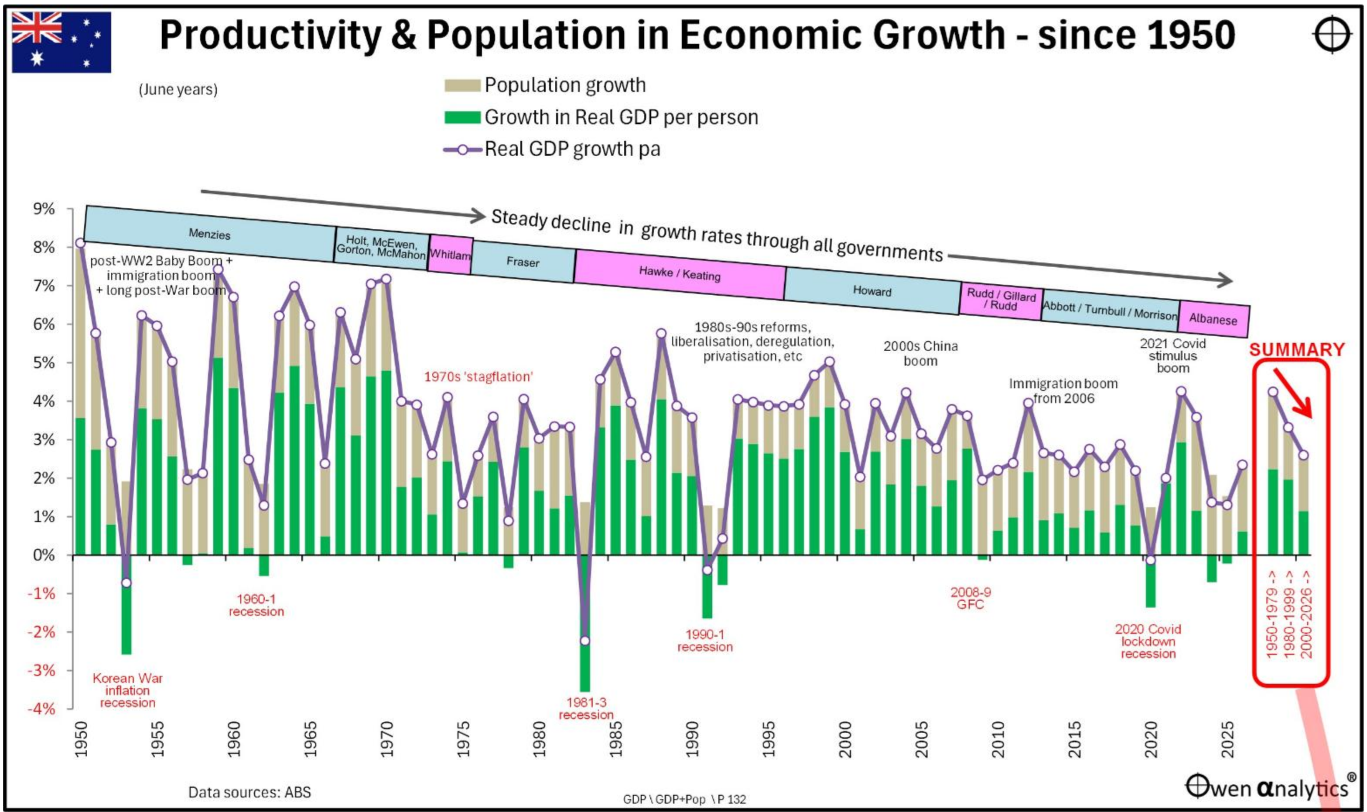
Population -v- productivity growth

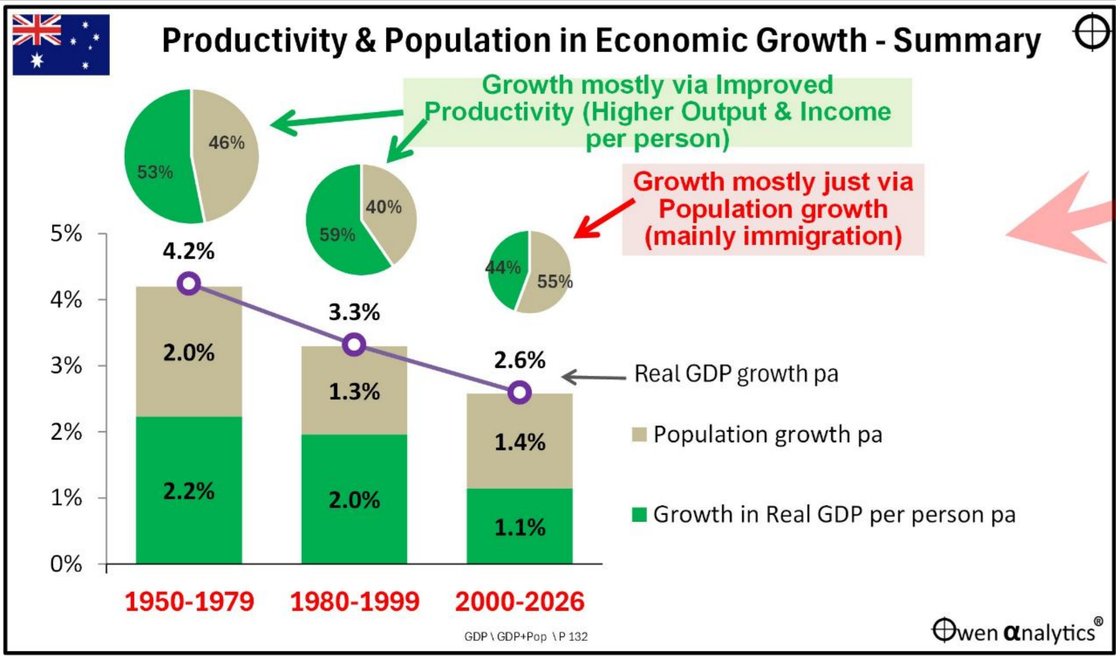
Of these two components of growth, the second is far more important and desirable, because it contributes to higher living standards per person, through higher levels of incomes and wealth per person, better schooling, and health care, etc.

On the other hand, population growth doesn't increase living standards per person. Economic growth through population growth alone just means more traffic, more crowded schools and hospitals, more pollution, more waste, more construction, more noise.

The problem is that most of Australia's overall economic growth has come from population growth, rather than productivity growth.

Long, slow decline in growth rates





The upper chart above shows annual growth in Australia's real GDP (purple line) per year since 1950, separated into the two main sources of growth: population growth (grey bars), and growth in GDP per person (green bars).

The most obvious feature is the steady decline in economic growth rates in Australia over many decades (punctuated briefly by recessions).

This steady decline has persisted through ALL governments from both sides of politics. Some governments have been better than others of course.

Without going into politics, the first observation would be that all governments of all persuasions, from the very first years of British colonial settlement, have generally been pro-growth, pro-resource exploitation, pro-immigration, pro-individual freedoms, and (mostly) pro-business.

We tend to take these things for granted here, but other countries have not had the same success. Australia's prosperity has not just been resource abundance - there are plenty of resource rich countries that are economic basket cases.

Summary of shrinking growth rates since 1950

The second chart expands the Summary section in the right section of the first chart.

Rates of overall economic growth in Australia have declined substantially - from 4.2% per year in the 1950s to 1970s, down to 3.3% per year in the 1980s and 1990s, and now down to just 2.6% per year so far this century.

Critically, more than half of the growth in the total economic pie is now just coming from population growth – the politically easy option.

Post-WW2 boom

During the second half of the twentieth century, Australia experienced the highest rates of growth per person (growth in living standards) since the first half of the nineteenth century.

(For the full story since 1788 see - Australia's shrinking growth - mostly just population growth)

The high rates of growth in the post-WW2 boom in the 1950s and 1960s ended in the 'stagflation' of the 1970s, a global phenomenon made worse by government policies here (on both sides).

1980s-1990s economic reforms

High growth rates were lifted once again after the radical economic reforms under Hawke/Keating (Labor). These included floating the dollar, removal of capital controls, deregulating banking, opening banks to foreign competition, privatising government businesses, reducing tariff protection, improving competition laws, productivity-based enterprise bargaining, tax reforms, central bank independence, compulsory 'super'.

In the Howard years (Lib/Nat) the Hawke/Keating reforms were extended but much of the windfall gains from the early 2000s China/mining boom were squandered on middle class welfare, which have been politically near impossible to wind back (although some of the gains were 'banked' by paying off the national debt and setting up the Future Fund).

Prospects for reforms to raise productivity and living standards?

The nearly two decades since the Global Financial Crisis have been a whirlwind of revolving door governments that have not demonstrated much ability to think beyond the daily news cycle or the next election or leadership challenge.

The current governments (Federal and State) are clearly moving backward toward centralised controls, reduced workplace flexibility, increased union power, industry-wide strikes, productivity-free wage rises, subsidising and picking 'winners'. Governments are squandering temporary windful mining gains on expanding government spending and rapidly increasing government debts, rather than paying them off.

Population growth easier than hard reforms

Genuine economic reforms are painful and politically risky.

Deep and radical government reforms in the past have only been made when the nation faced nightmare conditions – like persistent double-digit inflation (1970s), or 20%+ unemployment & income reductions (1890s, 1930s), or military attacks on our soil (1940s). Making far-reaching and unpopular decisions was an urgent necessity, not an option.

Compared to traumatic conditions in the past that triggered deep and lasting policy changes, conditions today are very mild. Life is just too good. Inflation, interest rates and unemployment rates are relatively low (historically), commodities prices are high and bumper export revenues are flooding in.

Instead of painful reforms, to keep the headline numbers growing - like jobs numbers and company revenues and profits, it is much easier to just increase the population.

Even after two centuries of experiencing the highest population growth rates in the world outside of Africa, Australia is still the sparsest country in the world (even if we include just the arable land). It is still virtually empty!

This vast, sparsely populated rock we live on seems to be packed with enormous reserves of an ever-increasing array of raw materials that other people in other countries want to buy from us, to turn them into useful stuff to sell back to us at hundreds of times the price we got for them in the first place.

The case for high immigration has always been that we need more people to dig up these bountiful natural resources we keep finding in and on our rock, and we need more people to defend the rock!

Populist pressure to radically reduce immigration

The problem is that increased voter populism today is not only making productivity-boosting reforms even more prohibitive and unlikely, all sides of politics are bowing to political pressure to CUT immigration significantly, which has been the primary source of economic growth this century.

This lower growth future will challenge Australian investors' long-held assumptions of steadily rising corporate revenues, profits and dividends that have been based primarily on high population growth.

Food for thought!

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

Why tomorrow's winners may not be today's index leaders

Robert M. Almeida, Ross Cartwright

The market has rewarded investors for owning the companies that grew into today's index leaders. But the next phase of the AI cycle may test whether owning the winners of the last cycle is enough. The active-passive investing debate is often framed around fees, market efficiency, and recent performance. Those issues matter, especially after a decade in which benchmark exposure has been difficult to beat. But they can obscure a more fundamental point: a stock is a claim on a company's future cash flows, and its price reflects today's expectations for those cash flows. Future returns, therefore, depend on the gap between what the market expects today and what ultimately occurs.

Why is this important to bring up now? Because AI is changing the economics of growth: the opportunity is large, but so is the capital required to pursue it.

In our view, today's AI-driven capex cycle will be more capital intensive for the companies that now dominate market-cap-weighted indices. Demand and earnings remain favorable, but growth now requires heavy investment, straining free cash flow and bringing execution, financing, regulatory, and overcapacity risk. The opportunity for strong returns has not disappeared, but the capital cycle has raised the bar and the margin for error has narrowed.

While stock prices are forward-looking, market-cap-weighted indices allocate the most capital to companies that have already become large, reflecting past earnings growth, share-price appreciation, and investor conviction. Passive investors, therefore, can remain anchored to today's market leadership through benchmark weights earned by prior success. Put differently, passive captures the consensus efficiently but does not challenge whether that consensus will prove to be right. If AI changes the economics of growth, the question is whether the conditions that produced today's market leaders can persist, and where the next generation of market leadership will emerge.

Beyond capex, AI is reshaping industries, redirecting profit pools, and challenging business models. Some companies will use AI to improve productivity, deepen customer relationships, and protect margins. Others may be disintermediated as software automates labor, distribution, or expertise. That makes capital discipline, not just technical ambition, central to the next phase of returns.

Why capital cycles matter

Capital cycles are simple but powerful: High returns attract capital; capital creates capacity; capacity changes competition; and competition affects pricing power, margins, and future returns. Successful companies may not necessarily fail, but exceptional returns should also not be assumed to persist. As AI investment accelerates, the key issue is how AI translates into durable value creation: some companies will deepen their advantages, while others will discover that growth is not necessarily value creation.

Active management seeks to distinguish between those outcomes before they are priced in. A market-cap-weighted index owns future winners and future losers in proportion to their current market value. It does not judge which companies, sectors, or assumptions will be rewarded or hindered in the next phase of the cycle.

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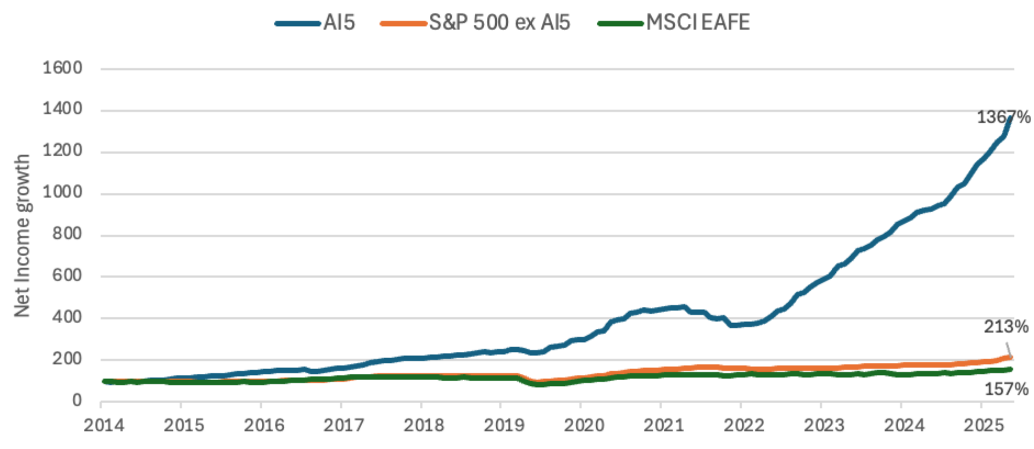
What happens to passive investing when the opportunity set shifts

The decade following the global financial crisis created unusually supportive conditions for passive investing: falling rates, abundant liquidity, globalization, and the rise of asset-light business models. Earnings growth was rewarded, multiples expanded, and the largest companies became larger. This produced a powerful feedback loop: strong fundamentals lifted prices, prices raised benchmark weights, and higher weights increased passive exposure.

As shown in the chart below, much of today's concentration has been justified by genuine earnings delivery. Concentration is not a judgement about future leadership; it is an outcome of past success. The question is whether those profit pools will remain durable, and what might cause leadership to broaden or rotate.

Exhibit 1: Exceptional earnings growth has justified recent concentration, but is this repeatable?



Source: FactSet Portfolio Analysis. Monthly data from 31 December 2014 to 30 April 2026. AI 5 = Amazon, Alphabet, Meta, Microsoft, and Nvidia. S&P 500 ex AI5 = S&P 500 excluding the AI5 stocks. Net income is last-12 months

Passive generally works well when the consensus is broadly right and the future resembles the recent past. It is less suited to environments where the opportunity set shifts, the cost of capital changes, and tomorrow's winners differ from yesterdays.

What changing market conditions mean for active investing

For active managers, rising market concentration and the growing dominance of the largest index constituents have had portfolio construction consequences: Underweighting the largest stocks became not only a valuation or conviction decision, but a portfolio-construction challenge. Not owning or underweighting these companies materially reduced portfolio beta, and investors often found it difficult to replace that exposure through other growth investments. As market returns became increasingly concentrated in a small group of stocks, lower beta portfolios faced a meaningful relative performance headwind.

Any credible argument for active management must acknowledge recent history: Many active managers have not delivered consistent excess returns, and investors have been well served by low-cost benchmark exposure. In some cases, active managers were too cautious toward high-growth companies, too reliant on mean reversion, or insufficiently differentiated after fees.

The lesson is to raise the standard for active management. It must be selective, differentiated, and disciplined and offer real value for the fees charged. The case for active management must therefore rest not on dismissing passive, but on understanding that market prices reflect expectations and expectations are assumptions, not facts.

Alpha requires both a differentiated view and an opportunity set in which that view can be rewarded. For much of the past decade, the opportunity side of that equation was constrained by low dispersion, dominant benchmark leaders, and macro conditions that lifted many businesses together. If dispersion rises, however, as capital cycles turn, the likely winners may be the businesses whose future cash flows can still exceed what the market has priced in. The winners of the last cycle earned their index weight; the next cycle will test whether they can keep it.

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What earnings surprises reveal about future returns

Jarrad Stuart

One of the foundational assumptions in investing is that share prices adjust quickly when important information becomes public. A company reports earnings ahead of expectations, the shares rise and the good news appears to be fully reflected immediately.

Yet, decades of research suggest the process is not always so neat. Companies that deliver unexpectedly strong earnings have historically tended to outperform for a period after the announcement, while those reporting negative surprises have often continued to underperform. Researchers call this phenomenon post-earnings-announcement drift (PEAD).

For investors, the opportunity may arise when a strong result signals that the market has not yet fully adjusted its expectations for a company's future earnings. The information is not secret. Everyone can read the result. The interesting part is that investors may take time to work out what the result means for the years ahead.

The first move is not always the last

Suppose analysts expect a company to earn $1.00 per share and it reports $1.15. Its share price might rise 8% on the day. The market has clearly responded, but investors still have to decide whether the extra 15 cents was simply temporary, or evidence of a more durable change.

Perhaps margins are improving faster than expected, a new product is gaining traction, or pricing is holding up better than analysts assumed. If the improvement is sustainable, the result does more than lift the current year's earnings. Forecasts for next year, and possibly the year after that, may also need to rise.

The market therefore faces two questions: react to the reported surprise, then reassess the company's longer-term earnings power. The first is answered almost instantly. The second can take weeks, months or even multiple reporting periods.

The surprise is measured against expectations

A company's results matter relative to what investors already expected. A business can report 30% earnings growth and see its shares fall because the market expected 40%. Another can report declining earnings and rally because the decline was much smaller than feared.

This is why earnings growth, considered on its own, can be misleading. Investors also need to ask what level of growth is embedded in the valuation and whether the latest evidence supports that assumption.

Results season provides a regular scorecard. When reality is materially better than expected, the useful question is not simply whether the company beat the number. It is whether the market has fully adjusted its view of what comes next.

Why forecasts adjust slowly

Academic studies have documented PEAD for decades. The central finding was simple: share prices did not always fully reflect what current earnings implied about future earnings. The finding has since been examined across different markets, periods and methods.

Behavioural anchoring is one possible explanation. Analysts and investors spend months developing forecasts. When fresh evidence arrives, they may revise those estimates in stages rather than discard the old framework at once. A forecast of $2.00 may move first to $2.20, then to $2.35 as further evidence confirms the change, even if the underlying business is already heading towards $2.50.

There is also a practical institutional dimension. Large investors rarely rebuild a position immediately. A portfolio manager may need to review the result, test the assumptions, speak with analysts and assess valuation before committing more capital. Information can become public instantly while portfolios respond more gradually.

Separate a beat from an inflection

None of this means investors should buy every company that beats consensus estimates. The quality and source of the surprise matter. A result supported by stronger revenue, improving margins and upgraded guidance usually carries more information than one produced by a tax benefit, delayed expenditure or a short-term cost reduction.

Research by Narasimhan Jegadeesh and Joshua Livnat found that the post-announcement effect was stronger when revenue and earnings surprises pointed in the same direction. That is intuitive: sustained revenue strength is generally harder to manufacture than a one-quarter earnings beat.

Cash flow should confirm the reported earnings. Investors should also examine orders, customer numbers, pricing, volumes and management's guidance. The aim is to decide whether the result changed the likely earnings path over several years, rather than merely shifted profit between quarters.

This is the difference between an earnings surprise and an earnings inflection. A surprise may disappear at the next result. An inflection can change the value of the business.

The second surprise can be more revealing

The most compelling bases involve companies whose earnings are repeatedly underestimated. It reports ahead of forecasts, analysts raise their estimates and, three months later, it beats the higher hurdle again.

This pattern can occur when a company enters a period of rising margins, gains market share, launches a successful product or benefits from a structural change that investors initially underestimate. By the third or fourth result, the market may accept that the old assumptions no longer fit.

In these situations, the real significance of the first beat is not the additional profit delivered in that quarter. It is the possibility that the market's assumptions about the business have been fundamentally wrong.

Valuation still sets the terms

There is an obvious risk in following earnings momentum. A good result can attract an expensive price. Once expectations move from too pessimistic to excessively optimistic, the process can reverse. A company priced for perfection has little room for an ordinary result, let alone a disappointment.

Earnings surprises should therefore complement fundamental analysis, not replace it. Competitive position, balance-sheet strength, cash generation, management quality and valuation still determine whether the shares offer an acceptable risk-reward trade-off.

The historical PEAD effect also varies across periods and markets. Trading costs, liquidity and the precise timing of information can reduce returns, particularly in smaller companies. Treating the research as a mechanical trading rule misses the point. Its better use is as an analytical clue: a strong result may contain more information than the first day's price move suggests.

Follow the direction of expectations

Investors devote enormous effort to forecasting the future. An equally important question is which companies are demonstrating, through their reported results, that today's forecasts are wrong.

When a business repeatedly exceeds expectations, improves its outlook and forces analysts to lift forecasts, investors should pay close attention. The market is forward-looking, but expectations can be sticky. Sometimes the most valuable information in a result is not what the company earned last quarter. It is what the result tells us about earnings still to come.

Selected research

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Individual SMSF Trusteeship directly liable for ATO fines

Michael Hallinan

For years, the debate has raged between advisors and their clients. Should we go to the trouble and expense of getting a corporate trustee for our self-managed superannuation fund (SMSF), or should we just be individual trustees? After all, we as the members are still all involved in any decision making either way, so what's the real difference – other than the extra costs and hassle?

It's not a bad question. Under section 17A of the Superannuation Industry (Supervision) Act 1993 (SISA), all members of a SMSF have to either be trustees personally, or alternatively if there is a corporate trustee then they must be the directors of the company. This ensures that every member has a say in the management and investment of their own super.

However, it also means that every member is personally responsible to ensure that their SMSF complies with all the legal requirements for its complying (and hence tax concessional) status to be retained. And if things go wrong, it also means that each and every member will personally suffer the consequences of getting it wrong.

This is where having a corporate trustee of your SMSF comes into its own – limitation of personal liability. Remember that a company is a separate legal entity from its directors and shareholders, and this carries over into the SMSF context. That separate entity status brings with it three clear advantages over having individual members being the trustees of their SMSF:

1. **There is no need to change the trustee if a member dies or leaves the SMSF** for any reason – all you need to do is remove or retire the outgoing director. If it was a two-member fund becoming a single member fund, the remaining member can become the sole director (assuming the company constitution allows for this – if not, it can usually be amended accordingly). This is to be contrasted with a fund with individual trustees, where a sole member would need to appoint a second person as co-trustee to satisfy the definition of "self-managed superannuation fund" under section 17A(2)(b) of SISA. There is also no need to advise banks or share registries of a change in trustee, since only the directors of the corporate trustee have changed rather than the trustee itself.
2. The **personal liability of directors of a corporate trustee is limited to the assets held within the SMSF**, assuming that the rules of the fund indemnify the trustee against liabilities incurred in the exercise of its trustee duties. In contrast, individual trustees (being the legal persons who transact on behalf of the SMSF) will be directly liable for any liabilities incurred as trustees, and whilst they may

have an indemnity from the fund if the assets are insufficient, they may be personally responsible for the excess.

3. Part 20 of SISA sets out the **'speeding tickets' regime** which applies to impose administrative and other penalties on SMSF trustees for breaches of the SIS laws – including fines of up to $21,840. Where the SMSF trustee is a body corporate, its directors at the time it becomes liable to the penalty will be jointly and severally liable to pay the amount of the penalty. However, **where there are individual trustees, the fine is personally imposed on each and every trustee** – so if there are four individual trustees, then the total fines may amount to $87,360! Or, $131,040 if there are six individual trustees. Moreover, these fines cannot be paid or reimbursed out of the fund.

These amounts are the maximum fines which can be imposed as of 1 July 2026. Actual fines imposed depend on which section has been infringed and whether there are any mitigating circumstances. Administrative penalties can be imposed on directors of corporate trustees if the director breaches a SIS provision which directly imposes an obligation on the director (rather than on a trustee) – such as s104A (obligation to sign statement recognising a trustee's obligations and responsibilities).

So if you are an individual trustee of your SMSF, the message is clear – make the switch to a corporate trustee as soon as possible. The inconvenience, initial investment and ongoing costs of doing so may pale into insignificance compared to the future inconvenience and costs of staying as you are in the name of 'keeping it simple'.

Michael Hallinan is a superannuation and financial services lawyer with over 25 years legal and superannuation experience gained in both private practice and corporate counsel positions. His work in the superannuation field in various capacities has given him an extensive understanding of the specialised field of superannuation and the superannuation industry.

He is Special Counsel – Superannuation, for SUPERCentral, an independent online platform provider of SMSFs, advice, legal documentation and wealth management services to accounting and financial planning firms throughout Australia.

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The currency bet you didn't know you made

Trevor Schmid

Somewhere in the paperwork there was a box, and you almost certainly did not tick it. 'Unhedged' is the default on most international share funds and the standard setting inside most super options, and it reads like an administrative detail, something to do with plumbing, safely left to the professionals. It is not plumbing; it is a currency position. Taken on your behalf, in your name, and last financial year it was expensive.

Here is the arithmetic up front. In Chant West's survey of super fund returns, international shares gained 25.5% in 2025-26 in hedged terms and 17% unhedged. Same companies, same year, same underlying performance. The difference, 8.5 percentage points, went to the Australian dollar on the way home. A member with $500,000 in a typical growth fund holds about 31% in international shares, roughly $155,000. Fully unhedged, that grew to about $181,000 over the year; fully hedged, to about $195,000. The gap the currency opened, 8.5 percentage points, is around $13,000 on that $155,000, and most members, whose funds sit somewhere in between, gave up a slice of it. The price of a position they never knew they held.

One caveat: this is not an argument for hedging, or against it. Over long periods the currency has been a friend far more often than an enemy, and that case is the strongest part of this article. The argument is with the word 'default'. You hold a currency position either way. The only real question is whether you know it.

Two bets in one trade

The mechanics are simple once you say them out loud. Buy a US share and your Australian-dollar outcome turns on two things: what the share did in US dollars, and what the Aussie did against the greenback while you held it. At around US72 cents, every one-cent move in the Australian dollar shifts the Australian-dollar value of a US holding by about 1.4%.

That sounds small until you see how far the currency travels. The Aussie has climbed since the end of 2024, from about US62 cents then to US67 cents a year later, and on to around US72 cents now, its highest level in over a year. Ten cents. About 16%, as big as a strong year in the share market, layered on top of it and running the other way.

What the two funds actually do

The hedged fund strips the currency out and pays you the world market return. The unhedged fund pays that return combined with the move in the Australian dollar. Neither is safer in the abstract. They fail in opposite conditions.

Scenario	Hedged (AUD)	Unhedged (AUD)
Global crash: shares −35%, Aussie falls 15%	−35% ($65,000)	−23.5% ($76,500)
Calm boom: shares +15%, Aussie rises 10%	+15% ($115,000)	+4.5% ($104,500)
2025-26 actual: international shares in super	+25.5% ($125,500)	+17% ($117,000)

Two Australians, $100,000 each in global shares. The first two rows are illustrative; the third is the actual 2025-26 outcome for international shares in superannuation (Chant West). Source: author's calculations.

The first two rows are the shape of the thing. In the crash, the falling Aussie absorbs a third of the damage. In the calm year, the rising Aussie eats two-thirds of the gain. Which one you would rather own depends on which year you get, and nobody chooses the year.

The honest objection: the hedged fund is usually the riskier one

Here is the strongest counterargument to everything above, and it is a good one. You would assume that leaving the currency exposed is the risky choice and that 'hedged' is the prudent one. For Australians in global shares, the long record says the opposite. The reason sits in the character of the currency. The Reserve Bank puts it plainly: the Aussie is a risk-sensitive currency, one that tends to rise when markets are calm and fall when they panic. So when world shares crash, the Australian dollar usually crashes with them, and that fall quietly rescues the unhedged investor, because a weaker Aussie lifts the Australian-dollar value of every offshore asset they own. The bet nobody chose becomes a shock absorber at the exact moment one is needed.

The global financial crisis is the cleanest example. As markets collapsed the Australian dollar fell around 31%. On Macquarie's analysis, unhedged global shares fell 33% for an Australian. Painful. The currency-hedged version, stripped of the cushion, fell 51%: half as much again, leaving about a quarter less capital standing. And it is not only crises. Over the two decades to September 2025 the same analysis puts unhedged global shares at 9.5% a year against 9.8% for hedged, all but identical, with the unhedged version delivering it at 11.5% volatility against 14.3%. Less risk, for a rounding error of return.

So 2025-26 is not evidence that the default is wrong. It is evidence that the default is a position, and positions have bad years. What should not survive the year is the idea that the box is administrative.

What to actually do about it

The answer is not the same for every dollar, which is why one setting across a whole portfolio is the mistake underneath the mistake. Money with a deadline in Australian dollars, a house deposit or a portfolio being wound down to a fixed number, is where the case for hedging is strongest: nobody wants a currency swing standing between them and a date, and that money is usually heading to cash regardless. International bonds are the other clear case, and it is why they are so often hedged as a matter of course; their job is to be the calm part of the portfolio and an unhedged currency swamps that job entirely. Equities held for decades are where the case for leaving it alone is genuinely strong, and the record above is why.

For super, the question worth 10 minutes is a factual one: what is your fund's hedge ratio? Most publish it in their investment guide. On Macquarie's reading of APRA's figures, more than three-quarters of the nation's international super exposure is unhedged. That is not a considered national view on the Australian dollar. It is a default, inherited by millions of people who were never asked. One honest uncertainty: the cushion depends on the Aussie continuing to do what it has reliably done, and that is to fall when world shares fall. That is a regularity, not a law. A shock that originates here rather than offshore, or one where the US dollar is not the haven everyone runs to, could see shares and the currency drop together, and the unhedged investor would wear both. Nothing in the record above is a guarantee about the next one.

So the choice between a hedged and an unhedged global fund is not the dull administrative checkbox it looks like on the application form. It is a decision about how much of your portfolio's fate rides on your own currency, and most Australians are making it by accident. It has been a good accident. But a bet you didn't know you made is still a bet, and the least you can do is make it on purpose.

Trevor Schmid has more than 20 years' experience across superannuation and financial advice. He holds a portfolio of unhedged international shares of the kind described here. This article is general information only and does not consider any individual's objectives, financial situation or needs.

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