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WHAT DOES THE FUTURE LOOK LIKE?

Insights from the Fixed Income Beyond
the Institutional Sector Summit 2019



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The seeds of the future are in the present - defining the key megatrends that will shape the future and help build portfolios that deliver over the long term.

While no one has a crystal ball to predict the future, it is possible to identify developing megatrends already underway in our society that are likely to continue to disrupt the world as we know it and bring major structural change for many years to come. By understanding these trends, we can steer a clearer course of action to secure a better future for ourselves and generations to come.

This was a key message of the KangaNews-NAB Fixed Income Beyond the Institutional Sector (FIBIS) Summit 2019, Australia's biggest and most comprehensive forum for non-institutional investors in the fixed-income market, with issuers, intermediaries, analysts and service providers all in attendance.

At the fourth iteration of the FIBIS summit, record numbers of attendees listened to a wide range of outstanding speakers who provided different perspectives on Australia's future and ideas on how to position investment portfolios to account for the changing landscape.

“The future is already here. It’s just not evenly distributed.”

– William Gibson, author of *Neuromancer*

Envisaging Australia 40 years on

Society is changing at a rapid pace. Just 40 years ago, there was no email, no Internet, and no smartphones with cameras. If you look a little further into the rearview mirror, beyond 100 years, half of the population worked in the rural industry on farms, compared to around 2% today.¹

In his opening remarks, Drew Bradford, National Australia Bank's Executive General Manager, Markets, highlighted the need to think carefully about what the industries of coming decades will look like so that we can invest well today and develop the right policies to help shape a better future.

Bradford noted that the recent Australian National Outlook 2019, produced by the Commonwealth Scientific and Industrial Research Organisation (CSIRO) in partnership with NAB, highlighted five key shifts we need as a society to make to ensure Australia reaches its full potential as an inclusive, resilient and prosperous economy in 2060.

These include identifying and investing in industries where Australia has a competitive advantage; planning for capital cities that are high density, multi-centred and well-connected to reduce urban sprawl and congestion; transitioning to a reliable, affordable and low-emissions energy economy; managing our land better; and restoring trust in institutions. "If we can get those things right, Australia will be a great place in 2060, not just a good place," Bradford said.

The starting point is not too bad. It has been nearly 30 years since Australia has experienced a recession, Australians are the second richest people in the world per capita², and we have the highest minimum wage in the world.³

Average household wealth passed the \$1 million mark in the 2017-18 financial year, a rise of 37% from a decade ago.⁴ However, a look at the portfolios of the average Australian household shows they are 30% invested in property, 30% in Australian equities and a third in cash, Bradford said. This high allocation to cash sits against a backdrop of low official interest rates and an environment where the Reserve Bank of Australia's cash rate is unlikely to go up, and if anything, is likely to go down.

NAB is seeking to address these inefficiencies by bringing investors interest rate products that diversify their portfolios and delivers sustainable returns significantly higher than the cash rate, providing a reliable income stream for the future.

Living and working longer; the problem of funding a 30-year retirement

Australian society is undergoing a fundamental transition.

Thanks to improved lifestyles and medical breakthroughs, life expectancy in Australia has improved over recent decades and this trend continues today. It is estimated that men aged 65 now will live another 19 years to age 84 and women another 22 years until age 87.⁵ This is the average. Many will live longer than this, and in the future, life expectancy will continue to increase. By 2055, life expectancy at birth is expected to be 95.⁶

While it is a positive development that we are living longer, healthier lives, it also brings with it some challenges. Funding for retirement hasn't kept pace with the rapid changes. Australia's superannuation system was designed for people who retire at 65 and live another 20 years in retirement. However, many people are retiring much earlier than this and increasingly living longer.

A panel discussion on work-life in the future canvassed the prospect that people will work longer in the future thanks to their better health and to help support their lifestyle in retirement. Panel moderator Gemma Dale, Director, SMSF and Investor Behaviour, National Australia Bank, said there are currently more people older rejoining the workforce than any time in history, and the age at which people expect to retire is rapidly increasing.

As people live longer lives, there will also be a need to rethink the traditional idea of a three-phase life, encompassing education, work and retirement. While people in the future may not have the stamina to work consistently to 80 or 100, they may step in and out of the workforce, taking work breaks in between, and reskilling to allow them to have various careers throughout a lifetime.

¹ Australian Bureau of Statistics, Labour Force, Australia, Detailed, Quarterly, May 2019

² Credit Suisse, Global Wealth Report 2018

³ OECD statistics, Real minimum wage (hourly), data extracted 5 August 2019

⁴ Australian Bureau of Statistics, Household Income and Wealth, Australia, 2017-18

⁵ Australian Institute of Health and Welfare, Deaths in Australia web report (last updated 17 July 2019)

⁶ 2015 Intergenerational Report Australia in 2055

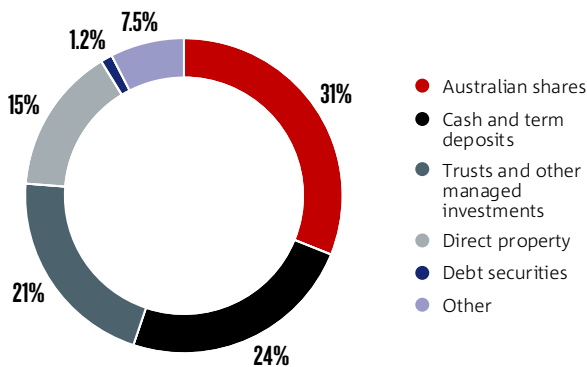
⁷ Australian Taxation Office, Self-managed super fund quarterly statistical report – March 2019

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Democratisation of the bond market – an opportunity for non-institutional investors

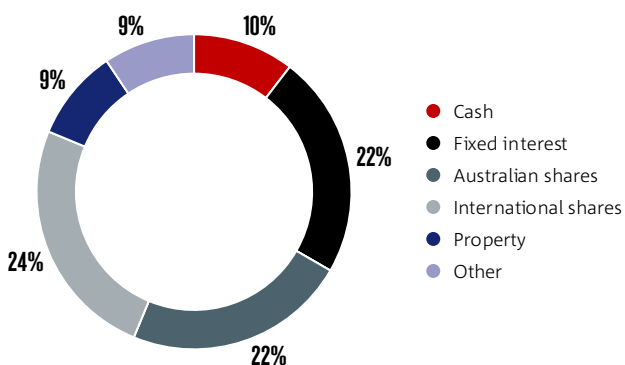
According to data from the Australian Tax Office, Australian self-managed superannuation funds (SMSFs) have 24% of their portfolio allocated to cash and term deposits⁷, far above the 10% allocated to cash by their institutional counterparts⁸, with most of the remainder being heavily concentrated in property and Australian equities.

SMSF asset allocations



Source: ATO

Commercial super fund asset allocations



Source: ASFA

A panel about the bond market revealed that investor interest in credit has been boosted in recent weeks in light of the Reserve Bank of Australia's recent cuts to the cash rate, as people see the need to make their cash allocations work harder.

Credit investments can help to diversify portfolios while delivering better yield than cash and less volatility than equities. Yet investment in fixed income by SMSFs is particularly low when compared to institutional investors. Debt securities represent around 1.5% of SMSF portfolios on average, whereas commercial superannuation funds have on average around 21% of their portfolios invested in fixed interest investments. That's something National Australia Bank is working to change, by bringing institutional grade credit investments to the non-institutional market, creating an access point to allow them to build out this part of their portfolio.

The future of agriculture: robots and plant-based meat

The world of artificial intelligence has already come to farms. Modern combine harvesters are able to navigate their own way around the fields, and robots are being used to monitor crops. However, according to futurist Mark Pesce, there are more big changes afoot that will dramatically increase the efficiency of the industry, and also change the food that we eat. The world is eating more protein than ever, which is good for our health, however the source of that protein is changing. "It's changing faster than we ever have thought and it's changing permanently," he said.

Plant-based meat is on the rise and investors have an appetite. Shares in US plant-based meat manufacturer Beyond Meat have soared around 170% since its initial public offer in April. Burger King recently announced a plant-based Impossible Whopper from Impossible Foods will be on its menus from next month. In Australia, the CSIRO's venture capital arm has entered into a partnership with Hungry Jack's to develop a plant-based alternative to the Hungry Jack's Whopper.

⁸ Association of Superannuation Funds of Australia, Superannuation Statistics, May 2019

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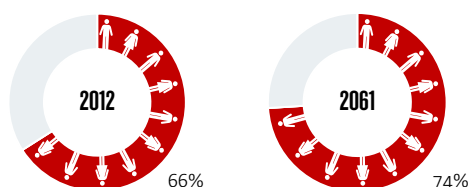
Plant-based meats and other uses of vegetable products are a huge opportunity in the current landscape where crop production needs to improve to accommodate rising populations; the environment is changing due to climate change; the numbers of middle class people in the world are rising; and the Internet is making people better informed and increasing their desire for sustainable production, meat alternatives and clean, green food.

At a panel on the future of agriculture, attendees also heard that there are increasing investment opportunities in Australian agriculture as many farmers realise that the next generation of their family doesn't want to take over. Transitions into investor ownership also provide an opportunity for taking the farms to a new level of efficiency and modernizing practices to maximize profits. As an asset class, the agricultural sector isn't without risks, however these can be managed. Droughts will continue and may become more frequent as the climate warms. Diversification, both geographically and by sector, is key to offsetting the risk of drought and natural disasters.

The panelists said there are opportunities to invest across the agricultural supply chain, from farms to distribution. Given the large contribution agriculture makes to carbon emissions, investors need to pay careful attention to sustainability and looks for ways to minimize wastage, whether it be by increasing water efficiency on farms or improving distribution times to reduce food spoilage. Some methods being trialed to reduce water wastage include covered and indoor farming.

Creating livable cities

Percentage of Australians living in a capital city



Source: ABS

Big cities are getting bigger around the world. Australia's population is rising thanks to steady immigration, and the lion's share of those people are heading to the capital cities. A panel on the future of our cities heard that people will increasingly migrate to Sydney and Melbourne unless we make other cities more attractive.

The panelists agreed that our cities and the buildings in them will continue to change in response to new technologies and the tastes of younger generations. Futurist Mark Pesce said millennials, used to using mobile apps such as Uber to acquire easy passage through their city, tend to prefer not to buy and often find it easier to rent. Panelists said this millennial preference could contribute to the evolution of a build-to-rent asset class in Australia as has long been in existence in the US and has also been growing in the UK.

The panelists foreshadowed a time when there will be no car parks in the city at all and people will be dropped off and picked up by autonomous vehicles. While there are still large challenges to be overcome in the development of autonomous vehicles and the associated infrastructure, already, developers are making new car parks convertible to office space, in anticipation of the time they are no longer needed.

Buildings are already changing in response to the preferences of millennials who are active, health conscious, concerned about sustainability and community minded. New office developments are incorporating end-of-trip-facilities such as showers and lockers, solar power, and apps that make the building feel more like a community, such as chat room apps for tenants.

Increased urban density is a sustainable solution for growing cities if the necessary infrastructure is put in place. The CSIRO-NAB Australian National Outlook 2019 report outlined that an increase in density of 60-88% on average in our major cities is preferable to increased urban sprawl if we are going to be a prosperous nation in 2060. Attendees heard that the construction of the Sydney Metro transit system is increasing the appeal of office properties in suburbs such as Chatswood where rents are as little as a third of those in the central business district. Meanwhile, the rise of ecommerce is increasing the appeal of industrial property as retailers compete to meet consumer demand for shorter delivery times.

In summary, it is clear that what we do today will impact the future, both our own and that of the wider community and the planet. That's why NAB is always working to understand the major megatrends so as to help investors and advisors to develop their portfolios.

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