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Greg Perry on insider trading and brokers as principals

Graham Hand

The hottest investment story of the week is the revelation in The Australian Financial Review (27 July 2013) by veteran fund managers Peter Morgan and Greg Perry that they received inside information through exclusive access to corporate executives, giving them an advantage over other investors that they admit was "unethical and unfair."

In the following extract originally published in 2002, Greg provides further insights, including his concern about other market practices such as principal trading by brokers. The full interview originally appeared in *Australian Business & Investment Explorer*, titled "Greg Perry's final farewell", written by myself on the occasion of Greg's retirement from Colonial First State in June 2002. At the time, Colonial First State had been voted the Morningstar Fund Manager of the Year in three of the previous five years, and Greg was the doyen of Australian fund managers.

In the interests of full disclosure, Chris Cuffe was Chief Executive Officer at Colonial First State over the 12 years to 2002. Chris and Greg turned a fledgling operation into the largest fund manager in Australia.

From the AFR report on the views of Peter Morgan and Greg Perry:

"His peer Greg Perry, who managed $13 billion at Colonial First State until he left funds management in 2002, backed Mr Morgan's suggestion of a register of access so anyone in the market could see which investors had been meeting a company's managers. Such meetings raised

a minefield of issues and the only way to ensure insider information did not seep out was to ban them outright, he said, although this might destroy the fund management industry.

"When I was a fund manager, we used to go and do company visits and you'd learn things, make no mistake," Mr Perry said. "Rightly or wrongly – gee, I might go to jail for saying this – you just did. You would ask the right question to get ideas of how they're going without them even telling you. You would pick up things."

Mr Morgan's and Mr Perry's decision to blow the whistle comes as ASIC prepares to conduct surveillance over meetings between companies and the analysts and fund managers who follow them. The surveillance has been sparked by ASIC's investigation into whether Newcrest Mining warned some analysts that next year's production of gold would be much lower than the market had been predicting.

ASIC plans to observe group meetings during the coming reporting season. Many fund managers, including Mr Morgan, believe the regulator may be wasting its time because the real problem lies with briefings outside of reporting season."

Graham Hand: Do you see a broader role for fund managers beyond maximising portfolio performance?

Greg Perry: I don't think the market realises fully the role that fund managers play in allocating resources and building wealth. People seem to think we just play with money, but it's a very serious role. I think there's a responsibility on behalf of fund managers to understand that and to try to have some influence on business ethics. Sometimes we have made points to companies when we think something is unacceptable.

GH: Were those discussions one-on-one with management?

GP: Yes. We would say things like something is unacceptable, and although I don't want to single anyone out, there is a greed factor that needs to be controlled. Too much regulation will stifle business, so it's a fine mix. Many people got away with a lot of things in the late 1980s. Anyone who rorts the system will eventually be brought down. Things got better in the 1990s. Decent people who care about society generally do better in the long run.

Something I'm wary of is principal trading by brokers. There are meant to be Chinese Walls between the agency business and principal trading, but there is a conflict. They're not working for us. I think principal trading in brokers is almost impossible to separate from advisory. One of the jobs of a principal trader is to know where the orders are – it's a natural thing – so they find out anyway. We ask, "Who's that?" and they say, "That's our trader". Then we ask, "Well, hang on a minute, who are you working for?"

GH: What do you do when you know a business is exploiting its customers, and you feel uncomfortable personally, but you expect the company to perform well in the short term?

GP: It's difficult. We shied away from some companies we were uncomfortable with. If a company is rorting the system in some way, inevitably, that rorting is going to come to an end. With the banks, you can't deny it, I think there's a real sense of rort that has gone on in the last few years [*Editor comment: note this was said in 2002*]. They have a massive return on equity, although you can argue it's good for the country to have strong banks. Mortgages were obviously an exploitation. Then the fees came in.

GH: That hasn't stopped fund managers investing in them.

GP: No (he sighs). But we have done well to avoid the really poor performing companies and the corporate disasters. When in doubt, get out and keep out.

GH: First State now has so much market power that chief executives come to see you. Is that important?

GP: It probably helps. There were only one or two of us initially, and we tried to visit companies once a year. Now we might see a chief executive three times a year. They come and see us. It gives you an entry and insights, but you've got to be careful.

GH: You mean with insider trading?

GP: Yes, companies are much more mindful of that now. It's more about seeing the thought process, where they are going and where they are taking the company. There might be angles and thoughts.

GH: But one of your roles as a fund manager is to research companies and learn as much as possible. If the company tells you things are going well and there's a degree of enthusiasm, does that mean you're not supposed to buy it?

GP: It's a fine line. There's a lot of insider trading that goes on because the market is not totally informed. But sometimes, you can hear one piece of information, and it's the last bit of the jigsaw puzzle. Take Westpac. They told us about their use of the intranet and said they were making more savings on the intranet internally than on the internet externally. We knew their costs were coming down through the introduction of technology.

It's not insider trading as such but something that clicks in your brain. Someone else may hear the same information and not use it, even if it was public knowledge. But if a company tells you profit is going up 50 per cent and the market thinks it's 20 per cent, that's insider trading, and we stay away from that.

GH: I guess it comes back to investing also having an element of art and not just research.

GP: Also, as you get older, you see the same stories being replicated. They say this business is hard. It's not hard if you read, listen and learn and see what happened in the past.

The fifth dimension of smart beta

Peter Bull and Michael Ng

Traditional index funds weight the companies in a portfolio according to their market capitalisation, and 'beta' represents the return achieved from an exposure to the overall market in such an index fund. 'Smart beta' strategies, such as a wide range of non market cap indices, seek to retain the benefits of traditional indices (for example, broad market exposure, low cost, diversification and liquidity) with the potential for performance superior to a market cap index.

We are sometimes asked how we evaluate all the different smart beta strategies now available, such as indices based on selecting stocks according to their momentum, value, equal weighting or volatility. Most people are not looking for an exhaustive survey of all the options, but rather, they want to choose one and provide a solid basis for their choice.

Asset classes have desirable and undesirable characteristics. In some cases, it's possible to separate the good from the bad and invest accordingly. But that's what people thought they were doing when they bought into style indices in the 1990's based on the work of Fama and French. Their analysis decomposed a strategy's returns into independent components, such as market, value, size, and momentum. So it was possible to pick a portfolio which, for example, had a small company/value bias, and expect to outperform a cap weighted market index.

Then the one-two punch of the tech bubble and GFC deflated those illusions. It turns out that when the market is most poised for disaster, style indices are a way of asking, "Please, sir, I want some more." One lesson is that identifying what makes sense for a core, ongoing, stable allocation is actually more difficult than devising a simple market-timing strategy.

More recently, opportunism has combined with genuine exasperation to push the expanding range of beta products to the limits of common sense, to the realm of the 'scientific' and beyond. And so a wide range of smart beta strategies are now available.

We usually recommend the following characteristics in selecting a smart beta strategy:

1. Rules-based, transparent, diversified, high capacity exposure
2. Low cost
3. Low turnover
4. Better expected risk-adjusted returns and total risk than market cap.

But these criteria are just a laundry list of our own biases and preferences. They offer no compelling basis to choose one option over another other than that it should perform 'better' than market cap. Other criteria are inherited directly from market cap indices themselves.

Revisiting our assumptions, the whole smart beta exercise is premised on the idea that markets are inefficient and that there are systematic ways to avoid being on the wrong side of those inefficiencies.

Style indices, on the other hand, were premised on the idea that markets are efficient and that investors should pick and choose from a menu of factor risk premiums, since excess returns are only available through taking on more risk. But the deeply unsatisfying reality is that almost all smart beta strategies, like their style index brethren, offer no return premiums above the same menu of systematic risk factors. In other words, with very few exceptions, seemingly dissimilar strategies can be shown to be simple repackagings of each other using the style factors (market, value, size, and momentum) as building blocks.

When a strategy offers no residual return independent to these extremely simple factors, it is said to have no 'alpha' relative to them. A thorough analysis of this type was conducted on alternative equity index strategies in the *Financial Analysts Journal* in 2011. Its main finding was that they are all more or less equivalent to each other when viewed on this basis, but some are easier to implement than others. Not a single US strategy delivered a significant alpha relative to the four factors listed above.

That's pretty small potatoes coming from the greatest minds in finance over the 20 years since Fama and French's original paper. If markets are inefficient, more return should be available with less risk and not completely attributable to these simple factors. It doesn't really count if you pick out one factor, like the market, and outperform it alone on a risk adjusted basis. We should now officially be 20 years beyond that kind of argument.

We also like to point out that explanatory variables do not necessarily make good investment decisions to begin with. The world does not run on linear regression alone. Common sense should have its place, in particular in the investment world where it can go missing for decades at a time and whole university departments are devoted to its absence.

So our preferred fifth dimension of smart beta is about as common sense as it gets:

5. Capital preservation.

This requires investors to leave behind the world of mathematical precision and get back to the reality that valuation matters. As simple as it sounds, the benefit of capital preservation is most pronounced in a dynamic multi-period framework, or in the world in which we actually live.

For example, equities as an asset class have terrible timing. They do well when people least need them to and poorly when other calamities tend to arrive, such as job losses and home foreclosures. Reaching for simple equity factor risk premiums can only compound this timing problem, so why make equities worse than they already are?

Cash is of course the ultimate exemplar of capital preservation. In a typical single period investment problem, it is the most boring asset in that it is the only one that offers a completely fixed nominal return. But its very fixed-ness in one period opens up more possibilities over multiple periods, as it offers the possibility to plan in a future that is otherwise unknown.

For example, consider the unfortunate event of an inflation surprise:

Period 1: Inflation surprise, duration and most risk assets are punished, cash holds up well.

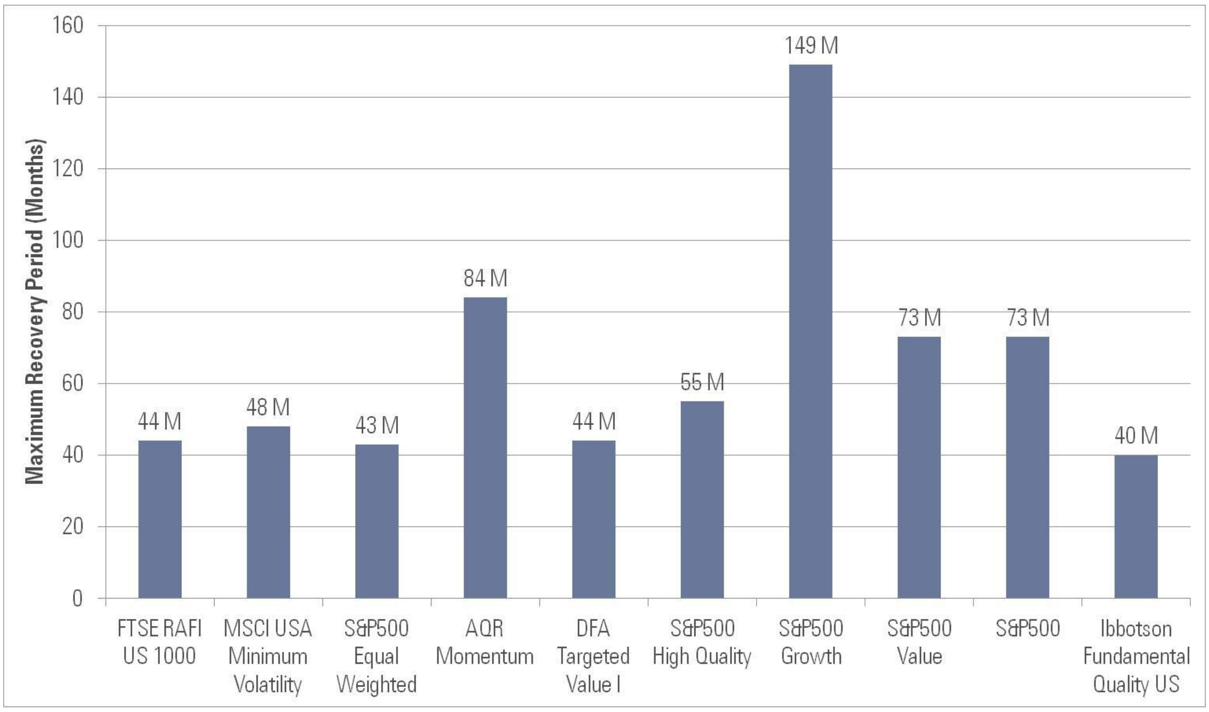
Period 2: More capital preserved from holding cash in Period 1 can be reinvested at a higher rate in Period 2.

Boring old cash delivers the triple-whammy: one benefit in Period 1 and two benefits in Period 2. Critically, it delivers these goods precisely when they are needed, not when everything is going swimmingly. So our fifth dimension is really a restatement of the well-known compounding effect, with a little reality check thrown in. In general, as valuation informs risk, defensiveness enables opportunism, and that is the true time-honoured formula to achieve long term investment objectives without crashing and burning in the interim. Smart beta strategies that have no built-in control for valuation risk are susceptible to bouts of extreme overvaluation and risk the permanent impairment of investor capital. For example, what will be the warning signs when a low-volatility smart beta strategy becomes overpriced?

Figure 1 illustrates an interesting capital preservation risk statistic, the maximum recovery period (defined as months taken to recover to the previous high level), among different US-based smart beta strategies and indices since the days of the tech bubble. The next best thing to avoiding capital losses in the first place is to have a reasonable expectation for a quick recovery in value. Please be aware that these do not all represent live track records but also include historically recreated strategies and indices.

As you might expect, style indices fared particularly poorly by this measure. In fact the S&P500 Value index is still in recovery from the GFC and S&P 500 Growth index took more than a decade to recover from the tech wreck.

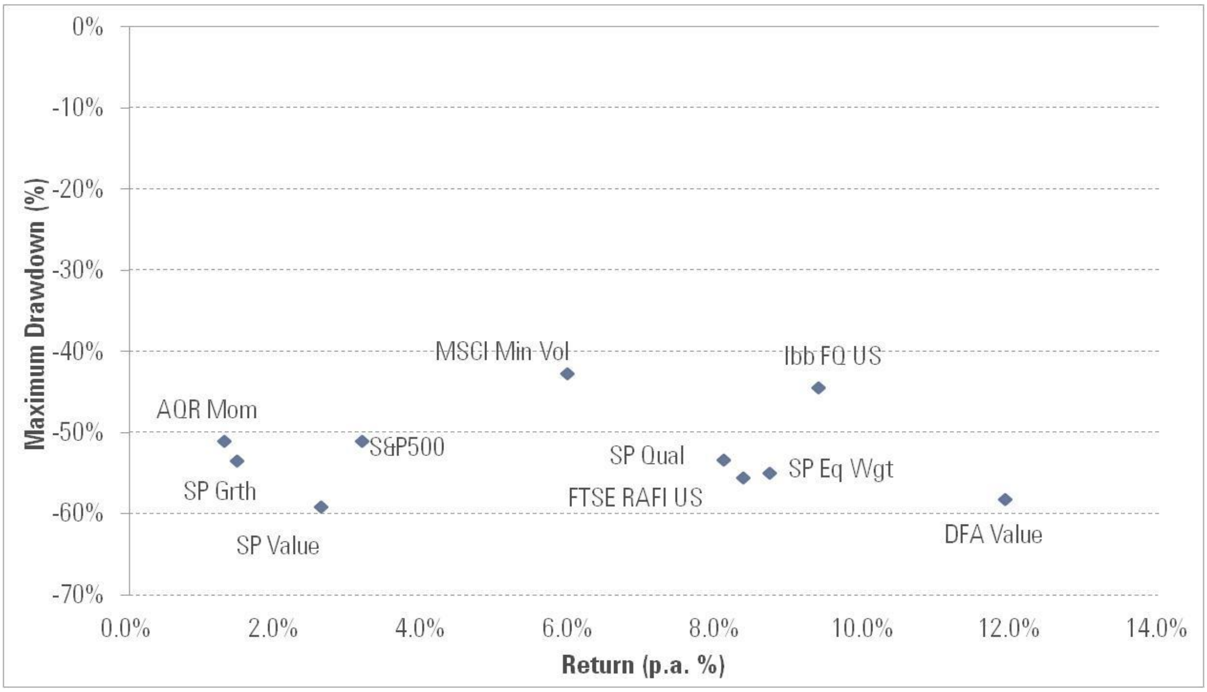
FIGURE 1 MAXIMUM RECOVERY PERIOD, TOTAL RETURNS IN USD, MARCH 2000-JUNE 2013



Source: Morningstar Direct, Ibbotson Associates.

Figure 2 shows maximum drawdowns (defined as percentage loss in the value of the portfolio) against annualised total returns over the same time period for the same strategies and indices.

FIGURE 2 MAXIMUM DRAWDOWNS VS. ANNUALISED TOTAL RETURNS IN USD, MARCH 2000-JUNE 2013



Source: Morningstar Direct, Ibbotson Associates.

In general we hesitate to rely on historical return statistics, whether they are live or simulated, and feel it is safer to focus on maximum drawdown and recovery risk statistics that are not as sensitive to particular starting dates. However, we wanted to show in concept at least the trade off that is potentially available between prospective return and risk as defined in a multi-period capital preservation context. The time period used in Figures 1 and 2 is limited by the shortest history available among the various strategies depicted. Otherwise March 2000 would certainly not have been our first choice for a starting date, since it is right at the peak of the tech bubble and may of course bias the return statistics in particular.

Finally, in Figure 3, in case our previous arguments are not persuasive, we show the Fifth Dimension itself to eliminate any remaining ambiguity.

Figure 3 The Fifth Dimension

Peter Bull is Head of Portfolio Construction at Ibbotson Associates and is also a member of the Morningstar Investment Management Strategic Asset Allocation Committee. Michael Ng is an Investment Analyst at Ibbotson responsible for supporting the investment and implementation capabilities.

Investing against the herd

Part 2, Consumer sentiment and equity returns

Ashley Owen

(Part 1 of 'Investing against the herd' focussed on resisting the emotional responses which are natural instincts for most investors, and can be reviewed here. In part 2, we check whether consumer sentiment is indeed at its maximum after a period of strong share market performance).

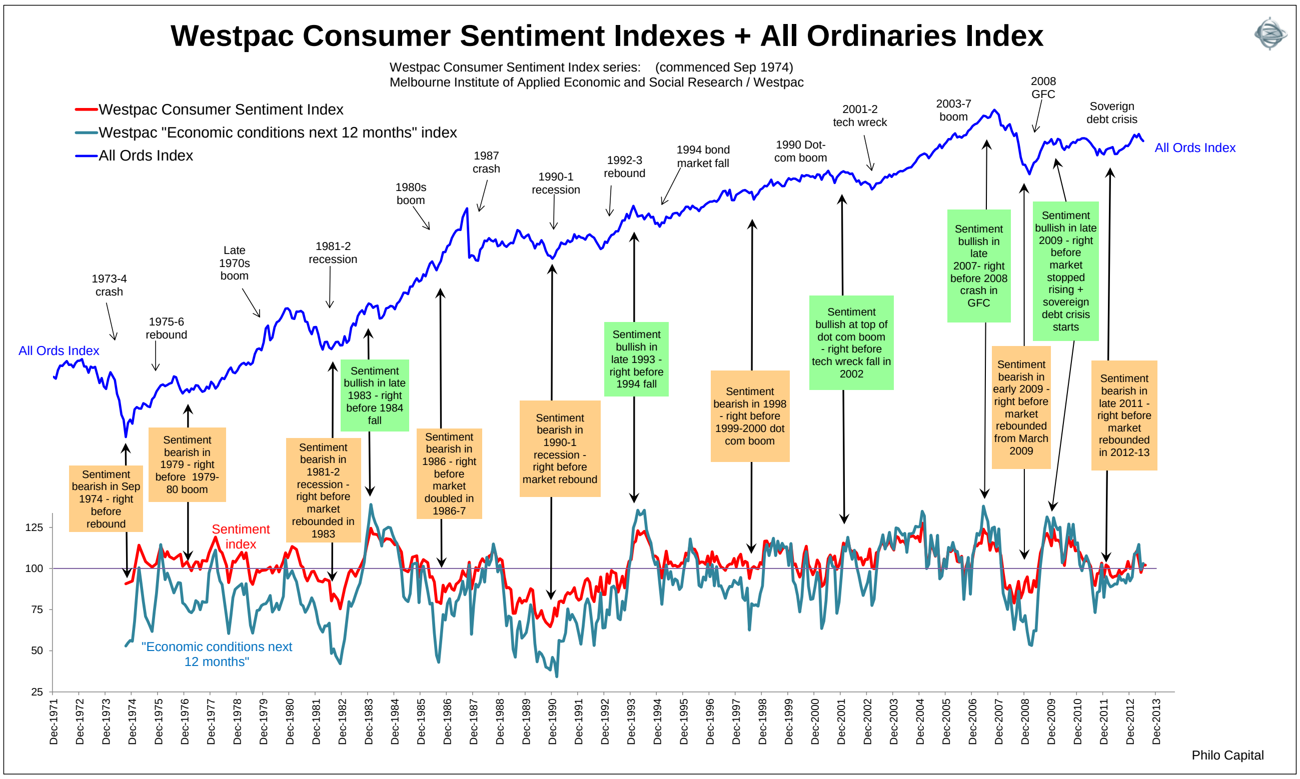
The longest running regular survey of consumer sentiment in Australia is the Westpac Melbourne Institute Consumer Sentiment series, which began in September 1974. The timing of its introduction was no accident. September 1974 was right at the bottom of the 1973-4 crash, which was longer and deeper than the 2008-9 GFC crash. (The Sydney All Ordinaries index fell 61% in the five years from its January 1970 peak to the bottom in September 1974. By way of contrast, in the recent GFC stock market crash the Australian All Ordinaries Index fell by 55% from its top in November 2007 to the bottom in March 2009, a period of 'only' 16 months, compared to an agonising 57 months in the 1970-1974 double-dip crash).

In the Westpac series, thousands of individuals across Australia are surveyed each month on several different aspects of how they are feeling about the economy and their finances. In addition to the overall 'Consumer Sentiment Index' there are also a number of other indexes including:

- ‘family finances over the last 12 months’
- ‘family finances over the next 12 months’
- ‘economic conditions over the next 12 months’
- ‘time to buy a major household item’.

The results are published in the middle of each month and are available at: http://melbourneinstitute.com/miaesr/publications/indicators/csi.html

The following chart shows the All Ordinaries Index at the top (blue line) and the monthly ‘consumer sentiment’ index (red line) and the monthly ‘economic conditions over the next 12 months’ index (bluey green line) at the bottom.



Philo Capital

We can observe several things from this chart.

A first observation is that the consumer sentiment index seems to reflect share price performance in the recent past. In most (but not all) cases, sentiment is relatively high when share prices have been rising, and sentiment is relatively low when share prices have been falling, especially in recessions. For example:

- Consumer sentiment appears to be relatively low when share price have been falling in recessions - in the 1973-4 crash, the 1981-2 recession, the 1990-1 recession, the 2008-9 sub-prime crash and the 2011 sovereign wealth crisis.
- Consumer sentiment appears to be relatively high when share prices have been rising strongly - after the 1983 rebound from the 1981-2 recession, after the 1993 rebound from the 1990-1 recession, during 1999-2000 at the height of the dot com boom, after the 2003-5 rebound from the 2001-2 tech wreck, and in 2006-7 in the late stages of the 2000s boom.

Of course there are many factors that affect consumer sentiment besides share prices, including unemployment, inflation, the dollar, politics, petrol prices, and so on. But the link between the recent direction of share prices and the consumer sentiment scores is clear.

Statistically there is a moderate positive relationship between the consumer sentiment index and recent past share price direction (the strongest relationship is to share prices over the most recent 6-12 months). This makes sense - people tend to feel wealthier and more positive about their financial position when share prices have been rising for several months, and they tend to feel less positive when share prices have been falling.

A second observation is that consumers are most bullish at or near the top of booms, right before the booms bust, and also that they are most bearish at or near the bottom of busts, right before the market rebounds. For example:

- Sentiment was very bearish when the survey was first done in September 1974, which was right before the market rebound strongly, starting in the very next month
- Sentiment was bearish in 1977 and 1978 - right before the 1979-80 boom
- Sentiment was bearish in the 1981-2 recession - right before the market rebounded strongly in 1983 (1983 was the best calendar year ever for the Australian stock market - up 60% - but both the consumer sentiment index and the "economic conditions over next 12 months" index were near their most bearish scores ever at the end of 1982, right at the start of the tremendous 1983 rebound)
- Sentiment was bearish in early 1986 - right before market doubled in 1986-7
- Sentiment was bearish in the 1990-1 recession - right before market rebound in 1993
- Sentiment was bearish in 1998 - right before 1999-2000 dot com boom
- Sentiment was bearish in early 2009 - right before market rebounded strongly from the depths of the GFC.
- Sentiment was bearish after the sovereign debt crisis in late 2011 - right before market rebounded in 2012-13

Conversely:

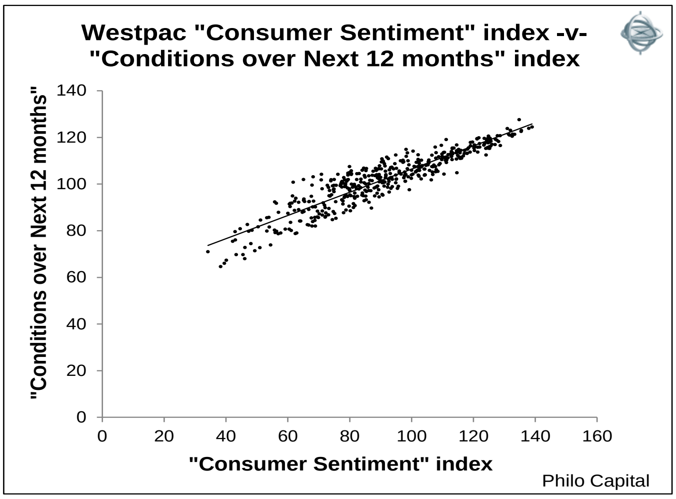
- Sentiment was bullish at the end of the 1983 rebound - right before the 1984 fall
- Sentiment was bullish at the end of the 1993 rebound - right before 1994 fall
- Sentiment was bullish at top of the dot com boom in 2000-1 - right before tech wreck fall in 2002
- Sentiment was bullish in late 2007- right before the 2008 crash in the GFC
- Sentiment was bullish in late 2009 after the GFC rebound - right before market stopped rising and the market fell in the 2011 sovereign debt crisis

A third observation is that the green line for 'economic conditions for the next 12 months' (which measures how people are feeling about prospects for the *next* year) follows the same general path as the red line for the 'consumer sentiment' index (which measures feelings about current and recent *past* conditions), except it is more exaggerated.

If they are feeling relatively good about the current conditions (which is generally when the market has been doing well in the recent past), then they believe the future holds more of the same, only better - i.e. a recent past rising market is likely to keep going up in the same direction (up) as it has been recently.

On the other hand if they are feeling relatively negative about the current conditions (which is generally when share prices have been falling in the recent past), then they tend to believe the future holds more of the same, only worse - i.e. a recent past falling market is likely to keep going up in the same direction (down) as it has been recently.

Statistically there is a very high positive correlation (0.92, which is very close to a perfect positive correlation of 1.0) between the monthly consumer sentiment index (which reflects recent past returns), and the 'economic conditions over the next 12 months index' for the same month.



We can see that the relationship between how people feel about the present and recent past (consumer sentiment index) and how they feel about the future (economic conditions over the next 12 months) is essentially a straight line.

People tend to believe that in the future markets will keep going in the same direction they have been in the recent past - both on the way up and on the way down. This confirms the straight line extrapolations of recent past returns that we proposed in our stylized description of investor behavior in Part 1 of this series.

Next week in Part 3, we test the theory that if we went *against* the herd by *selling* some of our shares when sentiment is bullish, and *buying* more shares when sentiment is bearish, then we ought to be able to avoid some of the buy-high, sell-low mistakes and be better off in the long run. You may be surprised to find out just how much money you could be losing or making by following the herd.

Ashley Owen is Joint Chief Executive Officer of Philo Capital Advisers.

The Evolution of Listed Investment Companies

Chris Stott

Listed Investment Companies (LICs) in Australia in recent years are going through a renaissance driven by the introduction of FOFA (Future of Financial Advice) and the amendment to the Corporations Act in 2010 allowing LICs to pay dividends when deemed solvent by the board.

This article will discuss these topics, the history of the LIC sector and what the future holds for the space.

A LIC is a listed equity fund: a managed share investment fund that is itself a listed share. In Australia there are 61 listed on the Australian Securities Exchange (ASX) with a value of $20.4 billion. Currently 46 of them are trading below the value of the shares they own, creating a lot of great value investing opportunities.

Evolution of LICs

The first investment trust was launched in the UK in 1868 by Foreign & Colonial. It was the world's first collective investment vehicle and planned to raise £1 million to invest in government stock of foreign countries and colonial territories. In the prospectus it said it aimed 'to give the investor of moderate means the same advantages as the large capitalist in diminishing the risk of investing in foreign and colonial government stocks, by spreading the investment over a number of different stocks'.

Unique structure of LICs

This principle is still the same today. Like unit trusts, LICs are pooled funds invested in a diverse range of shares that are listed on a stock market. But, unlike unit trusts, LICs are incorporated as quoted companies and instead of buying units in a fund, investors buy shares in a company.

LICs are closed end funds with a fixed amount of capital. No one can buy shares in a LIC unless someone else is willing to sell. Therefore the share price moves according to the rules of supply and demand rather than as a direct reflection of the movement in the underlying assets of the LIC. Thus LICs often trade at either a premium or a discount to the value of the assets they own, namely their Net Tangible Assets (NTA).

It is this premium or discount that makes LICs appear complicated. Most investors are familiar with unit trusts, which quote their unit values every day. Investors can buy or sell the units at the stated NTA daily. With LICs, the variance between the value of the LICs assets and its share price is a complication for some, but provides an incredible opportunity for others.

In a market downturn, such as the GFC, investors in a managed fund are likely to sell their units to get cash, forcing the managed fund manager to liquidate some of their holdings to repay the unit holders. This means the manager is selling into a market that has fallen, and may be forced to sell stocks that they believe are cheap. In a bull market, when money is rapidly flowing into managed funds, the reverse is the case. The managed fund manager may be forced to buy shares they know are over-valued as money pours in from investors. This is never the case with LICs. The LIC manager can continue to hold the same portfolio, and is never forced to sell or buy any stock. Their total focus is on managing money for the benefit of all their shareholders — the manager's investment strategy is not dictated by market sentiment or flow of funds. They may start buying in a downturn and pick up some bargains or sell stocks that become overvalued in a bull market. Supporters of LICs argue that the closed end structure enables them to invest more efficiently and outperform unit trusts or other managed funds over time.

Australian evolution and outlook

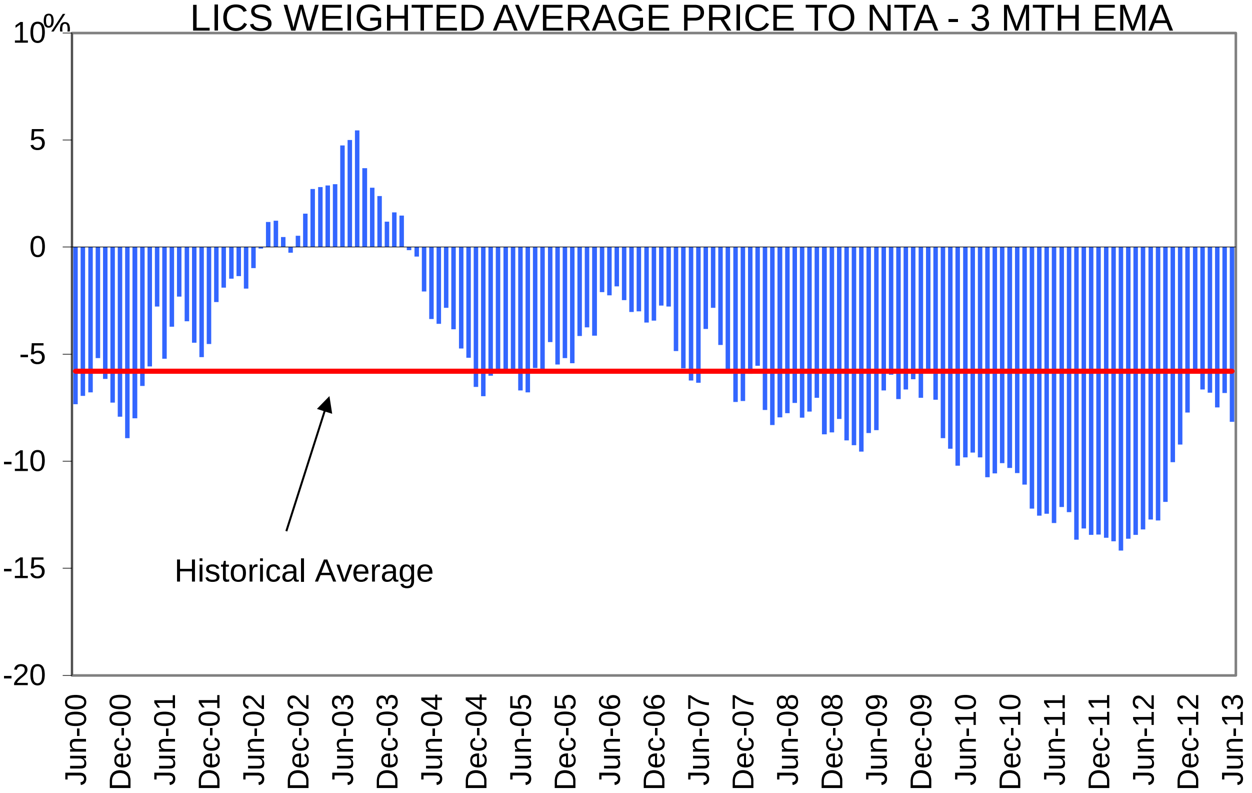
The origin of the LIC sector in Australia dates back to the 1920s. The oldest investment company that is now listed is Whitefield Ltd (WHF), which was incorporated in 1923, originally as an investor in mortgage loans. Its business has been solely focused on equity investment since 1949, though it didn't list on the ASX until 2 August 1971.

The largest Australian LIC started life in 1928 as Were's Investment Trust Ltd. In 1936 it changed its name to Australian Foundation Investment Trust Ltd and it adopted its present name, Australian Foundation Investment Company Ltd (AFI), in 1938. It listed on the stock market on 30 June 1962. In 1973 it was used to amalgamate the Capel Court group, which resulted in the takeover of Capel Court Investments, Breton Investments, Clonmore Investments, Haliburton Investments, Jason Investments, Jonathan Investments, National Reliance Investments and Shelbourne Investments. AFIC now has assets of $5 billion. The second-largest LIC, Argo Investments Ltd (ARG), was established in 1946 and listed on the ASX in 1950. It currently has a market cap of $4.3 billion.

The LIC sector is currently benefiting from two major structural changes.

The first is the change to the Corporations Act in June 2010, allowing companies to pay dividends as long as they are solvent. Previously they could only pay a dividend if they had an accounting profit, so the company might have had the cash flow, the cash and the franking credits, but if its assets had fallen in value (as happened during the GFC) it couldn't pay a dividend. This is no longer the case. This change in legislation will give companies greater flexibility with dividend payments. Since this change was implemented we have seen several LIC's pay a steady stream of dividends which in my view has helped to narrow the discount to NTA in the last two years.

The second significant structural change is the reform of the financial planning industry. From 1 July 2013, commissions paid to financial planners by providers of managed funds will be banned on new allocations. This will remove a significant impediment for financial planners looking at LICs or other investment products listed on the stock market, such as Exchange Traded Funds. LICs don't pay trailing commissions. For years financial planners have had a significant financial incentive to recommend managed funds, and thus LICs have not fully benefited from the significant growth in the funds management industry. Finally, the playing field will be level. In our business at WAM, we are already seeing an increased level of interest from financial planners in LICs with our funds under management increasing from $300 million to $700 million over the last 12 months.



Source: Patersons Securities. EMA = Exponential moving average.

Since these changes were first discussed, the discount to NTA of a number of LICs has decreased. Currently the average discount for the sector is 8.4%. The above chart from Patersons Securities highlights the experience since 2000. To date in 2013, we have seen two successful LIC floats being the Naos Emerging Opportunities Fund and the Watermark Market Neutral Fund. These are the first LICs to make initial public offers since the GFC, further evidence that interest is returning to the sector. I believe that the momentum gained in recent years has scope to continue given the thematics for the sector.

Chris Stott is Chief Investment Officer and Portfolio Manager at Wilson Asset Management.

Education not just legislation

Rick Cosier

Although certain elements have been delayed, the introduction of commission bans (FOFA) and low cost super (My Super) are beneficial improvements. Notwithstanding the extra compliance and paperwork, the ban on commission should reduce the linkage between advice and product, Fee

Disclosure Statements creates transparency and the Best Interests Duty increases professionalism and improves trust.

Superficially, MySuper seems logical, since:

- most people are not interested in their super, so give them something cheap and reasonably diversified
- it increases the super guarantee to 12% and makes sure it can't be touched until retirement
- by this time, many will have accumulated sufficient super and will not need an age pension.

All this sounds fine except that history tells us that human beings still find ways to make bad decisions about their finances. I believe that FOFA and My Super attack the symptoms and not the causes. One cause is fraudulent behaviour by licensees and advisers. Another is bad product design. But in my opinion, the biggest is the Australian public's widespread lack of knowledge about even the most basic principles of financial planning and investment.

It starts in schools. My eldest daughter is in Year 10, 16-years-old, and attends a school that is caring and takes education seriously. Although there is a Commerce option in Year 10, this doesn't cover financial literacy. Then when I look at the Maths syllabus I find that her exam allocates 75% of the marks to algebra, equations, geometry and things like finding the area of a trapezium.

It doesn't get much better in Year 11 and 12. There were only two HSC subjects that have any kind of relationship with money – economics and business studies. However, neither of these subjects include fundamental concepts of personal financial planning such as saving and investing, risk versus return, cash flow, managing debt, understanding tax, home ownership versus renting, death and disability insurance, making a will.

Not only is the education system failing our children by not preparing them for the 'real world', the knowledge and understanding of these key financial planning concepts is not learned later on. Surf lifesavers will tell you that they watch adult swimmers just as much as children. Adults are reluctant to admit they are struggling and do not call for help early enough. They are embarrassed. It's the same with financial affairs. Many adults repress their lack of financial knowledge for fear of looking foolish. Consequently, they are prone to make unwise investments and fall prey to people who are good with words.

Until a generation ago, it could be argued that financial planning didn't matter much. The average Australian left school, got married, had children, saved up, bought a house, worked till retirement, collected the age pension for a few years then passed away.

In the last 30 years many things have changed, but three in particular stand out:

- we can now expect to live until we are well into our 80s and 90s, so we will experience decades without a wage to fund our lifestyle
- although wages have risen faster than inflation, and both members of a couple usually work, the average household does not save much money
- when compared with their income, the average household debt has quadrupled.

Most actuaries agree that the increase in longevity means that a couple retiring today needs to have at least $1 million to be sure that their money doesn't run out before they do. Not many retirees have $1 million but they tend to have lower spending habits than current generations, and they have the age pension.

Baby boomers will probably manage to fund their lifestyle in retirement because they have made a lot of money from property and can potentially downsize. They also have the advantage of tax free super. Generation X, now in their 40s, may not have either of these luxuries.

The other two bullet points above relate mostly to Generation X. Even after adjusting for inflation, Australian households are generating substantially more money than they were 30 years ago, but it is not saved for a rainy day for the years when they won't be working. The money has been spent on a combination of material possessions and property.

When I run financial literacy seminars, the only subjects that spark any interest are property, property and more property. It is undeniable that property has been an incredible investment over the past 30 years. According to a study by Peter Abelson and Demi Chung ('Housing prices in Australia 1970 to 2003'), the median price of a Sydney house was $81,425 in 1983. According to Propertydata.com.au, it is now $542,250. A 644% rise.

Can property repeat its stellar performance over the next 30 years? Obviously, Australians think so, because they are borrowing to the hilt to get into the market. The level of debt being carried by Generation X is incredibly high by any stretch of the imagination. In 1983, according to Morgan Stanley, a household's debt was equivalent to 40% of their income. By 1996 it was 60%. In 2012 it was around 180%.

Getting the facts about certain aspects of property investing isn't easy, but here is what I am experiencing:

- Australians are incorporating property into their super funds, and taking on even more debt without thinking through the potential issues
- young adults in their 20s and 30s are buying property with their parents acting as guarantors for the loan. The security for the loan is usually the parent's home. The thinking is that the children can pay off the debt quickly while interest rates are low. If just one variable changes (interest rates, illness, pregnancy, unemployment), both generations will lose their homes and their financial future will be in ruins.

The last 20 years have been very prosperous for Australians. A whole generation has never experienced a recession or unemployment or 12% interest rates. Just one of these events will create havoc. Also, people do not realise how hard it is to create sufficient money to live on for 30 years without a salary. Maybe they can work until they're in their 70s but many of my clients who are in their late 50s and early 60s can't find jobs that pay enough money.

Australians should be creating a comprehensive financial plan to live within their means, save for things they want to buy and put money aside for their retirement. Instead they are spending everything they earn, taking on an ever-increasing debt and have a one dimensional view that property investing is the answer to all their problems. FOFA and MySuper provide a good basis for protecting Australians, but it's not enough. Unless we incorporate financial planning into our education system for adults and children alike, I am worried that things will turn out badly.

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