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This Week's Top Articles

Busting the bond myth

Steve Garth

The decline in interest rates to historic lows in recent years has led to anxiety among Australian investors about what will happen to their fixed interest holdings when overnight interest rates begin to rise.

This apprehension is based on the conventional view that longer-dated bonds underperform in this type of rising interest rate environment.

However, historical analysis of past periods of increasing interest rates in the US and Australia show there is no guarantee that bonds do badly relative to short-dated securities at such times.

In fact, in most of the five distinct periods covered by this study, longer-dated bonds outperformed their shorter-dated equivalents.

The second deduction from this analysis is the reinforcement of the virtues of global diversification in fixed interest. In each period, a globally diversified portfolio of bonds outperformed an Australian-only portfolio.

Thirdly, the experiment confirms that even during periods of rising short-term interest rates, bonds can continue to play a diversification role in a balanced portfolio, reducing overall volatility and expanding investors' opportunity set.

Background

Interest rates and monetary conditions in developed economies have been maintained at extraordinarily easy levels since the global financial crisis as central banks sought to generate self-sustaining recoveries.

A dominant theme recently relates to how and when central banks will start to reduce this level of accommodation and what the impact on risky assets will be. Market sentiment has waxed and waned. Most attention has been on the US Federal Reserve, which has flagged an increase in its funds target rate over the coming months. The rate has been close to zero now for nearly seven years since the peak of the GFC.

The Fed began the process of normalising monetary policy in late 2013, gradually winding back its purchases of bonds. This 'quantitative easing' programme added more than $US3.5 trillion to the Fed's balance sheet over five years.

But central banks elsewhere have shown no hurry to follow. The Bank of England has kept its benchmark at 0.50% for six years. At its August 2015 meeting, just one of the nine members of its monetary policy committee voted for an increase.

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Table 1 . OFFICIAL SHORT-TERM BENCHMARK LENDING RATES

August 2015

CENTRAL BANK	BENCHMARK RATE	LAST MOVE	WHEN
European Central Bank	0.05%	▼	Sep 2014
US Federal Reserve	0.25%	▼	Dec 2008
Bank of England	0.50%	▼	Mar 2009
Reserve Bank of Australia	2.00%	▼	May2015
Reserve Bank of NZ	3.00%	▼	Jul 2015

The European Central Bank, having resisted quantitative easing for years, began its own programme this year. It is buying 60 billion euros of assets a month in a bid to lift inflation back towards its target of just under 2% by late 2016.

The Reserve Bank of Australia has cut the official cash rate 10 times since November 2011 to 2.0%. With commodity prices falling and inflation pressures contained, the bank has recently indicated that it is in no hurry to raise rates.

Bonds 101

The market values of bonds rise and fall on changing expectations for inflation and interest rates, shifting perceptions about the creditworthiness of individual issuers, and fluctuations in the general appetite for risk.

The yield on a bond and the price of that bond are inversely related. If the price falls, it means investors are demanding an additional return to compensate for the risk of holding the bond.

So if interest rates 'can only go up' from current levels, why hold bonds? There are a few points to make in response.

First, it is extremely hard to accurately forecast interest rates with any consistency. Standard & Poor's regular scorecard shows most managers fail to outpace bond benchmarks over periods of five years or more (Standard & Poor's Indices Versus Active Funds Scorecard).

Second, outside of the US, there is no guarantee that rates will rise anytime soon. Even in the US, some observers doubt whether the Fed will carry through.

Third, bonds perform differently to shares. Regardless of what is happening with the rate cycle, there is a diversification benefit in holding bonds in your portfolio and making for a smoother ride.

Fourth, each investor's allocation to the risks associated with bonds, both from a maturity and credit quality standpoint, is an individual decision dependent on each individual's risk appetite, circumstances and goals.

Finally, if you look at history, it has not always been the case that longer-term bonds have underperformed shorter-term bonds when short-term interest rates are rising.

A case study

To test that last statement, we carried out a case study of periods of rising rates from the last three decades in both the US and Australia.

To meet the definition of a rising interest rate environment, the increases had to be spread out over 12 months or more and cumulative increases had to be at least 1.5%. Table 2 shows the periods under study.

In the US case, using Barclays' indices, we found that in two of these four periods long-term bonds did *better* than shorter-to-intermediate-term bonds. In the other two periods longer term bonds underperformed. See Figure 1.

For the Australian case study we used Citigroup World Government Bond indices. Figure 2 compares the performance of Australian Government bonds over the 1-3-year maturity (in blue) and longer maturities (in green).

Table 2. PERIODS OF RISING RATES

	TARGET FEDERAL FUNDS RATE			
	BEGINNING OF PERIOD	END OF PERIOD	CHANGE	NUMBER OF MONTHS
PERIOD				
June 2003 – August 2007	1.00	5.25	+4.25	52
November 1998 – December 2000	4.75	6.50	+1.75	25
September 1992 – June 1995	3.00	6.00	+3.00	33
December 1976 – March 1980	4.75	20.00	+15.25	39

	RBA TARGET CASH RATE			
	BEGINNING OF PERIOD	END OF PERIOD	CHANGE	NUMBER OF MONTHS
PERIOD				
July 2009 – April 2011	3.00	4.75	+1.75	22
February 2002 – May 2008	4.25	7.25	+3.00	76
May 1999 – October 2000	4.75	6.25	+1.50	18
January 1994 – August 1995	4.75	7.50	+2.75	20
January 1988 – November 1989	10.70	18.35	+7.65	23

Figure 1. US CASE STUDY—TERM

Have shorter-term bonds outperformed in rising rate environments?

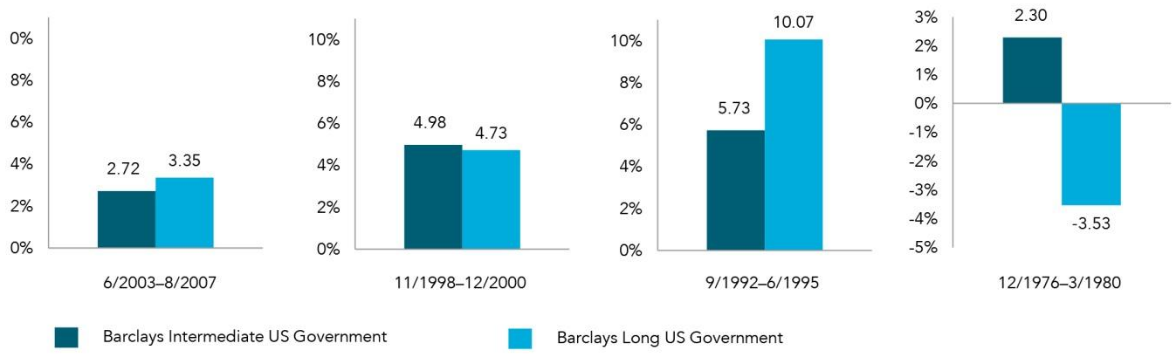
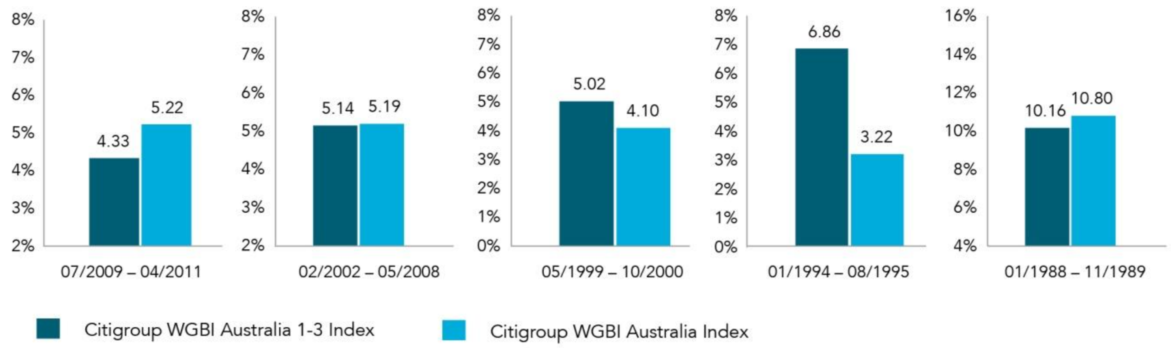


Figure 2. AUSTRALIAN CASE STUDY—TERM

Have shorter-term bonds outperformed in rising rate environments?



We can see that the longer-term bonds actually outperformed the shorter-dated bonds during all periods except for the infamous 1994–95 market correction.

Similar results were seen when we compared the performance of a global bond portfolio, hedged to the $A, compared with a domestic-only portfolio.

While this may seem counter-intuitive, remember that longer-term bond holders are often reassured when a central bank is perceived as moving pre-emptively against this threat of higher inflation.

The study also shows bonds continued to provide positive returns, contradicting the often expressed view that rising interest rates are always associated with bond losses. The exception in this study is the late 70s when the longest-term US bonds suffered during a period of very sharp increases in rates.

Summary

Investors are worried about what will happen to their fixed income portfolios when central banks begin normalising interest rates, yet recent decades show longer-term bonds do not always underperform when short-term rates are rising.

In any case, there is no need to forecast. There is sufficient information in today's prices to base a strategy on. We believe risk can be tempered by diversifying across different types of bonds, different maturities and different countries.

Dr Steve Garth is a Portfolio Manager in Sydney with Dimensional, a wholesale asset manager with more than $500 billion under management globally. This article is for educational purposes and does not consider the circumstances of any investor.

Meeting the work test to make contributions

Monica Rule

I've had a paradigm shift! Just when I thought I could confidently predict the ATO's view on meeting the work test to make contributions, they have come back and surprised me!

Let me explain. I have been assisting a client where the ATO wants to charge her excess contributions tax. My client is over the age of 65 and at the time she made the contribution, she had not met the work test. My argument was that as she had not met the work test at the time she made the contribution, the trustee should not have accepted the contribution. However, the ATO has taken the view that as she has an SMSF and is self-employed, she would have known that she would satisfy the work test at a later date in the financial year. I did not see that coming!

The need to be 'gainfully employed'

The timing of contributions has caused a great deal of confusion for SMSF trustees, members and industry professionals. The superannuation law states that once an SMSF member is aged 65 or over but is less than 75, they can only make superannuation contributions into their SMSF if they are gainfully employed on at least a part time basis during the financial year in which the contributions are made.

The definition of 'gainfully employed' under the superannuation law means to be employed or self-employed for gain or reward in any business, trade, profession, vocation, calling, occupation or employment. The concept of gain or reward envisages receipt of remuneration such as a salary or wages, business income, bonuses, commissions, fees or gratuities, in return for personal exertion. It does not include the passive receipt of income such as rent, trust distributions or dividends. Therefore, if a member only receives passive income, they would not meet the gainful employment test. Unpaid work also does not meet the definition of gainful employment.

The term 'part-time' means to be gainfully employed for at least 40 hours in a period of not more than 30 consecutive days in a financial year. So if you work 10 hours per week in one month or 10 hours over four days, that would be sufficient.

The 'paid work' condition only has to be met once in each financial year you make the contribution, after turning 65. Once you have met it, you do not need to be gainfully employed for the rest of the financial year or need to meet the work test again each time you make a contribution into your SMSF.

Timing difference between public fund and SMSF

Based on the ATO's interpretation in my client's case on the work test, it seems to depend on whether you are making contributions into an SMSF or a public superannuation fund and whether you are self employed.

If you are making contributions into an APRA regulated superannuation fund, then you must meet the work test prior to making your first contribution after turning 65. This is because the trustee of the fund will need to be satisfied that you have met the work test in order to allow you to contribute into the fund.

If you plan on making contributions into your SMSF, then it seems that as long as you have met the work test once in the financial year after you turned 65, you can contribute. This is especially important for members who are self employed. If you know that you will be in part-time paid employment at some time during the year, after turning 65, you can make contributions into your SMSF even though you may not have worked part-time at the time you make the contribution. Of course, if you assumed that you will work that year (after turning 65) and then fell ill and therefore were unable to work at all, then the contribution would need to be returned to the member within 30 days of the SMSF trustee becoming aware of the member's illness.

The ATO's decision in my client's case seems to have wider applications. It seems to me that if you have an SMSF, as long as you meet the work test in the financial year that you make a contribution, it is not a contravention; regardless of whether the contribution was made before or after you satisfied the test.

Monica Rule is an SMSF specialist and author. Her website is www.monicarule.com.au. This article is for educational purposes and does not consider the needs of any individual.

Lifecycle funds can increase super engagement

Sean Henaghan

Engaging people with their superannuation is the holy grail for the wealth management industry. It's encouraging to see the work super funds are doing to increase engagement but it's a slow process. The road to that holy grail is paved with challenges, not least of all the intangibility of retirement, particularly for younger customers.

We believe lifecycle funds and MySuper can play a role in achieving greater customer engagement with superannuation.

Lifecycle funds are not only about returns

Lifecycle funds, otherwise known as target-date or age-based funds, invest in a predetermined way depending on the age of the customer. The asset allocation shifts as the time horizon changes and the customer moves towards retirement.

With lifecycle funds, performance is not the sole aim. The primary focus is the final outcome: delivering a suitable level of income at retirement.

One of the advantages of defined benefit funds, once the mainstay of the superannuation industry, was that they gave customers certainty of income at retirement. Today, defined contribution funds are the norm. But the primary measure for success for defined contribution funds is past performance. Being a backward-looking metric, customers don't have a future figure they can plan around.

Another prevalent measure of success is performance in relative terms i.e. against a peer group or a benchmark. This can provide fiduciaries with important information about the success of manager selection or the management of business risk. However, it provides no information to the *customer* about their path to a comfortable retirement. What does it mean to a customer if a fund is a 'second-quartile performer'? It tells the customer nothing about whether their retirement strategy is on track. And this is partly why engagement is so low.

As an industry, we're blinkered by performance figures, and it's critical that a fund performs well. However, it's just as important to look forward and consider whether a fund will deliver a suitable level of income at the end of a working life. Customers are more likely to be engaged with a fund that focuses on a tangible retirement outcome. A lifecycle fund creates a strong platform for customer engagement, including as part of a MySuper solution.

Lifecycle funds aim to manage the competing objectives of maximising return while minimising sequencing risk. This is best expressed through the metaphor of crossing a river. While a river may, on average, be four feet deep, a quarter of the people crossing the river risk drowning because there are pockets in the river that are seven or eight feet deep. The average depth of the river is irrelevant. Our intention is to get as many people as possible across the river without drowning.

We manage our lifecycle funds actively. The fund manager looking after each age-based cohort aims to optimise customers' income in retirement and increase the certainty of achieving that outcome. In the early years, it's about maximising return. As members mature, certainty of outcome becomes more important, while rejecting the temptation to de-risk too quickly. It's made us think about things in new and different ways.

Take customers on the journey

Communication is critical in reaching that holy grail. We need to focus on whether the fund is on track to meet its objective. This might also serve to dissipate investor concerns about short-term volatility as it reminds customers that superannuation is a long-term investment.

MySuper communications now look and feel different to what people are used to. The reports reflect how each age-based cohort is managed and focus on an expected income in retirement rather than a lump sum dollar value. This will help build engagement (although there is nothing stopping a balanced fund from using a similar form of customised communication).

Of course, lifecycle funds aren't the panacea for engagement and the issues the industry faces. We need to ensure people do not think lifecycle funds give some sort of guarantee. As with all forms of investing, lifecycle funds remain at the mercy of market risk. The challenge is to talk about this risk openly. Customers need to know about the action they can take to help meet their goals in retirement, such as increasing their contributions or planning to work longer.

The hope is that this will lead to customers participating more actively in their super, such as moving out of default choices. The more people are interested in their retirement, the better.

Sean Henaghan is AMP Capital's Multi-Asset Group Chief Investment Officer.

Responsible investing is now retail and mainstream

Simon O'Connor

Banks are walking away from major resources projects, super funds are dumping stocks based on human rights induced investment risks and climate change related shareholder resolutions are gaining 98% support.

Few in the investment industry have failed to see a change underway, as some of the nation's largest investors start taking a more active role in understanding issues that were traditionally considered non-financial.

Environmental, social and corporate governance issues – or ESG – are attracting an ever-stronger focus by investors, companies and shareholders, and these factors are proving to be as critical to understanding market valuations as EBITDA.

It's not about suddenly becoming ethical

This is evidenced in the advisory relationship between CBA and the Indian listed company Adani recently coming to an end, super fund HESTA selling down its stake in Transfield last week, and earlier this year, BP supporting a climate change resolution at its AGM, which attracted an unprecedented 98% of the vote.

No, the majority of investors are not suddenly becoming ethical investors. Recent trends highlight how these ESG issues are clearly core business risks that investors are closely monitoring as part of their investment decision-making. And yes, at times, they are choosing to sell out of companies (dare I say, divest).

Responsible investment is a broad term that captures many different investment approaches, and an increasingly major part of Australian's investment community. Indeed, the recently launched Responsible Investment Benchmark Report 2015 found that responsible investment strategies now sit atop 50% of professionally managed assets in Australia, at $630 billion in Assets Under Management (AUM).

The styles range from integrating ESG factors into investment decision-making (accounting for 95% of the $630 billion AUM), through to screening investments (positive, negative and best of sector), sustainability-themed investing, and impact investment. The last three categories accounted for $32 billion AUM at the end of 2014.

What investment action is really underway?

Uniting all of these investors is the commitment to systematically considering ESG and/or ethical issues as a core part of the investment decision-making process. Not instead of, but in addition to, deep systematic financial analysis.

According to CalPERs and many of the world's largest asset owners, undertaking ESG becomes the requirement to win mandates, with those who don't manage these risks having "a sub-par investment process".

Nine of Australia's largest 10 asset managers, and around 50% of the top 50 super funds have stated a commitment to understanding a broader set of risks and investment drivers than those reported in financial statements.

Australian Share Funds		1 Year	3 Years	5 Years	10 Years
	Average Responsible Investment Fund (Between 16-30 funds sampled depending on time period)	6.9%	17.6%	8.0%	8.1%
	Large-Cap Australian Share Fund Average	4.3%	14.2%	5.8%	6.8%
	S&P/ASX300 Accumulation Index	5.3%	14.7%	6.5%	7.4%

International Share Funds		1 Year	3 Years	5 Years	10 Years
	Average Responsible Investment Fund (Between 2-13 funds sampled depending on time period)	15.5%	24.7%	11.7%	4.2%
	Large-Cap International Share Fund Average	12.5%	22.9%	11.1%	4.9%
	MSCI World ex Australia Index $A	15.0%	24.8%	12.5%	5.5%

Multi-Sector Growth Funds		1 Year	3 Years	5 Years	10 Years
	Average Responsible Investment Fund (Between 4-10 funds sampled depending on time period)	10.9%	13.9%	7.6%	7.7%
	Multi-Sector Growth Fund Average	7.8%	12.9%	7.2%	5.6%

Source: Responsible Investment Benchmark Report 2015

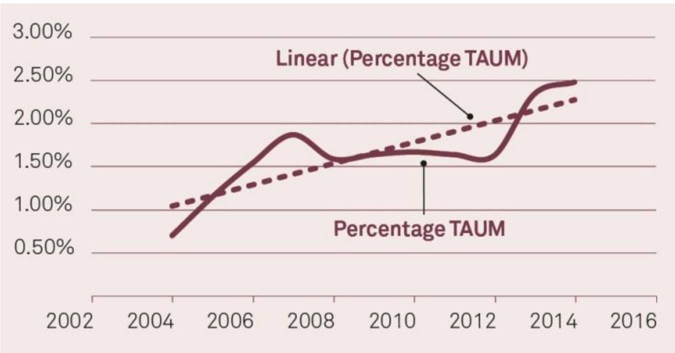
This strong uptake is resulting in an increasing appetite in Australia to drive a variety of strategies to better understand and mitigate these risks. We're seeing much greater corporate engagement, both direct and collaborative, between investors and listed companies, a strong focus on voting, as well as weighting portfolios, based on ESG factors (including carbon), allocating to sustainability-themed funds (e.g. green bonds, green property, sustainable agriculture and forestry), and selectively divesting of certain holdings or industries.

Perhaps best exemplifying the change currently underway is the rapid move of around 30 super funds over the past two years to sell out of tobacco stocks. This is notable in the way it signals a willingness to act strongly on certain issues.

It's not only for institutional investors

One of the most interesting movements of all is the sudden awakening by retail investors (including charities, high net worth and family offices) to the fact that there are options to invest in line with their values and beliefs.

This segment of the market has lead a surge in retail demand for ethical investments that has seen AUM double in just two years, to $31.6 billion. Where there were four fund managers managing over $1 billion in ethically-managed AUM three years ago, there are now eight (and soon to be nine).



Source: Responsible Investment Benchmark Report 2015

To those in the super industry, it would not come as a surprise that the surge in consumer demand for these options comes when member engagement with their super seems to have started to improve. Polling tells us that a massive 69% of Australians expect that their superannuation is invested responsibly and does no harm. These are not ethical investors, but mainstream Australians who simply expect their retirement savings to be managed with their base level of values being respected. There are, after all, few out there who would put their hands up to profit off the production of cluster bombs or child labour.

As members of the public start to open the letters from their super funds to look at who they are invested in, there are increasing numbers who aren't pleased with what they are discovering.

This retail story is inextricably linked with the institutional story as one feeds the other with growing momentum.

There are multiple drivers at play which are directing more consumers towards responsible investment products. With ethics and economics fairly closely tied together, this is delivering on investment outcomes.

Responsible investment is truly what a fiduciary should be delivering if they are deeply grappling with investment risks over all time frames in the best interests of their clients.

Simon O'Connor is Chief Executive Officer of the Responsible Investment Association Australasia (RIAA).

Do ethics and investment management fit together?

Anthony Asher

A virtuous life is one of aspiration – to be good, to be fulfilled, and to make a contribution. Ethics is not about doing your duty reluctantly, but rather asking the confronting question: what do I want to be remembered for? Peter Drucker says that if you think you can answer it at 25, you have not yet understood it, but if you cannot answer it at 50 you have wasted your life. How does this impact the investment management industry?

I tell an economist that I am writing a book about ethics in finance, to which she replies, "Why would I want my investment manager to be ethical?" I say, "So he does not rip you off." What she was asking is whether her investment manager should be involved in projects to achieve altruistic objectives, but I avoided this question. This article is written partly to redeem myself.

People have legitimately different values

I should have said that ethics should not be narrowly defined as controversial social or environmental issues that pit those with tender consciences against those without. There are no easy answers to difficult ethical questions, which require trade-offs between two (or more) goods or values. People come to legitimately different decisions if they see the facts differently, or place differing weights on the competing goods. I may choose to invest through ethical managers, who put social or environmental issues above returns, but cannot say that others have an ethical obligation to do the same.

I could also have said that my book was only partly written for those investment managers who want to make a vocation of being ethical, in the narrower sense, by managing funds with explicit ethical criteria; by lobbying for legislation that requires funds to conform to particular ethical stances; or by using their income to support ethical causes.

If we want to live full lives, we would do well to discover a really worthwhile objective – a vocation by which we can be remembered. I would argue that there are also vocations in funds management outside the narrowly ethical. Let us return to the question of what we can legitimately want from others with whom we do business.

The traditional cardinal virtues, when added to integrity, provide a foundation:

- Self-control - and thus diligence in analysis and administration
- Prudent – or wise in choosing investments and limiting risks
- Just – in charging fairly and avoiding conflicts of interest
- Courageous – in making decisions even if they may appear wrong to others.

Let's consider these.

Self-control and prudence

At first sight, the industry might seem to do well on self-control and prudence. But Gaurav Mukunda writes in the Harvard Business Review:

"The financial sector's influence on management has become so powerful that a recent survey of chief financial officers showed that 78% would 'give up economic value' and 55% would cancel a project with a positive net present value—that is, willingly harm their companies—to meet Wall Street's targets and fulfil its desire for 'smooth' earnings."

The survey dates back to 2004, but not much appears to have changed. It suggests neither diligence nor wisdom, but rather careless analysis and poor thinking by analysts, managers and, mainly, institutional investors.

It is also an injustice perpetrated against other investors, who do not have the same influence as the institutions. The power of investors (or at least the crude analysts who may be dominating the discussion) also appear at times to encourage companies to abuse employee loyalty, and be aggressive with their tax, safety and environmental policies. Voting at shareholder meetings has improved but is barely effectual.

Charging fairly

Injustice also involves over-charging and over-servicing. Over-servicing seems a problem for small investors who have portfolios individually managed and administered by personal financial advisors. The costs and additional risks are significant. I have also yet to see any relative performance statistics that might show their losses against the index. Investment markets are complex and require teams of professionals with access to the best information to make sensible decisions.

One has sympathy with those who use their local advisor, because the professional teams are only to be found in larger institutions, which are likely to be over-charging. Although he is speaking to his own interests, John Bogle, founder of Vanguard, is hardly alone in arguing that active investment managers are: "parasites with their fees and transaction costs eating into returns earned by the ultimate host: public corporations."

When I wrote my actuarial investment examinations in 1980, we learnt that the investment department should cost in the order of 0.1% of assets. As a member of various investment committees over the last 35 years, I have seen the number rise significantly, and it was double in Australia when we came from South Africa in 2003. The ethical fund, of which I was chairman until 2002, managed a small profit on 0.5% of the equivalent of about $500 million assets. This was after paying fees for both investments and the evaluation of the social criteria we used. It may also be a difficult ethical problem to draw the line at what precisely is an ethical level of charges, but I would suggest that we are well passed it. The best evidence probably comes from the low SMSF management fees, often managed by finance sector employees who would not dream of investing in the funds their employers offer.

Courage

Courage appears in short supply and not just in the CFO's referred to by Mukunda. Courage is not recklessness, but being prepared to defend one's position when necessary. The preparation involves both making the resolve to maintain your integrity, and ensuring that you are equipped to do so successfully. This can be a long term exercise. It is surely part of the success of long term fundamental investors such as Warren Buffett, Jeremy Grantham and Allan Gray. They display integrity in telling investors that they will not always get it right, and will not always appear to be right, and courage in sticking with their views in the face of market irrationality. Not, of course, that the courageous always succeed. Tony Dye, of UK fund managers PDFM, famously lost his job weeks before the burst of the dot.com bubble. The Economist's obituary praised his courage, but had it: "Mr Dye has too few successors, but the clients are at least partly to blame." Trustees also need fortitude to resist ill-informed sponsor and member pressures.

The severity of some of these moral issues may have crept up on us unawares. Most of the people I know in the investment management industry are smart, hard-working and honest. But Gaurav Mukunda is not the only one who believes that the industry is toxic in a number of respects. My book is aimed at my students and those entering the financial service industry. I am a little fearful I might encourage some into 'heroics' that will be costly to them. Older readers of this article might be more active and outspoken with less danger to themselves.

Anthony Asher is Associate Professor, School of Risk & Actuarial Studies, UNSW Business School. His new book is Working Ethically in Finance (Business Expert Press 2015). These views are his own and not the opinions of the University of New South Wales or Cuffelinks.

Why global? More choice and cheaper pizza

Jason Sedawie

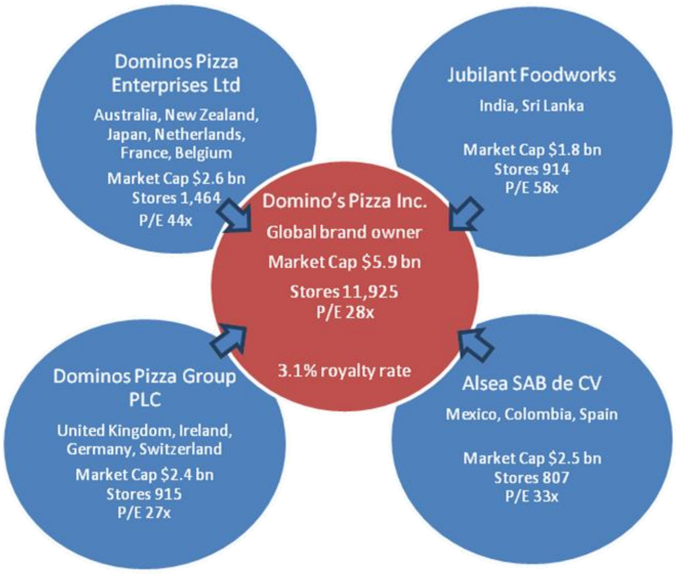
Going global gives you choice. Just like buying online you get more items at cheaper prices. Your portfolio will benefit from trends and industries that are not available in Australia. The local market is heavily weighted to banks and resources, otherwise known as the two options of debt or dirt. With the mining boom winding down, investors have to look offshore for growth.

The majority of the disruption we see every day is benefitting companies overseas at the expense of our past market darlings. We can see what has been happening in stocks like Fairfax and Channel Ten. New media like Facebook and YouTube are taking eyeballs and attention away from old media. The rivers of gold from print advertising can now be found online. There are some disruptive stocks in Australia that are benefitting, like realestate.com.au and Domino's Pizza. But they trade on expensive multiples because of the scarcity of these investments in Australia and the weight of superannuation money. The amount of money in superannuation is larger than our domestic stock market. If we look overseas these same trends can be accessed at much cheaper prices.

Which pizza would you choose?

Domino's Australia (ASX:DMP) has been a great outperformer in the local market but there are four other listed Domino's companies around the world. All four pay a royalty of 3.1% to the US company which owns the brand, yet Dominos in America (NYSE:DPZ) trades at a one-third Price/Earnings multiple discount to the Australian-listed Dominos.

Investors get access to the brand owner at a cheaper price because it's listed overseas where the choices are greater which makes for cheaper valuations.



Store numbers as of end of June 2015, Market cap in USD as of August 2015

Digital ordering

Going global gives you options. We have seen how popular Domino's has become with digital ordering. Large restaurant chains have benefited tremendously as smart phones allow ordering on the go. Domino's mobile application even tracks the driver so customers can watch real time as the driver decides which street he is going to take!

Being global you can apply this trend elsewhere. I personally see a similar opportunity in Starbucks as they roll out digital ordering this year in their 13,000 US stores. It's great ordering coffee ahead – there's no waiting in line. The app will ask whether the customer is driving or walking to better estimate when the coffee should be ready at the closest store. The introduction of drive-through at Starbucks grew revenue incrementally by 50%. Digital ordering will have a significant impact decreasing lines while increasing sales at peak hour. Like Dominos, once the Starbucks app is downloaded, orders are customised and saved on the phone.

Access to trends

Going global gives exposure to other trends like electronic payments. Customer purchase behaviour has changed every day at stores. How often do you see customers use tap and go with their Visa and MasterCard debit cards? I hardly carry any cash around anymore. I've even forgotten my password a number of times as I'm so used to tap and go.

When we purchase on the internet we don't use cash we use PayPal and our credit cards. They are great businesses clipping the ticket on every transaction. Electronic payments is such an important trend that Monopoly has produced a version of its game without cash, just debit and credit cards. Though I have to admit holding the cash in the original version is a lot more fun.

Access to brands

Many of the brands we use everyday are listed overseas, especially the majority of growing brands revolving around technology, like Google and Amazon. Brands have historically been good investments as they have pricing power. How often do you see Starbucks dropping its coffee prices when prices of beans go down? Compare this to commodity companies like BHP which have to take whatever the market pays. Of the top 100 brands measured by brand value, only five are from Australia (source: Brandz).

Invest in companies that 'buy commodities, sell brands'

Warren Buffet has become widely successful, mainly because of four words: "Buy commodities, sell brands". He invests in companies like Coca-Cola. Brands tend to be durable investments as customers seek them out as they know what to expect from the product and service. Apple is a modern day brand example. The semi-conductor chips they buy are commodities but their services and high quality brand differentiates them from competitors allowing them to charge high prices for their products.

The great thing about investing overseas is that we should be more comfortable with these companies. How often do you buy something from BHP? We all have Apple iPhones (it has been estimated we look at our phones 214 times a day) but hardly anyone in Australia even considers buying the shares.

Global provides more options at cheaper prices

Going global gives you access to more items at cheaper prices. You can benefit from all the brands and trends you see every day. Because there are so many disruptive companies investors have plenty of choice leading to better valuations than if they were listed here in Australia. As investors we have figured out it is better to put our money in bank shares rather than bank deposits but what about other trends like ordering over the internet and electronic payments? In Domino's case, going global gives you a higher quality pizza at a cheaper price.

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