Cuffelinks
Connecting investors with ideas

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Cash is king when the market holds the aces

Roger Montgomery

Editor's note. I asked Roger this question about holding cash.

"I heard you on Mark Todd's programme last week say your funds are now 30% in cash.

If I have an investment with an Australian equity fund manager, it is part of my overall portfolio. I have decided in my asset allocation I want x% in Australian equities, and I allocate money to other asset classes including cash. If my Australian equity manager then puts the money into cash, my asset allocation is upset. I want exposure to the specified asset class. At its extreme, for example, if an equity manager went to 100% cash, and the market rallied, I would feel it was more than a poor call, but that it went against my allocation wishes.

When I ran the geared share funds at CFS (which at one stage held $10 billion), we explicitly stated that we would gear the funds to their maximum. Everyone knew that's what they were buying, and I did not have the skills to second-guess the market. It was a supercharged portfolio in both directions, and we told investors and advisers to look elsewhere if they did not want the associated risk and volatility.

I know many top quality managers see a need to protect capital, and as you said on TV, you have hurdle rates which companies must meet. But I go to equity managers like you for Australian equity exposure."

Cash. For such a simple investment, it can cause an awful lot of grief.

Has there ever been a time in history when investors had so much to worry about? Not a day passes here at Montgomery that a client or blog subscriber doesn't express some concern about Brexit, the perils of asset prices inflated by unprecedented central bank intervention, the coming collapse of China or the Japanese-led deflationary spiral. Charlie Munger and Warren Buffett once observed, "Market forecasters will fill your ear but will never fill your wallet."

But in reality, there has always been a time with an equally-worrying frequency of concerns. Consider the investor in the 1920's, the 30's, the 40's, the 60's, the 70's, the late 80's, the early 2000's, the late 2000's and so on. With monotonous regularity, fears concentrate and abate. It is safe to assume that stocks must be an incredibly risky asset class to invest in. In fact, cash is riskier.

Cash seems safe but erodes purchasing power

In the age of retiring baby boomers demanding income, cash might seem like the safest option but cash returns currently guarantee your purchasing power will be eroded the longer you remain invested in it. It is as certain as the sun rising in the east tomorrow.

Check out the Top 200 Rich List. How many decades did many of those entrants take to achieve their wealthy status? And how many black swan events hit the market and the economy in that time? And how many of them listed 'cash' under the heading, Source of Wealth?

Of course most investors in the stock market don't think of their portfolio as a selection of stakes in operating businesses. They instead think of their portfolio as a group of 'stocks' that rise and fall with every latest fad and fear. To them, risk is the volatility in the share prices. But if the temporary movement in the prices of stocks is compared to the permanent erosion of purchasing power from holding cash, should not we be endeavoring to hold as little cash as possible?

The answer is yes. Our aim should be to fully invest in the assets that produce the highest long-run returns. And that's pieces of the types of wonderful businesses we have defined here at Cuffelinks previously.

What if equities are expensive?

The problem and subsequently-required decision however emerges when the preferred assets are not available at an attractive price. Share prices should be so attractive that even a mediocre performance from the underlying business produces an attractive return.

And while the current rate of cash is likely to produce sub-inflation returns, so too will the overpayment for equities and property.

The decision must then turn to the more immediate probability or risk of capital destruction. On that score, equities possibly have higher downside risk. Stan Druckenmiller recently highlighted 1981 as a beautiful time to be invested in equities. Interest rates were at 15% and the real rate was 5%. Those high rates ensured companies were careful with their capital allocation and interest rates were about to commence a long decline. Productivity received a boost from the advent of the internet and debt was so low that a long-run credit-fuelled expansion was possible. The S&P500 Price to Earnings ratio was just 7X. Between 1981 and 2000, the S&P500 produced a return of almost 15% per annum, creating a 16-fold increase of your wealth.

Today, we have almost the mirror opposite image. Debt is double that of 1981 and appears to have reached its limit. Full employment and declining productivity suggests corporate profit margins are about to decline and interest rates cannot fall much further, and may begin to rise. Since 2011, earnings per share in aggregate have not grown but US company payout ratios have increased from 55% to more than 75%. Combined with elevated levels of debt, it suggests little earnings growth will be experienced in the near future. And investors are paying 18x earnings. So how can the polar opposite of 1981, be an equally attractive time to invest? It cannot.

The current market justifies a cash holding

In that scenario, holding some cash seems prudent, and cash is particularly valuable when no one else has it. On cash being to a business as oxygen is to a body, Warren Buffett said: *"Never thought about it when it is present, the only thing in mind when it is absent."*

The only people who can benefit from a correction and take advantage of cheaper prices are those who hold cash. As India's Warren Buffett, Prem Watsa, recently noted;

"Cash gives you options, gives you the ability to take advantage of opportunity but you have to be long-term. The cash gives us a huge advantage in terms of taking advantage of opportunity as and when they come. At the moment, we don't think they're many, so we are building cash."

Remember Warren Buffett's observation that fund managers are playing a baseball game where the investors in the bleachers are always yelling out "don't just sit there, swing at something!" Private investors aren't playing a game where they have to listen: they can sit there and wait for the perfect pitch.

Cash provides that opportunity, even though it is a terrible long term investment. It should be thought of as a call option over future cheap shares with no strike price and no expiration. Cash is guaranteed to avoid one risk

- the risk of permanent capital loss - but it is also guaranteed to adopt another risk – the loss of purchasing power. Having all your assets in cash all the time makes no sense.

In the long run, share prices will always follow the performance of the underlying business. In the short run, the share price will bear no resemblance to business performance. That is why Ben Graham observed that in the short run the market is a 'voting machine' but in the long run it is a 'weighing machine'.

It follows then that owning equities for a week or a month or even a quarter is risky. The corollary is that owning cash for a short period must be safe. When investing for a multi-decade period, daily share prices are meaningless and being fully invested should be the goal. Building a diversified equity portfolio over time is the process

And there's your answer. You are buying 'over time'. In the meantime, hold some cash. It's an option over future lower prices. Don't hold all your assets in cash, that's not sensible. But don't eschew the wealth-protecting and wealth-building power of cash either.

Roger Montgomery is the Founder and Chief Investment Officer at The Montgomery Fund, and author of the bestseller 'Value.able'. This article is for general educational purposes and does not consider the specific circumstances of any individual.

Opportunities in new company floats

Mark East

We continue to see a steady stream of company floats or Initial Public Offers (IPOs) coming to market, although the current IPO cycle appears quite mature. Unlike previous cycles this far advanced, this one is still offering some attractive opportunities for investors.

The typical IPO cycle

The IPO cycle typically starts with the listing of higher quality companies. To overcome investor apprehension, they are often priced quite attractively and accordingly they generally deliver good returns for investors. The success of these IPOs then allows lesser quality companies to come to market, with the quality falling away over the course of the cycle. The IPO cycle will continue for so long as the market remains receptive. Sometimes, it will be a market correction that ends the cycle. This was the case with the GFC, when IPOs stopped dead.

Other times the end comes about as a result of a run of poor performing IPOs or a high profile failure. For example, the last IPO cycle ended with Myer, which floated in late 2009, and whose share price halved within two years (it has halved again since). The IPO cycle lay dormant until around 2013 despite the fact that the market was strong until then. It was at this point that the current IPO upcycle began.

This IPO cycle

True to form, the current IPO cycle came with some early successes, including IPH, Mantra Group, Aconex, and Burson Group. All of these stocks have doubled or tripled since their IPO at the start of the cycle. What has perhaps been different this time is that there has not been the same obvious deterioration in quality over time. Both successes and failures have been spread quite evenly across this IPO cycle. Early in 2013 we had the IPOs of Vocation and Dick Smith, both of which found their fate in administration. And more recently we have had some high quality IPOs that have already delivered decent returns.

One recent example is BWX Limited, which owns the Sukin range of natural skincare creams. It is a quality company, with a strong brand, an astute CEO, and bright growth prospects. The company floated in November 2015 at a share price of $1.50. Since then, it announced strong first half year financial results in February 2016, and it is further down the track in its offshore expansion plans. It's share price has already tripled since its IPO.

There have been a number of other decent companies that have undertaken IPOs recently with decent success. For example, in April we had the IPOs of Motorcycle Holdings (+38% since listing), Reliance Worldwide

Corporation (+22%), and WiseTech Global (+32%). Recent successes like these are allowing this IPO cycle to continue, and while we are conscious that quality may well in fact deteriorate, we are still seeing some attractive opportunities coming our way.

A focus on quality, but IPOs have specific issues

At Bennelong (BAEP), we analyse all new companies coming to market just as we would those already listed. For us, that means focusing on the fundamentals and looking out for high quality, strongly-growing companies that are reasonably priced. However, in our analysis, there are a few peculiarities in the specific case of an IPO:

1. Research timeframe

The research effort for an IPO must be completed in a compressed timeframe and before the drop-dead date to bid for stock. Investors often have less than two weeks to put in bids once a prospectus is released. Fund managers will usually have longer, with broker research released a few weeks prior, and often with the benefit of meetings with management in the previous 6-12 months as part of so-called 'non-deal roadshows' (brokers use these to gauge interest for an IPO).

2. Track record

IPOs have limited financials and other important information. The typical prospectus will provide just two to three years of historical financials. Investors generally have little familiarity with the business, including its performance in various business conditions, and little exposure to management and their capabilities.

New investors thus start at a considerable disadvantage vis-à-vis the vendors of the business, who have normally been intimately involved with the company and management for far longer. Vendors have the luxury of choosing the timing of their exit, and this is likely to coincide with when the business is performing well. New investors must assess the sustainability of current earnings and whether forecasts are achievable.

On the other hand, the disclosure of a longer track record will often signify a strong business, not least because the disclosure probably comes because the record is attractive. A recent example is Reliance Worldwide, which is a well-run manufacturer of plumbing supplies and provided 10 years' history of sales revenue, which had grown at 13% per annum. Of course, even in these cases, it is necessary to consider whether the future will be as bright as it has been in the past. For us at BAEP, this included undertaking a large number of meetings with customers and other industry contacts in the short timeframe we had.

Investors may be familiar with the business because it has been listed before in one form or another. Have things changed for the better? Generally, they have not, with Dick Smith a case in point. This business struggled for decades under Woolworths' control, with numerous CEOs and strategic reviews before being sold in 2012. The private equity buyers relisted the business the following year at a materially higher valuation, after a very quick 'turnaround' that more than doubled profits and supposedly set the company on a more prosperous course. As it turned out, the troubled track record was indicative of the company's ultimate outcome.

3. Vendor's motivations

Understanding the vendor's motivations allows investors to understand the opportunity. An important distinction should be drawn between two scenarios:

a) Existing shareholders selling their shares as part of the IPO, leaving them with no or little remaining interest in the company. Such vendors are effectively cashing out, and are likely to be motivated purely towards maximising the proceeds, with little regard for the company's success once listed. Extra care is required here, with private equity exits such as Dick Smith and Myer serving up cautionary tales.

b) The company itself raising the money through the issue of new shares. Existing shareholders do not sell shares and remain in. Here, the capital raised goes to the company itself, to be used for its benefit to invest in growing the business. Existing shareholders retain their shares and price maximisation is not the sole motivating factor in setting the IPO price.

Special situations

There are a two types of floats that are particularly attractive: privatisations and demergers.

Privatisations involve an IPO in which a government is the vendor and it sells a public asset. Governments are minded to give incoming investors, who happen to also be voters, a positive experience, and this often means pricing at a reasonably attractive level. Commonwealth Bank, CSL, Telstra, Aurizon and more recently Medibank are typical examples in which investors have done well.

Demergers involve the distribution of shares of a subsidiary company to the shareholders of the parent company. The new demerged company is let free to chart its own course, with management often more focused and incentivised. Except in the unusual case, demergers do not also involve raising new capital. Consequently, there is no need to sell the IPO to any new investors, and unlike most IPOs, there is no special sales effort behind the listing. A recent example of a successful demerger is Clydesdale Bank, which separated from National Australia Bank, and floated in February 2016. The demerger was undertaken because the business was considered non-core, but left alone, it has already prospered and its share price has risen accordingly.

Conclusion

Gaining comfort in a soon-to-be-listed company and its prospects as an investment is generally more difficult than those we've been researching for some time. However, the research effort is always worth it, even if only to become familiar with the company with the potential of investing further down the track. Keep an open mind, recognise that IPOs can be attractive, and remember that every company of course was once an IPO.

Mark East is Chief Investment Officer of Bennelong Australian Equity Partners (BAEP). This article is general information and does not consider the circumstances of any individual.

Focus on quality industrial stocks regardless of the economy

Anton Tagliaferro

Since the depths of the GFC and the early stages of the economic recovery in 2009, there has been more of a focus on the 'macro' economic environment than ever before. While there is a frenzy of reporting and analysis with each GDP data release, it is IML's view that world growth will remain subdued for many years to come.

Deleveraging and China are long-term factors

Our reasoning is that most countries in the western world such as the USA, Australia and large parts of Europe would take many years to deleverage the debt accumulated by households and governments. While many commentators were excited about China and convinced it could continue to lead the world out of its downturn, it was clear to us that China's GDP could not continue to expand at the double digit rate of growth indefinitely.

In addition, China's economy was transitioning from growth led by fixed asset investment towards a more service sector-led economy. This of course has direct implications for Australia as the service sector is less commodity-intensive than fixed asset investment. The growth in demand for many of Australia's exports such as iron ore and coal would not be as strong as it was in the previous decade. The huge expansion in the supply of commodity exports, as many Australian companies spent tens of billions to ride the China wave, is clearly not good news for Australia's resource sector.

The deleveraging of debt and China's economic transition are long-term factors that will have an influence beyond the next quarter's GDP numbers. The economic outlook is broadly set and unlikely to change significantly in the short to medium term.

What is also clear is given the lacklustre outlook for global economic growth, that low interest rates are here for a long while. Investors need to focus on the key question: "How do I find opportunities for income and capital growth for the future given this environment?"

Focus on 'micro' - what and why?

Stock selection will be the key to successful investing in future. The banks and resource sector which dominate the Australian share market and have traditionally been the core of portfolios, are unlikely to drive investors' returns going forward. Banks are experiencing low credit growth and higher capital constraints due to changing regulations. Resource companies have to deal with lower commodity prices driven by oversupply and softer demand, in particular as China transitions.

Our portfolios that focus on the ex-20 sector of the Australian share market provide a broader and more diverse opportunity set containing stocks in sectors such as the gaming, packaging, utilities and healthcare which are not represented in the top 20 stocks. We look for companies with a strong competitive advantage, recurring and predictable earnings, capable management and an ability to grow over time. We aim to buy these companies when they are trading at what we deem a reasonable price.

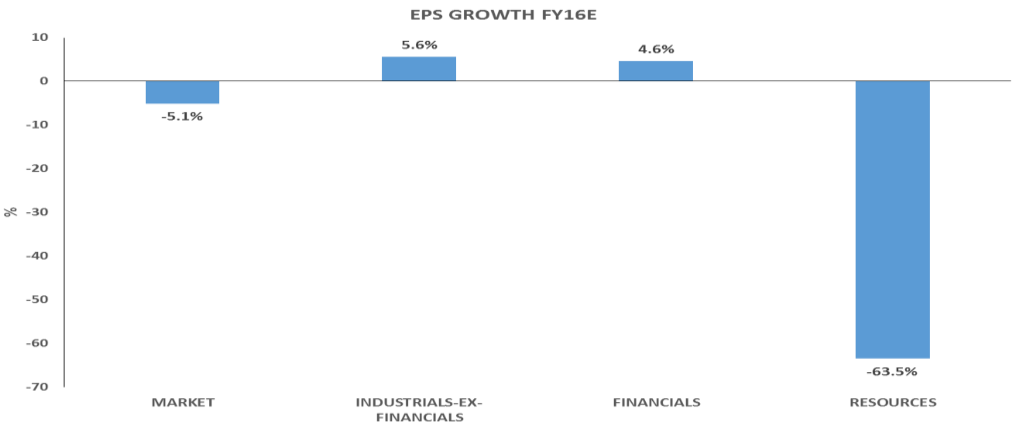
The focus is on identifying companies with the ability to generate earnings growth despite the expected lacklustre economic conditions of the years ahead, especially in the following ways:

- Acquisitions
- Restructuring
- New products
- Contracted growth
- Market share gains

Sector prospects vary

The varying prospects for growth for the whole S&P/ASX200 is depicted below. The estimated eps growth forecasts for FY16 are based on consensus estimates, although our forecast for the eps growth for financials is lower than this.

Estimated consensus EPS growth financial year 2015-2016



Source: UBS, Consensus, 1 February 2016

Our focus remains on finding the quality companies with internally-driven growth strategies. Fortunately, there are a number of quality non-bank industrial companies that are coping well with the current economic environment, but identifying them early and then carrying out intensive research remains the key.

Companies with internally-driven growth strategies

Examples of companies that we have bought and which meet our quality criteria as well as internally-driven growth strategies include:

Acquisitions - **Steadfast and Pact**

Steadfast and Pact are both market-leading companies in their respective fields of insurance broking and rigid plastic packaging. They should grow steadily in the years ahead thanks to their low risk bolt-on acquisition strategy of buying small competitors at low multiples where they can generate cost synergies and earn stronger returns.

Restructuring – Fletcher Building and Caltex

Fletcher Building and Caltex are market leaders, respectively in New Zealand building materials and fuel distribution. Both are restructuring by selling or closing poor-returning divisions (sand quarries for one and an oil refinery for the other). This will lead to better cash flows and returns to shareholders in the years ahead.

Contracted growth – Spark Infrastructure and Hotel Property Investments

Spark Infrastructure is a regulated utility which owns monopoly infrastructure (electricity poles and wires) and HPI owns a portfolio of pubs all leased to Coles for long terms. Both companies have contracted growth. Spark's return on its assets are set by various government regulators while HPI's returns derive from long leases on its extensive pub portfolio and accompanying liquor licences to Coles. This should ensure the growth in earnings and distributions to shareholders over the medium term almost irrelevant of the economic environment.

Market share gains – Clydesdale Bank

Clydesdale Bank is one of the longest-established banks in the UK. After a chequered history under the ownership of NAB, it has listed as a separate entity on the ASX. The bank has not grown its mortgage book under NAB as everything was put on hold for a number of years as NAB decided its future. With a newly appointed Board and a focussed and experienced management team implementing a sensible strategy, we are confident that this newly-listed bank will progressively increase its market share of new mortgages.

Dividend yield and dividend growth are also critical

Companies paying sustainable, growing dividends are attractive in all market conditions for three key reasons:

1) Historically the share market has delivered returns of around 9-10% p.a. so if one can find a company which can pay a sustainable growing yield of 4-5% you are almost half way there.

2) Dividends are the part of investors' returns the company controls and are more dependable than relying on capital growth from the share price which depends on the state of the market. No matter how impressive the management team is, they cannot control the share price or your annual capital return.

3) In times of falling markets, stocks with strong dividend yields tend to hold up better than the overall market and they tend to recover quicker as investor confidence returns.

While the headlines have been dominated by BHP and Rio significantly cutting their dividends and speculation about banks maintaining theirs (and ANZ already has), many companies identified above continue to grow their earnings and dividends, despite the challenging economic environment:

	December 2014 (cps)	**December 2015 (cps)**	**% change**
Steadfast	2.0	2.4	+20.0%
Pact	9.5	10.0	+28.0%
Fletcher Building	18.0 (NZD)	19.0 (NZD)	+5.5%
Caltex	50.0	70.0	+40.0%
Spark Infrastructure	5.75	6.0	+4.3%
Hotel Property Investments	9.0	7.9	+13.9%
Sonic Healthcare	29.0	30.0	+3.4%

In a world where economies continue to flat line and conditions for most companies remain challenging, focusing on the 'micro' issues and stock selection is key.

Our job is to identify these companies and buy them at a reasonable price, as we believe these companies will deliver solid returns for investors over the next three to five years through a combination of capital appreciation and income. Finding these companies is the focus of the IML investment team as we strive to deliver returns to QVE shareholders.

Anton Tagliaferro is Investment Director at [Investors Mutual Limited](#) (IML), which is the investment manager of QV Equities Limited (ASX: QVE) as well as unlisted funds.

Hybrids: the good, the bad and the ugly

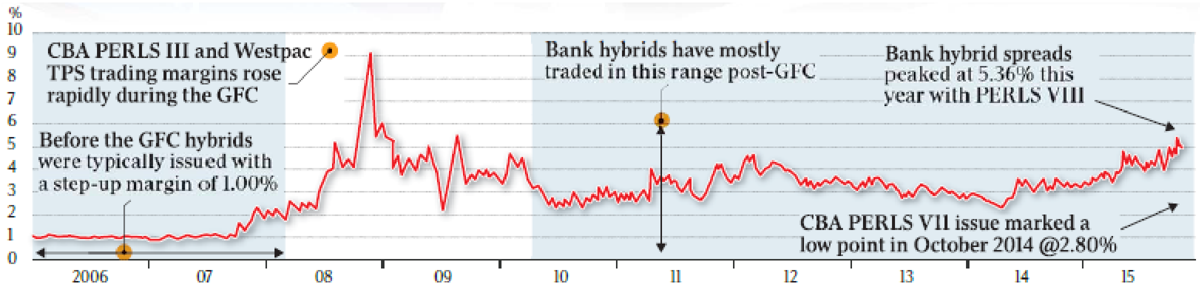
Elizabeth Moran

Hybrids are the cane toads of the financial markets, and just as cane toads have evolved to survive in a range of climates, hybrids have adapted to changing regulatory and interest rate environments. The similarities do not end there because like cane toads, hybrids have good, bad and ugly characteristics.

The good

Hybrid margins (the difference between the interest earned and the benchmark interest rate) are higher than what has been offered historically and are attractive, especially in a very low interest rate environment (the bank bill benchmark rate is currently about 2%). Interest is calculated quarterly and all ASX-listed bank hybrids are floating rate. Back when interest rates were high, hybrid margins were relatively skinny. NAB's National Income Securities (ASX: NABHA) were issued in financial 'pre Jurassic times' in 1999 with a margin over the bank bill benchmark of just 1.25% pa and investors were happy to invest at that level.

Figure 1: Paying better returns – hybrid spreads widen



Source: Bond Adviser

In recent times, margins have increased. All of ANZ's five listed hybrids were issued in the 3% range. But returns hit a low point in October 2014 with the CBA Perls VII issue offering a margin of just 2.8% over the benchmark. This issue was a big one with CBA raising $3 billion. Since then investors have sold down hybrids and the price of Perls VII trades well below its $100 par value and is often in the high $80s to low $90s, pushing the margin up for new investors to over 5%.

While CBA wins the prize for the lowest margin hybrid on issue, Perls VIII issued in February 2016 was at the other end of the scale with a 5.2% pa margin, perhaps rewarding tolerant investors for past mispricing. This issue has tended to trade above par, implying investors would be satisfied with a lower rate.

The most recent Westpac issue, Capital Notes 4 (ASX: WBCPG), settled at a 4.9% margin and raised $1.45 billion, well over the targeted $750 million, a good result for investors and the bank. Next horse out of the gates was NAB with margin set at 4.95%, a small sweetener over the Westpac issue.

Separately, ANZ has announced a USD hybrid, a first for any Australian bank. Considerable work would have gone into marketing the issue, but they will reap the benefits of expanding their investor base and having issuance in another currency. The fixed coupon in USD is 6.5% and the cost of the issuance is rumoured to be higher once swapped back into Australian dollars as a premium for a new market is fairly typical.

The success of the heavily-oversubscribed ANZ deal will open another market for the majors and could mean reduced issuance here. Depending on demand, this could push hybrid prices higher. The issue will provide an international comparison of margins and terms for our own insular, domestic market.

The bad

The complexity and range of terms and conditions in hybrids makes them hard to assess. Comparing older hybrids that were more debt-like with new ones is extremely difficult. For example, the ANZPC and WBCPC were issued soon after Basel III was implemented and contain capital trigger clauses but not a non-viability clause that was mandatory from early 2013. So what extra return do you require over and above the margins on those securities to compensate for the additional risk?

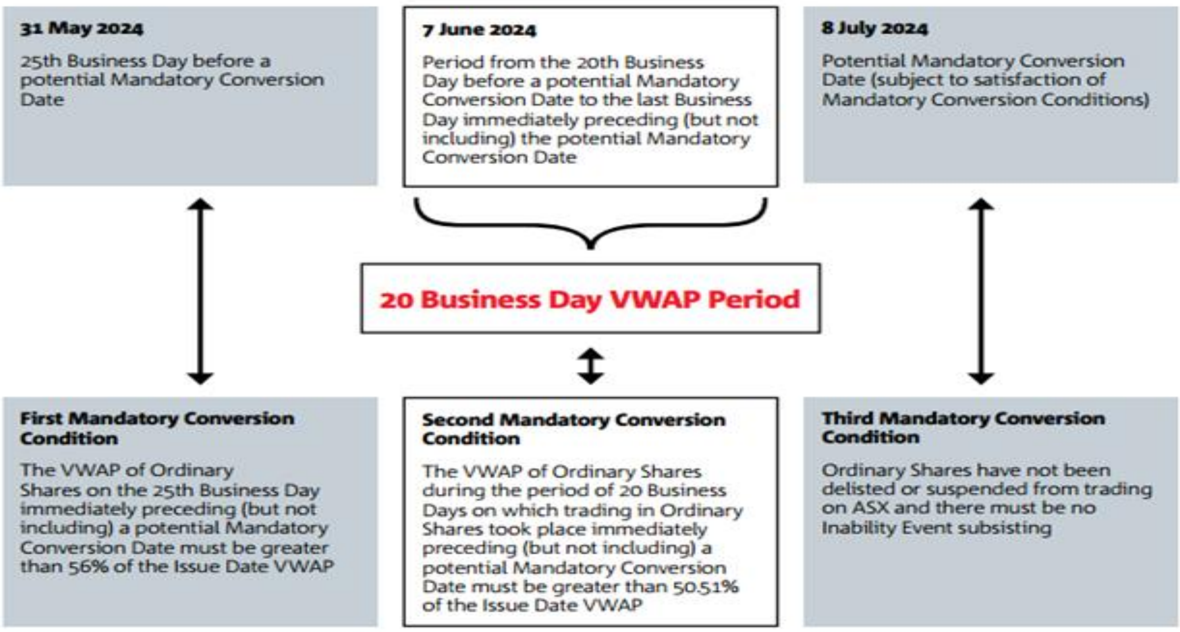
The non-viability clause is important for investors to understand, and we have prepared [this fact sheet]() for those requiring more information.

The ugly

The conversion terms and conditions especially those following a 'loss absorption' event are ugly. Practically every hybrid has variations to these terms and percentage conversion rates can differ, even if issued by the same bank. It's part of the evolution of hybrids.

Investors should be aware of multiple possible outcomes, and follow the share price of the bank as it determines conversion or not. For example the NABPD requires that "The VWAP (volume-weighted average price) of ordinary shares on 25th business day immediately preceding (but not including) a potential mandatory conversion date must be greater than 56% of the issue date VWAP". All new hybrids have similar clauses. It means hybrids aren't set and forget investments and you need to keep track of share price movements. Those hybrids issued when share prices are high are at greater risk of non-conversion. For an example of the complexity, consider the terms of the NABPD conversion.

NABPD conversion conditions



Source: National Australia Bank, NABPD prospectus, page 24

The success of all the recent hybrid issues shows investors are willing to accept these 'ugly' terms and conditions as they search for yield, but in financial markets, there's no reward without risk. Remember that cane toads were originally introduced to Australia to control a major pest, the sugar cane beetle, and many decades later, that has turned very ugly indeed.

Elizabeth Moran is Director of Client Education and Research at FIIG Securities. Click on this link for a [free copy of FIIG's 2016 Smart Income Report]() designed for income-seeking investors. This article is general information and does not consider the circumstances of any individual.

Where is Australia's future growth coming from?

Phil Ruthven

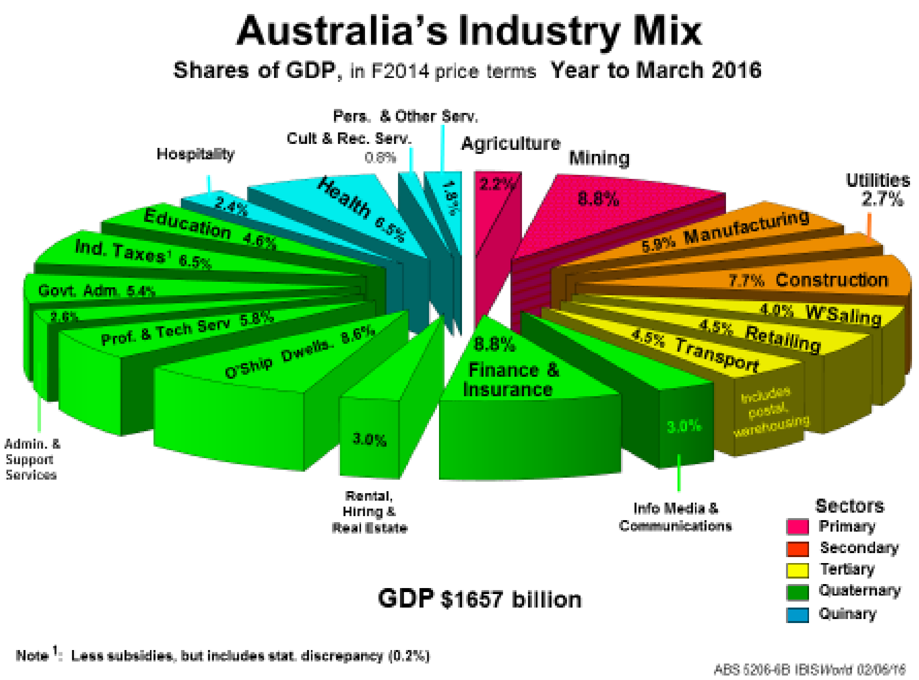
We are told that Australia has the fastest growing economy in the developed world. True, but at 2.7% in the year to March 2016 and the same growth per annum over the past five years, we are not growing as fast as the average for Australia over the past 50 years (3.2% pa) or the 20th Century (3.5% pa). Everyone seems to know the slower growth is due a lack of reform to our labour market, taxation and parliament, and having the worst broadband speed and capacity in the developed world; a disgrace in an age of digital disruption.

Australia should be part of the New World in Asia

It is small comfort to know that the rest of the developed world is growing slower than we are, has different problems such as national debt levels, larger government deficits, excessive taxation, and excessive legislation. This is less relevant when we realise we are not part of the old rich world of the European Union and North America, but are part of Asia which is bigger in GDP as well as population than both those regions and growing three times as fast as they are. And at more than double our speed. Asia is our new economic and demographic arena. It is where we are competing and need to be compared.

But, we do have a modern economy in terms of our mix of industries, and we do have growth in enough of them in terms of value-add and employment to keep the show on the road.

The first chart below shows the mix of industries as recorded by the ABS in the most recent National Accounts release.

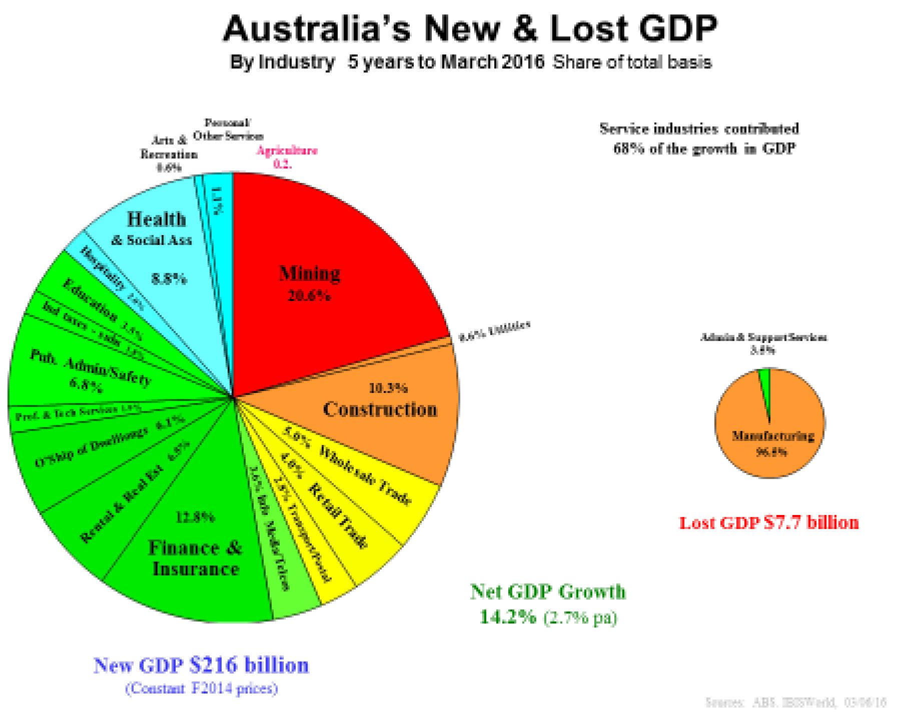


It is a mix dominated by service industries, as are all the developed economies of the world.

Manufacturing is poised to fall to 5% of our GDP soon, having been almost six times that share at 29% in the early 1960s. However, our standard of living (real GDP/capita) is three times higher than in 1960, so clearly manufacturing has been replaced by more wealth-creating industries.

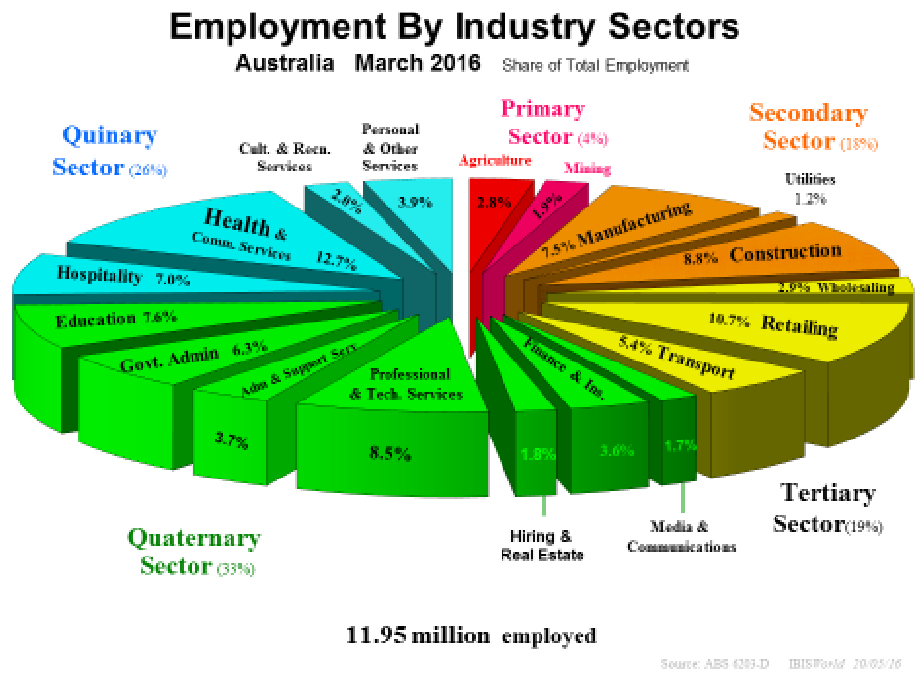
So where is Australia's growth coming from?

The next two charts show where the growth has come from over the most recent year and five years.

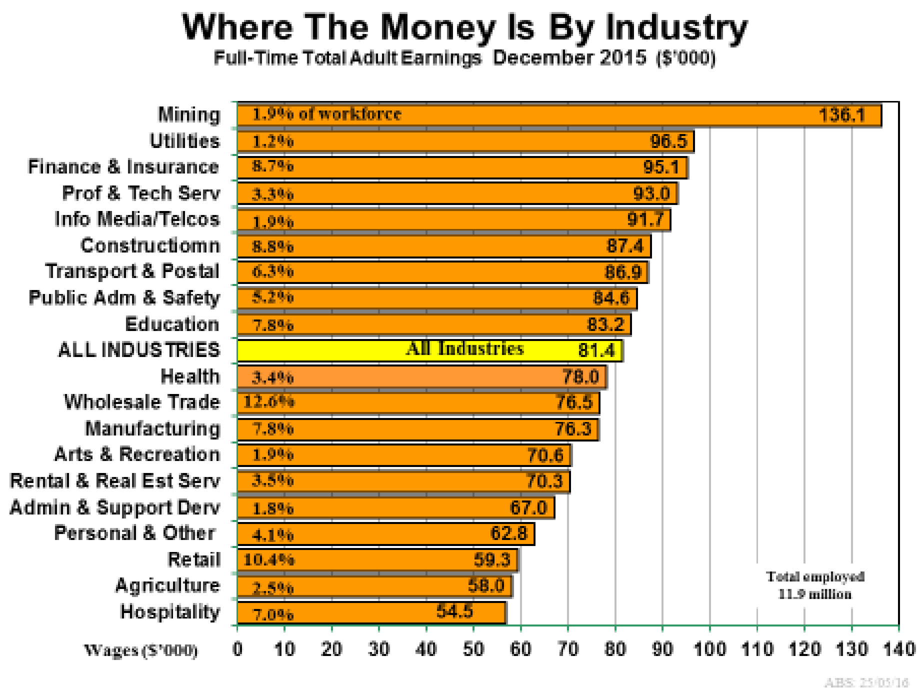


The only goods-based industries contributing to our growth are mining and, to a lesser extent, construction. Most of our losses are in manufacturing. Mining of course has had an horrific fall in prices over the past few years, but volumes (upon which real GDP is measured) continue to grow. However, some 70% of all growth over the past five years has come from our service industries.

A not dissimilar picture emerges when we examine the structure and growth of our industries in employment terms. The first chart below shows where our 12 million employees were in March 2016, and the second exhibit reveals what sort of total earnings were being enjoyed in each of the nation's 19 industry divisions in 2015.

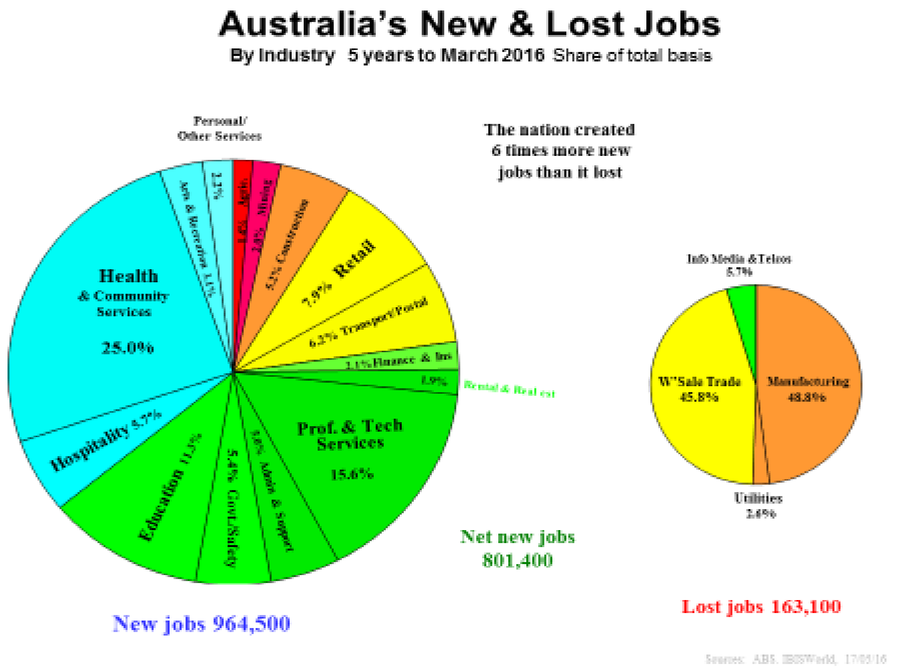


(Note: The quinary sector of the economy is the top economic sector where decisions are made, and the quaternary sector is where knowledge is based).



Again, it is a nation where the workforce is dominated by service industry jobs. And contrary to common belief, there are more above-average earnings in the service industries than in the goods-based industries. Manufacturing is well below the national average nowadays. Why do we still have some politicians suggesting we should go back there? Regressive economics.

The good news - that is not publicised enough to a society nervous about jobs for themselves and their children - is that we are creating far more jobs than we are losing. This is abundantly clear in the two exhibits below that cover the year to March 2016 and the five years to the same time.



In the latest year, we created three-and-a-half times more jobs than we lost, and in the past five years, we created six times more than we lost. So why on earth do we make big song-and-dance and hand-wringing routines about job losses, but practically no celebration of our new jobs?

We have a lot to cheer about, but we cannot be complacent about urgent and overdue reforms.

Phil Ruthven is Founder of IBISWorld and is recognised as one of Australia's foremost business strategists and futurists.

Time and tide should dampen negative gearing proposal

Noel Whittaker

In 1027, King Canute stood by the seashore and commanded the incoming tide to halt. Of course, the tide ignored him and he ended up with wet feet. As legend has it, he leapt backwards, saying: "Let all men know how empty and worthless is the power of kings." Contrary to the common myth, the wise king was not showing off – he was demonstrating to his subjects the limit of his power.

Canute's order to the sea is an analogy for the Labor Party's attempt to make housing more affordable for first home buyers. It simply can't be done. It's ironic that the catalyst for the GFC was President Clinton's idea that housing should be available to everybody. It started with a boom as the American property market became overbuilt, with loans offered to everybody irrespective of ability to pay. It finished with a bust whose reverberations are still being felt around the world.

Australia faces a perfect storm

But the GFC was more than a bust. It triggered collapses in stock markets everywhere, with interest rates around the world falling to historically low levels as central banks try to stimulate their economies.

Australia was not immune. But what was different here was a growing attack on our superannuation system by politicians and so-called independent think tanks.

So we faced the perfect storm. The average Aussie investor has lost all faith in the stock market, and they are scared off superannuation because of the adverse publicity and threatened changes. They also know that earning a piddling 2% in the bank isn't the way to go long term.

Consequently, they invested in the property market. As interest rates fell, making mortgages more affordable, prices started to rise. As always happens, the moment any asset class starts to rise in value, everybody wanted to jump on the bandwagon. Yes, that made it tougher for first home buyers, but historically every initiative by government to make housing more affordable has simply raised home prices further, because more buyers are attracted to the market. Think of the first home owners grant and stamp duty concessions.

On new property, the developer has made the profit

Labor's policy of restricting negative gearing to new homes simply won't work. It will push unsophisticated investors into new property where the profit has already been made by the developer, leaving the established market for savvy investors. They understand that the way to make money in real estate is to buy a rundown property on a good block and add value to it. The irony is that they will use the money they can no longer contribute to superannuation as a deposit. This may make the property positively geared from the outset.

Let me quote a case study from Philip, in the interests of a rational debate about negative gearing.

"I purchased an apartment in October 1987, borrowing 100% of the purchase price using my residence as security. The taxable loss was $7000 a year so my tax refund was in the order of $3,000 p.a. Three years later I paid it off when rates hit 17%. Total tax saved over those three years was around $10,000. After paying off the loan it was positively geared and I was paying $2000 in tax on the net rents.

The property has been positively geared for the last 25 years. Current net rent is $6,000 p.a. and at my marginal tax rate of 32.5% my tax is around $2,000 p.a. So having gained a net tax benefit of approximately $10,000 in the late 80's, I have paid $50,000 in tax since.

The value of the property has risen substantially from my purchase price of $58,500 to a current value of $320,000. But when I sell I will be liable for capital gains tax of $30,000.

Since 1987 I have enjoyed net tax refunds of approximately $10,000 but have subsequently paid $50,000 in income tax and will shortly pay another $30,000 in CGT. The government has made a significant net $70,000 benefit from my investment risk and the subsequent good capital growth will almost certainly eliminate my ability to claim a pension in retirement. This sounds like a great deal for the Government to me."

Limiting negative gearing will be as successful a policy as was holding back the tide for a wet King Canute.

Noel Whittaker is the author of Making Money Made Simple and numerous other books on personal finance. His advice is general in nature and readers should seek their own professional advice before making any financial decisions. See www.noelwhittaker.com.