Firstlinks
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Editorial

Big numbers that once grabbed our attention have lost their impact. They whizz past our consciousness every day and we are no longer impressed. How easy millions became billions and now trillions. Billionaire... big deal... there are 2,755 of them according to **Forbes**, and **Amazon's Jeff Bezos** is one 177 times over. With 493 new names on the list in 2021, that's a new billionaire every 17 hours.

The old UK definition of a billion was a 'long scale' million million (12 noughts), but English-speaking countries, including Australia and the US, now accept a billion means a thousand million (9 noughts). It's not quite so difficult now to become a billionaire and Bezos is 17.7% of the way to becoming a trillionaire.

Name	Short scale	Long scale
million	1,000,000	1,000,000
billion	1,000,000,000 (a thousand millions)	1,000,000,000,000 (a million millions)
trillion	1 with 12 zeros	1 with 18 zeros
quadrillion	1 with 15 zeros	1 with 24 zeros
quintillion	1 with 18 zeros	1 with 30 zeros
sextillion	1 with 21 zeros	1 with 36 zeros
septillion	1 with 24 zeros	1 with 42 zeros
octillion	1 with 27 zeros	1 with 48 zeros
googol	1 with 100 zeros	

Pretty soon, these will become serious amounts of money. We can see why **Google** chose its name based on 1 with 100 zeros, as it sees its potential reach as unlimited. With **Alphabet** (Google) valued at US$1.8 trillion and **Apple** at US$2.4 trillion, it will be a long time before we need quadrillion in our lexicon. Where are zillion and gazillion in this list? They are informal words with no precise meaning.

Remember how China is a communist country and all aspects of life are under authoritarian control? No capitalism there. The recent tech and education crackdown by the Government cost Chinese billionaires billions but don't worry. They're not down to two-minute noodles yet, despite losing... yes, billions.

Let's move on from mere billions. The US national debt is nearly US$29 trillion, an increase of US$5 trillion in the last year. It is estimated to reach US$89 trillion by 2029, even without the US$1.5 trillion infrastructure bill recently approved and a coming US$3.5 trillion antipoverty and climate change plan. Major overhauls of health, education, welfare and infrastructure far exceed political desire to tax people.

The US **Congressional Budget Office** projects that US GDP will reach US$34 trillion in 10 years. In this context, what's a few trillion on some decent bridges and roads? It's fascinating to watch the US debt clock in real time. As soon as you take a screen shot, it is out-of-date. There's the US$29 trillion, with US$1.3 trillion a year spent on Medicare/Medicaid and US$1.1 trillion a year on social security.

So what? Well, as we become inured to the big numbers, we accept that a six-year-old BNPL called **Afterpay** that has never made a profit should be worth $39 billion, unlisted **Canva** is worth US$15 billion and tech startups are worth hundreds of millions on little more than fumes and a good idea. When future cash flow potential is discounted by tiny interest rates, numbers head to infinity. There is so much money sloshing around that investors park US$1 trillion in spare cash in the US Federal Reserve every night earning zero.

Well-known US analyst and fund manager **John Hussman** said last week:

"It may be the greatest collective error in the history of investing to pay extreme multiples for extreme earnings that reflect extreme profit margins and extreme government subsidies, while imagining that those multiples also deserve a 'premium' for depressed interest rates that reflect depressed structural economic growth."

More powerfully, Hussman quotes **Ben Graham**, the 'father of value investing' whose principles are followed by **Warren Buffett** and many leading investors, from his writing in 1959:

"Speculators often prosper through ignorance; it is a cliché that in a roaring bull market, knowledge is superfluous and experience a handicap... All my experience goes to show that most investment advisers take their opinions and measures of stock values from stock prices. In the stock market, value standards don't determine prices; prices determine value standards."

Think about that. Knowledge is superfluous. Experience is a handicap. Prices determine value standards, not the other way around.

In this week's edition...

We summarise last week's **Reader Survey** on retirement income, with more support for Government initiatives than expected. Many thanks to the 1,200 or so readers who responded, an excellent result, and we have included a thousand comments in a large PDF attached to the article. A great cross section of retirement views which we have sent to **Federal Treasury**. Some bed-time reading for Josh.

Still on retirement, former asset consultant, **Don Ezra**, who wrote a popular piece on his own retirement spending a few weeks ago, responds to some of the comments on his article this week.

Moving on to other investment stories, **Ned Bell** identifies six stocks he calls 'COVID opportunists'. It is fascinating to read the types of companies that have prospered in such a difficult climate.

Then **James Maydew** highlights how real estate is also changing, with new non-traditional sectors also benefitting from the way the world is changing. Anyone looking for commercial property exposure should look beyond the traditional office and retail.

We often hear analysts talk about the ways bond and share prices should move together, citing the 'negative correlation' benefits. **Warren Bird** dissects these claims with a warning about asset allocation and correlation assumptions.

It's the middle of reporting season, but what does this mean? **Hugh Dive** takes us inside the life of a fund manager or broker or institutional asset manager faced with an intense period of company announcements and meetings.

While the market loved the **CBA** result this week, pushing the stock to an all-time high, there was a nasty number hidden in the details. The remediation bill owed to **Countplus** after its purchase of parts of the CBA financial advice business has topped $260 million, in addition to the billions CBA has already paid out elsewhere. **Rodney Horin** argues financial advice that says 'do nothing' is often the best. What a poor job the major banks did when defending themselves at the **Financial Services Royal Commission.** The lawyers who told bank witnesses to lay down and die are not the ones taking the consequences.

Overall, the August 2021 earnings season has gone well so far as many businesses benefited from the massive government stimulus (and $25 billion of **JobKeeper** was retained by companies who ultimately did not meet the criteria), a rise in consumer spending and the reopening of the economy, and the current lockdowns have not delivered a reality check.

The good times are also rolling in the US. According to **Bloomberg**, as shown below, **Standard & Poor's** has upgraded the corporate ratings of 624 US companies and downgraded 339 in the year-to-date. Most of the upgrades are in the 'high yield' (non investment grade) space, showing what an amazing job low interest rates and easy liquidity have done to improve balance sheets. The blue line in the right hand chart of the up/down ratings ratio shows a remarkable recovery in 2021.

This week's White Paper from **Capital Group** explains how ESG bonds have become a popular way for fixed income investors to signal their ESG preferences, but how can investors avoid paying the 'greenium'?

Given the thousand-plus comments last week (check them in the Reader Survey article) with so many great thoughts, we are reluctant to nominate a Comment of the Week, but this from **AlanB** was too good on the point of the **Warren Buffett** challenge.

"I'm going to say it. We're all tone deaf! If this was an exam or assignment everyone would have scored an F with the only marker comment: Read the question. Buffet, Hand, et al., are inviting us to consider making the world a better, fairer place. We're talking about: the risk of paying some extra tax because our Sydney property is more valuable than one elsewhere; the absurd notion that we're rich simply because we work very long and hard (not because we live in a uniquely privledged country); taxing or not of franked dividends; etc. Please re-read the question, and re-submit your paper. Or withdraw from the course and avoid the course fee."

Unexpected results in our retirement income survey

Graham Hand

It is difficult to design a survey without some preconceived idea of what the answers might be, and it’s a welcome surprise when prior assumptions are challenged. It was certainly the case here.

I feel honoured that so many of you shared your personal views on death, retirement and spending.

Our Survey received almost 1,200 responses which is probably the largest sample on this subject since the two papers on retirement income were issued by Treasury. The Survey results have been sent to the Government and hopefully it is valuable input to policy decisions.

We also received well over 1,000 comments which is obviously too much to include in an article.

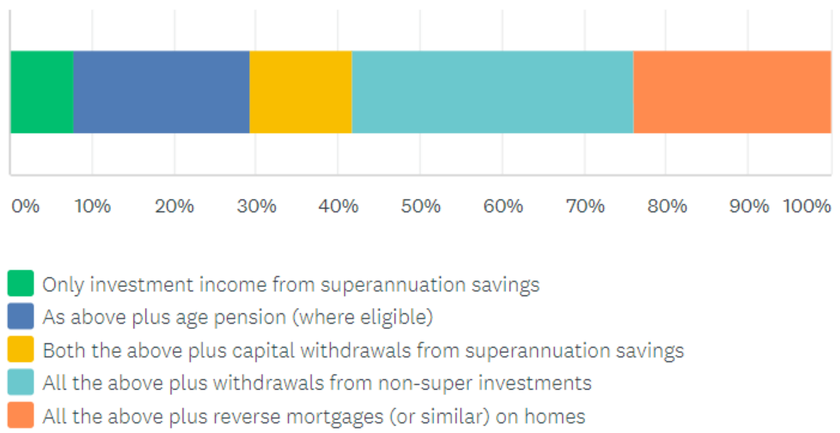
The comments are attached here in full and largely unedited (*warning, we have removed a few unsavoury words and personal identifiers but some may have slipped through*).

I encourage you to scan the comments. They are as important as the overall results and many were passionate, considered and heartfelt. Millions of Australians live on their super and policy determines the quality of their lives.

For background, two previous articles are here and here and we will leave the Survey open until Thursday evening.

Here are some highlights:

Q1 The definition of retirement income should be:



This was the first surprise. The question allowed readers to cumulatively add to the previous category. Based on past comments received in Firstlinks, I expected far more people to say that retirement income should comprise only pensions (where eligible) and superannuation (both income and capital). These items are widely accepted as sources of retirement funding but the sum of the three was only about 42%.

A further 34% of people accept that retirement income includes withdrawals from non-super assets, and again surprisingly, a solid 24% more accepted the need for reverse mortgages (or similar) on homes.

My interpretation of these results is the Government has more support for its definition of retirement income than I expected. Most people accept it should include drawing widely on assets held during retirement, not only super. This should give the Government more confidence pushing ahead with its broad definition.

It also shows support for equity-release schemes (although a later question suggests not for own use). The Government should improve the Pension Loan Scheme, especially the punitive interest rate of 4.5%.

Here are some sample comments:

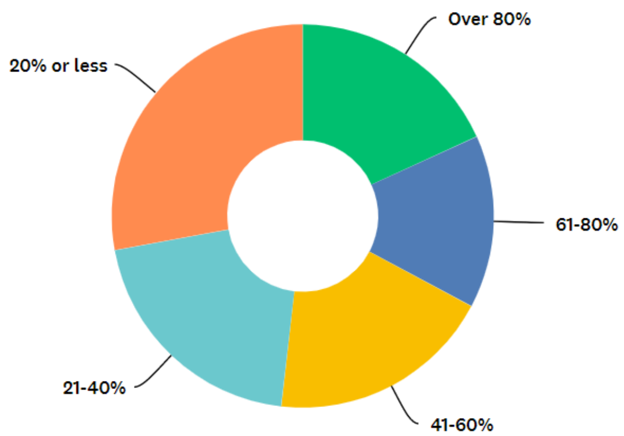
"I do not accept the right of Government to apply conditions to how I spend my own 'all taxes paid' wealth. I grudgingly accept the Government may have some moral right to applying conditions to how I spend a Government Pension or wealth earned under Super tax concessional rules."

"With the taxpayer-subsidised boom in assets values of property, it is absurd not to include that stored value in any consideration of lifestyle sustainability."

"To regard as income the withdrawal of your own life savings from the cookie jar, the bank or under the bed just defies logic."

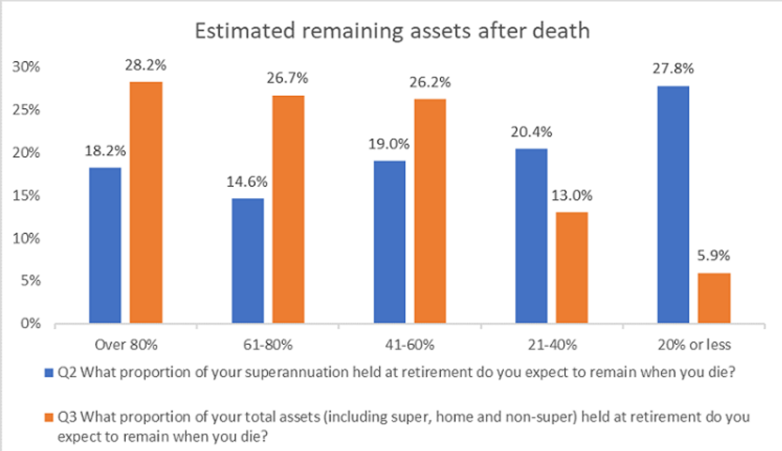
Q2 What proportion of your superannuation held at retirement do you expect to remain when you die?

Another surprise, I did not expect such an even distribution. Only 18% of respondents expect over 80% of their super to be left over on death and 28% expect to have 20% or less. That shows significant expectation to spend the majority of super in retirement, with nearly half at 40% or less.



Q3 What proportion of your total assets (including super, home and non-super) held at retirement do you expect to remain when you die?

This chart contrasts the results for super remaining before death (blue bars) versus all assets remaining (orange bars). This tests the claim that *"... retirees die with around 90% of the assets they had at retirement."* (Retirement Income Review). It shows most people (28.2%+26.7%=54.9%) expect over 60% of their assets at retirement to remain at death. Less than 20% expect to have only 40% of assets remaining compared with nearly half of super alone.

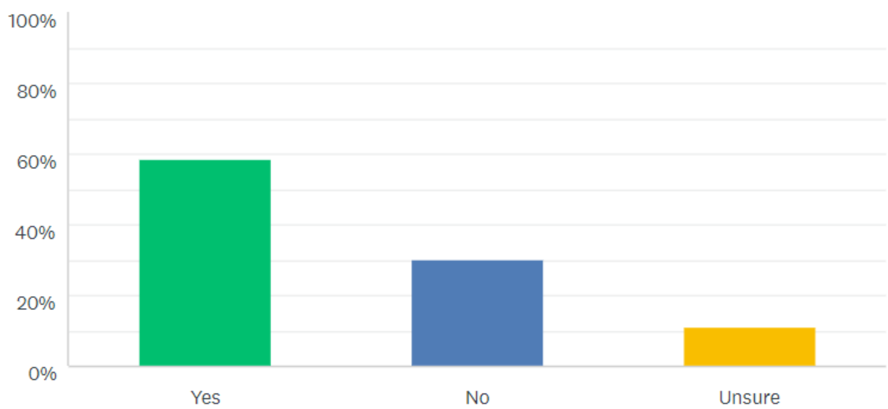


It's logical and expected that people generally accept super is for spending in retirement but less of their total assets will be consumed.

"I have an ethical preference to minimise consumption, and leave as much as possible to charity. While there is still so much poverty in the world, it seems not right that the well-off among the world live to maximise their own consumption."

"I expect at least that my home, unmortgaged and my super, will remain to support my wife and kids. It is not reasonable to expect to use up everything before one dies. The money all goes around anyway."

Q4 Would you spend more in retirement if you knew you would never run out of money?



Our previous article quoted research that people would spend more if they knew their money would never run out, and it is one reason the Government is encouraging the development of retirement income products. Again, these results will encourage the Government. About 59% would spend more which confirms their view that some people are living frugally as they are unsure how long their savings will last.

Some respondents thought this was a silly question, assuming that **of course** people would spend more if they knew they would never run out of money. But that is assuming a certain type of behaviour. Plenty of retirees have enough income to live on and do not want to spend more, while many will leave money to their kids. The question is not intended to test whether people would rush out to buy a Ferrari and take a first-class world cruise if they knew they would not run out of money.

"I spend what I need to spend and that should be sufficient for the government, leave me alone let me die in peace when it is my time and what is left can be used by my offspring."

"I'm too old to get much pleasure from big spending. I am fortunate in being able to spend what I want; but I am not extravagant, and expect to die with more assets than I have now.(I am 85 yo)."

"I doubt if I will run out of money. I could spend more but want to leave something for my children. I believe my children will have less than I have. They may not all own a house."

"Have saved all my life and wouldn't be able to change if it's within my power."

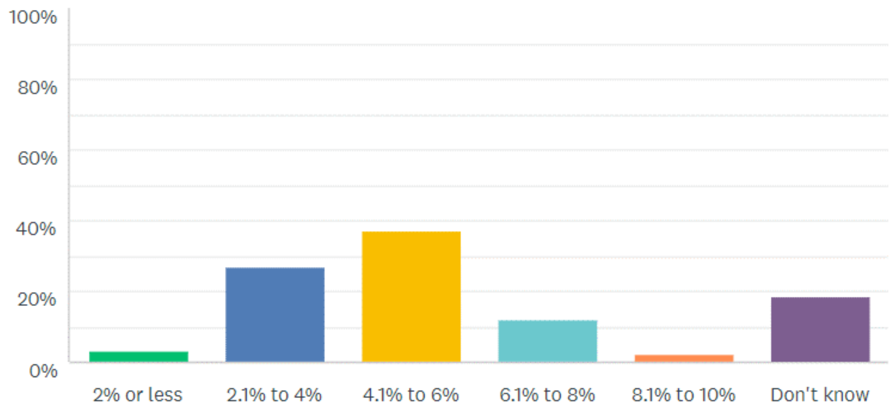
"My income is more than enough to cover my expenses."

"We come from humble beginnings, so v expensive cars, boats are not us - so there is no means to actually spend more if wise investments keep accumulating. Its then up to the next generation(s) to be wise or spend or

have a balance. "That's a no-brainer!! Seriously I probably would not. I have lived a comfortable but value focussed life & that will not change. I buy what I want, travel where I want & what is left each year I give to the kids!"

"I am happy with my life, why spend more than I need to. Spending more does not buy more happiness."

Q5 If someone is 60 years old with a life expectancy of 90, what is a safe annual withdrawal rate to never run out of retirement savings?

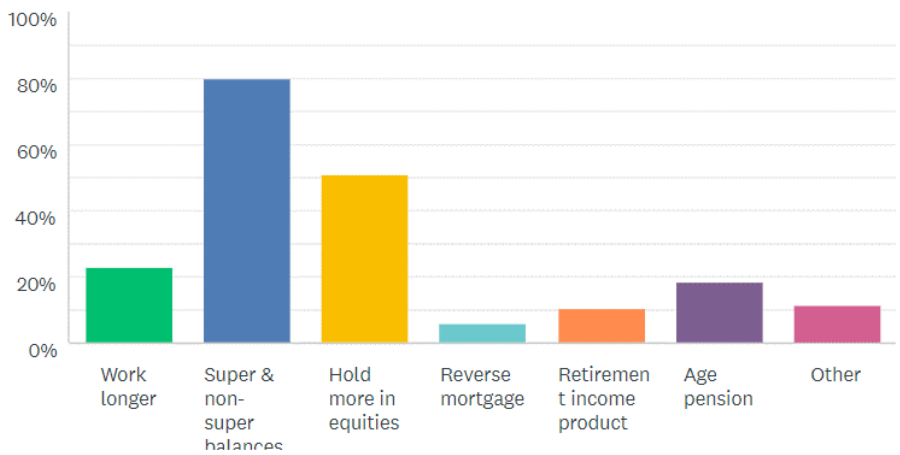


Safe withdrawal rates are hotly debated in the industry and academia, but the most popular in this survey was in the range of 4.1% and 6%. Of course, there are many assumptions in this question and we left it very broad. The sum of responses over 4.1% was 51% so there is a fair amount of optimism that growth assets will continue to deliver, because money would run out over 30 years if invested in term deposits at 1%.

"The government has only itself to blame. In today's zero-interest-rate environment, where you can't safely earn enough to keep pace with inflation, you can hardly blame pensioners for being overly cautious about spending and drawing down their assets."

"Don't care, the strategy of focusing on income in a combination of age pension and dividends plus franking to provide all my required spending without capital withdrawal is a far better option."

Q6 How will you generate money to live on after age 65? (multiple answers allowed)



The most obvious and popular answer which scored 80% is drawing down on super and non-super, and reflecting the wealthier people who read Firstlinks, only 19% expect to go on the age pension. Our audience also expects little use of reverse mortgages for themselves (although in question 1, they supported others using reverse mortgages). Half of respondents indicate a switch from term deposits (and similar) to equities to generate income.

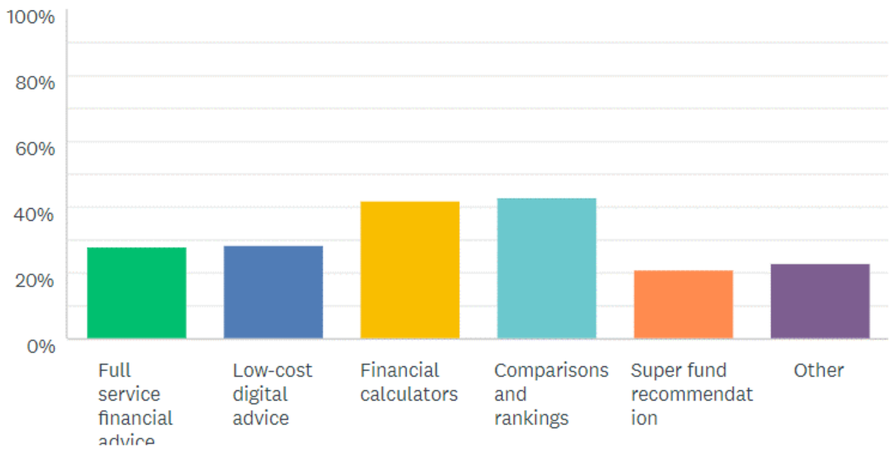
"I'd work if a suitable job could be found."

"Already retired - having to move up the risk curve significantly to retain income. Almost no TD's now."

"I'm ex fund manager, ex VC/PE so we tend to get higher returns, the key being not to be a slave time wise to finding or helping such investments."

Q7 Which of the following might you use in selecting your retirement strategy, if they offered good functionality? (multiple answers allowed)

Many different products are likely to be used as people plan their retirement strategies, although less than 30% of responses nominated full-service advice if the cost was about 1% of the asset value (which is a typical level). Cheaper digital advice gained similar support. The most appealing choices were online calculators and comparison tools at over 40% each, and a decent 21% would consider a product recommendation from their super fund.



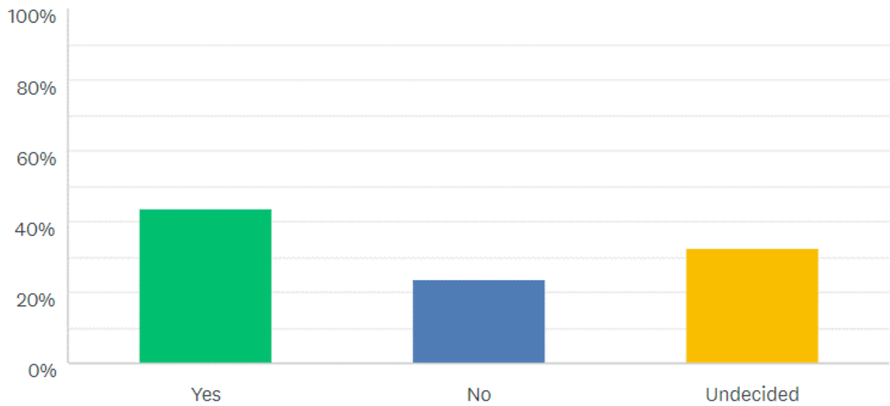
"Have learnt to invest through self education."

"My own bloody spread sheet!!"

"Full service advice at a fixed fee rather than a percentage. Like going to a lawyer or accountant. You pay for what you need when you need it. The best step that could be made in the interest of consumers is to stop the annual fee on a percentage of funds service or at least develop the alternative mentioned above."

"I like to invest directly in equity (with diversification) and do so through an online broker. Since my goal is to leave as much of my wealth as possible to charity, I have an investment horizon that extends beyond my own life time."

Q8 Do you plan to leave an amount available to buy a place in an aged-care facility?



This response was also higher than I expected, indicating that a reason many people live less lavishly than their resources seem to allow is the uncertainty of the final cost of an aged care place. A strong 44% of respondents plan to leave an amount aside and only 24% will not, although the undecided is a high 33%. Many of the comments on this question were highly personal.

"I hope for the fate like my mother. Wake up in the morning take five paces and drop dead."

"An important question. Recent experience with relatives indicates a lump sum of $500 K to $1Mill to secure a good to high standard of care. This is a very substantial amount for most."

Q9 Any other comments on retirement income, intergenerational inequity, superannuation policies, etc?

With over 400 comments on this question alone, it is impossible to do them justice here. See the attached paper for a full list, lots of great ideas.

Thanks to everyone who participated.

Graham Hand is Managing Editor of Firstlinks. The Reader Survey was open from 5 August to 12 August 2021.

Six COVID opportunist stocks prospering in adversity

Ned Bell

Last year was a tough year for global earnings. The pandemic shook up stock markets, with large earnings drawdowns across the world. In particular, global small and mid-cap (SMID) stocks were hit hard, with earnings falling by more than 50% in 2020.

This year, we are seeing strong recoveries in revenue and earnings as economic growth picks up and pandemic concerns subside. Small and mid-cap stocks are well placed to see a strong rebound, similar to what we saw after the 'dot-com' and GFC market drawdowns.

However, the upgrade cycle for global SMID cap companies still looks to have a long way to play out.

Within the SMID cap sector, we see several high-quality companies that have emerged even stronger since the onset of COVID and are well placed for outperformance. We call these the 'COVID Opportunists'.

This article will delve into these companies and look at why they are dominating their industries and the global SMID cap market for investors.

The strong getting stronger

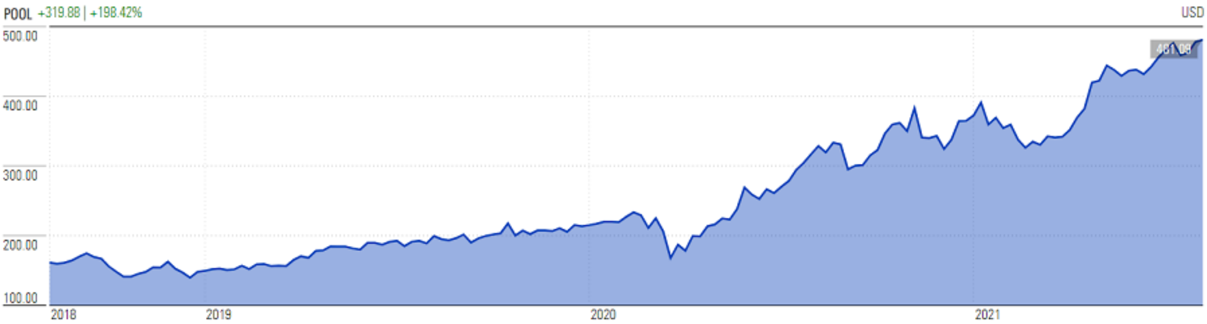
In a year where earnings fell by half for the broader SMID basket, the below six companies which are currently held in our Global SMID portfolios managed to grow revenue by over 15% and earnings by over 30%, on average.

These COVID Opportunists took advantage of the environment to build on their already strong franchises. Their earnings are driven by strong underlying franchises and not just economics. They are less cyclical than many other companies in the market. They have deployed capital well with high sales and exceptional earnings growth.

Here is a selection of 6 global SMID caps and why we believe will keep getting stronger:

1. Pool Corp

The world's largest wholesale distributor of swimming pool supplies, equipment, and related products, Pool Corp operates about 400 service centres throughout the Americas, Europe, and Australia and serves some 120,000 wholesale customers. The company is 20 times larger than its nearest competitor and enjoys huge network advantages.



Source: Morningstar as at 9 August 2021.

Unlike a lot of distributor businesses that rely on M&A, Pool Corp is mainly an organic growth story and management has a proven track record of delivering solid organic growth (6-8%) and exceptional shareholder returns.

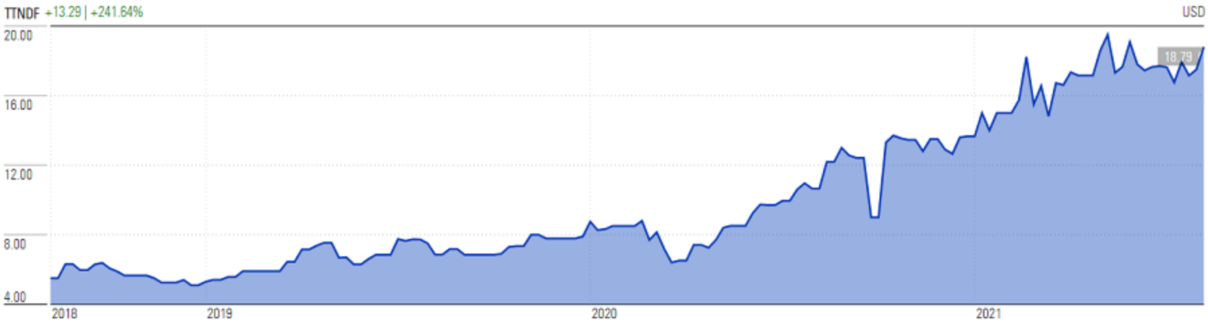
Pool Corp benefited from consumers being at home and more pool usage during COVID, boosting its maintenance revenue (60% of total revenue). Families chose to invest in backyard pools and outdoor living which benefitted the company with revenue from refurb and remodelling (25% of total revenue). New construction activity (15% of total revenue) is picking up along with the strong housing market in the US.

The company's strong backlog combined with favourable end market conditions, give us confidence that solid growth will continue.

2. Techtronic Industries

Techtronic Industries is a cordless power tool provider with leading market share in both consumer and commercial markets with brands including Hoover, AEG, Ryobi and Milwaukee.

It has seen seven consecutive years of 20%+ growth in the Milwaukee brand, driven by strong new product launches, especially heavy-duty tools in professional end markets, and more widely, one-third of its revenue is driven by new products.

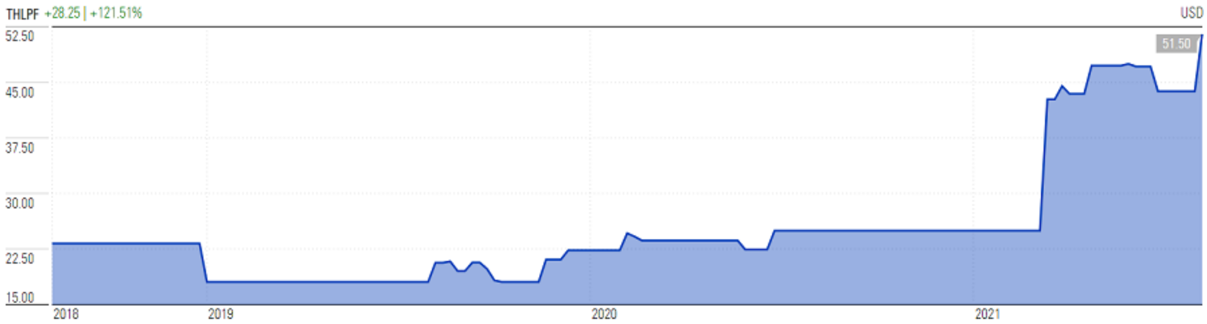


Source: Morningstar as at 9 August 2021.

While the company benefited massively from people working from home during COVID, we believe in a robust growth trajectory for the stock post COVID through the recovery in the commercial market, as well as accelerating market share gains.

3. Thule

A Swedish business and a global leader in bicycle racks, roof boxes, and cargo carriers, Thule benefitted from COVID through staycations and an upward tick in biking. It is expanding into related outdoor leisure markets using the strength of the Thule brand name.



Source: Morningstar, as at 9 August 2021.

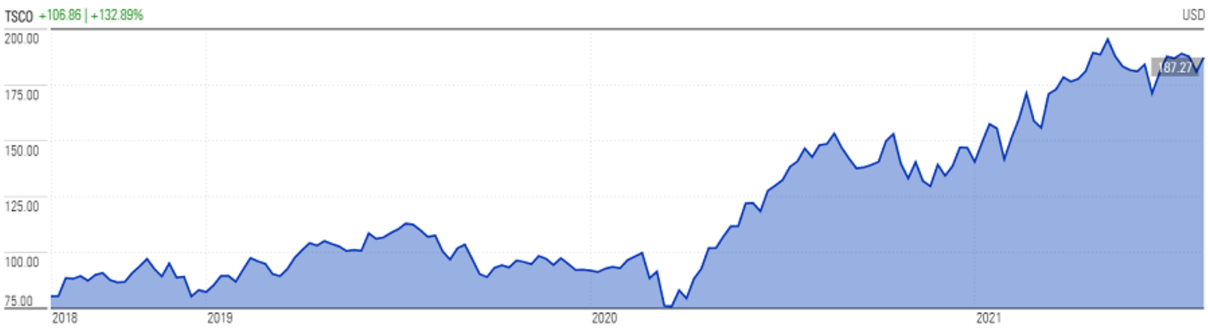
The staycation trend has a long way to play and ongoing supply chain constraints in bikes and RV related categories will help to extend the brand strength seen during COVID for more years to come.

4. Tractor Supply

Tractor Supply is the largest retail farm and ranch store chain in the US with over 1,900 stores in 49 states. It thrived in the face of adversity. The business picked up 9 million new customers in 2020 and those customers keep coming back.

Its US customer base has an average income above the US national average income and cost of living that is below national average, providing more disposable income.

As a business, Tractor Supply benefits from little competition, strong management with exceptional track record of execution, high visibility in unit growth and continued initiatives to drive margins higher.

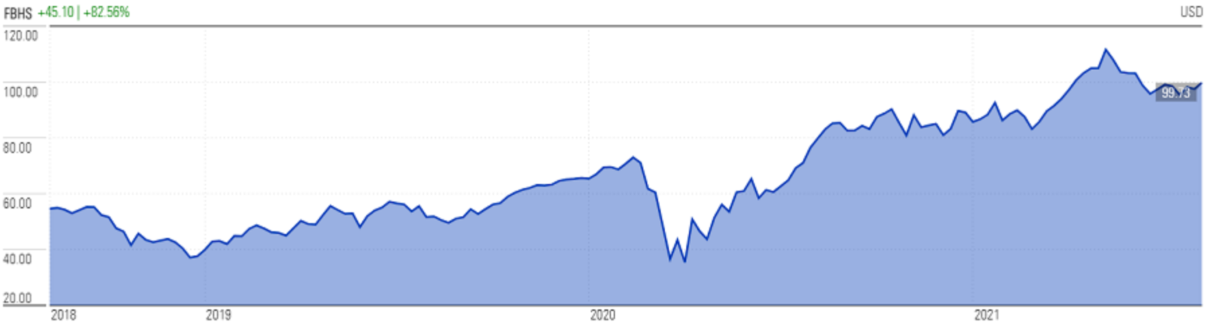


Source: Morningstar, as at 9 August 2021.

5. Fortune Brands Home & Security (FBHS)

FBHS produces a range of home improvement products including cabinets, doors, locks, decking, fencing and plumbing solutions.

FBHS has benefitted from consumers being in lockdown and choosing home improvements and DIY in place of travel. Looking forward, we believe there is a strong under-appreciated housing recovery underway in the US over the next few years, and FBHS is well placed to benefit from this.



Source: Morningstar, as at 9 August 2021.

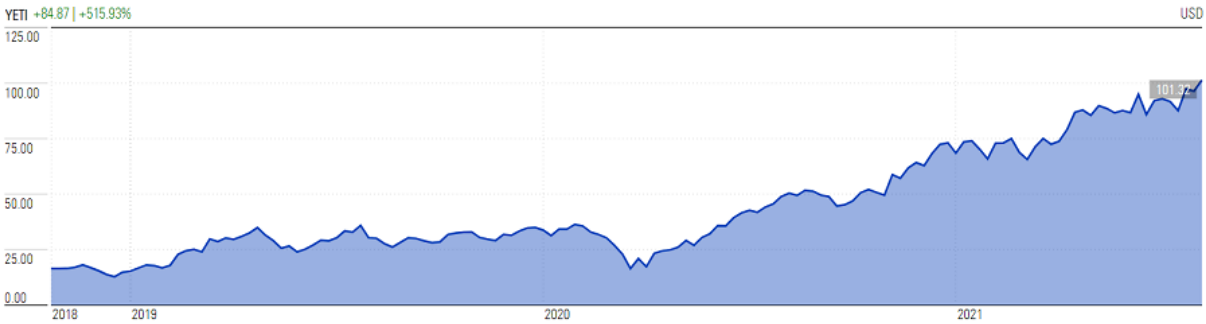
With a strong macro backdrop, good opportunity to expand margins, and upside from successful capital deployment, we see good upside to earnings over the next few years, which does not look to be accounted for in the current valuation.

6. Yeti

Yeti Holdings designs, markets, and distributes branded products for the outdoor and recreation markets, including drinkware, coolers, bags and apparel.

Demand for Yeti's products was incredibly strong during the COVID period. US consumers spent more discretionary dollars on 'outdoor living' and this trend is continuing as lockdowns persist and US consumers decide to have more localised and outdoor type holidays.

Yeti has also benefited from a very strong online presence and loyalty program, with sales through its direct channel (both Yeti.com and Amazon), growing by 46% in FY20, reaching close to 60% of total company sales.



Source: Morningstar, as at 9 August 2021.

International (outside US) markets provide an excellent long-term growth opportunity for Yeti. In 1Q21, international sales grew over 100% y/y but still make up less than 10% of total company sales.

Yeti generates gross margins over 50%, strong ROE and positive free cash flow despite still being early on in its expansion phase. We see good upside to earnings for many years to come.

Looking ahead

While the backdrop for global markets remains supportive for a strong earnings recovery, we should expect volatility as global corporates deal with a range of external risk factors such as new COVID variants, supply chain issues, cost inflation and the risk of rising interest rates from current depressed levels.

In this environment, it is important to focus on the underlying fundamentals of companies and invest in the names that are well placed to handle any external disruptions. There are many high quality global SMID companies that should emerge even stronger in a post COVID world.

Ned Bell is Chief Investment Officer and Portfolio Manager at [Bell Asset Management](), a Channel Capital partner. Channel Capital is a sponsor of Firstlinks. This information is not advice or a recommendation in relation to purchasing or selling particular assets. It does not take into account particular investment objectives or needs.

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Five megatrends driving the Liquorice Allsorts of real estate

James Maydew

Urban Dictionary describes 'Liquorice Allsorts' as something that has many different varieties and assortments. It is a perfect description of the alternative real estate sector that continues to grow in importance as investors adapt to its uniqueness. We take a look inside the box to see what shapes and flavours are on offer in the real estate universe.

How real estate is evolving

Let's first take a history lesson on market evolution to date as many investors are yet to implement this evolution in their real estate exposure. History shows that investors who ignore evolving trends are doomed to holding portfolios dominated by yesterday's heroes.

The top five names of the 1980s – IBM, Exxon, General Electric, AT&T and General Motors – are nowhere to be seen at the top of the S&P500 today, replaced by the likes of Apple, Microsoft, Facebook and Google.

Investors that ignored the evolution of the economy and the rise of industries, such as Big Tech, would have been left holding companies in relative decline.

Why should it be different in real estate? It's not.

Today, Australian real estate investment is dominated by the same types of assets that have informed asset allocation decision-making in super funds for decades. Using unlisted property exposure as a proxy for institutional ownership, it's clear that office and retail leads allocations in unlisted real estate funds among Australian institutional investors. Industrial property (growing fast) makes up much of the rest.

Forward-thinking investors have been recalibrating their portfolios and we believe there remains a long runway from here.

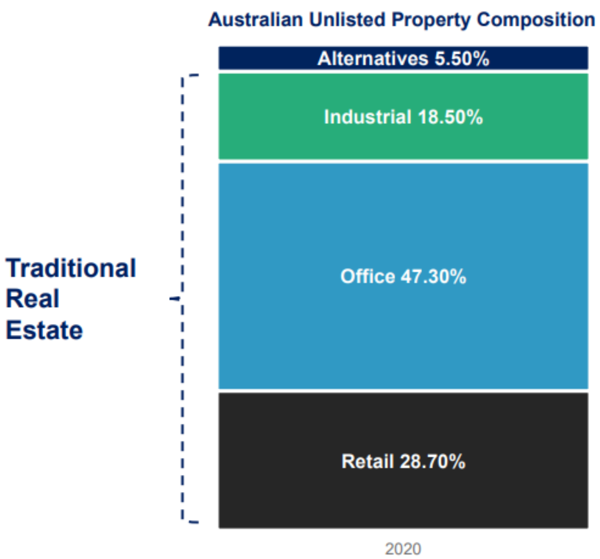
They are watching the changes that occur in the economy, in particular the evolution of technology, generational and demographics trends, and relating this to the underlying real estate demand.

The emerging asset class of alternative real estate will define the property industry over coming decades as both fast and slow-moving global trends, including the continued dependency on technology, advances in healthcare and an ageing population, combine to create sweeping demand shifts on the property industry.

What is alternative real estate and where does it fit?

There is no universally agreed definition of alternative real estate, except that it sits in the other bucket that is not traditional real estate of office, retail and industrial.

By using the slogans of some of the biggest commercial landlords in the world and also adding our own twist, alternative real estate can be summed up by this five-word summary: beds, sheds, meds, bytes and life.



Source: Real Investment Analytics. As at 31 December 2020

Simply put, this means the cohort comprises:

1) shelter such as build-to-rent and student housing (beds)
2) logistics including last mile – not strictly alternative but it has most certainly evolved from what the demand/supply dynamics of industrial once were (sheds)
3) healthcare, aged care and life sciences (meds)
4) data centres and telecommunications (bytes), and
5) property assets servicing changing consumer needs which are 'everyday life' in nature, including self-storage, agriculture and childcare (life).

It's a Liquorice Allsorts of assets but it is growing rapidly, driven by unstoppable underlying economic and societal forces.

In the US, alternative real estate assets already dominate portfolio allocations making up 55% of the REIT index composition. We believe Australia, NZ, Europe and the UK remain at the early phase of this powerful real estate evolution, with Asia not likely far behind.

Blockbuster vs Netflix

Not so long ago, the only way to watch a movie at home was to rent a hard copy on video tape from a local retail store. In 2004, the US leader in movie rental was Blockbuster, a household name with more than 5,600 physical shops across the nation's strip malls and main streets. Effectively, the retail sector had a lucrative monopoly on movie rentals.

Fast forward to today and Blockbuster has one just store remaining open globally, stubbornly clinging on as a nostalgic memory of a different time.

The difference, of course, was technology harnessed by Netflix, which started with mail order DVDs and rapidly built a market-leading streaming service. The underlying story is technology and the disruptive real estate that facilitated the change.

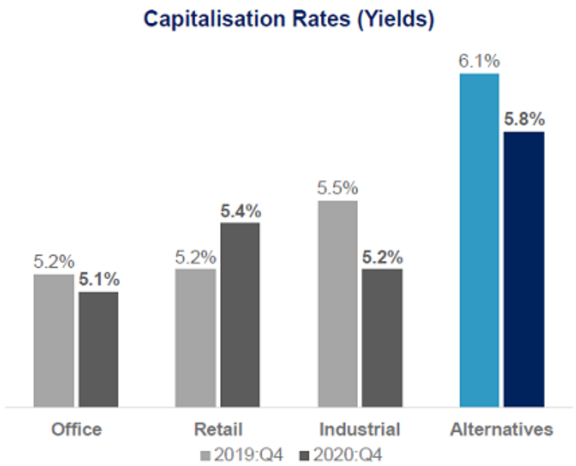
Datacentres and, more recently telecom towers, offer two key examples of alternative real estate assets that dominate the US listed markets.

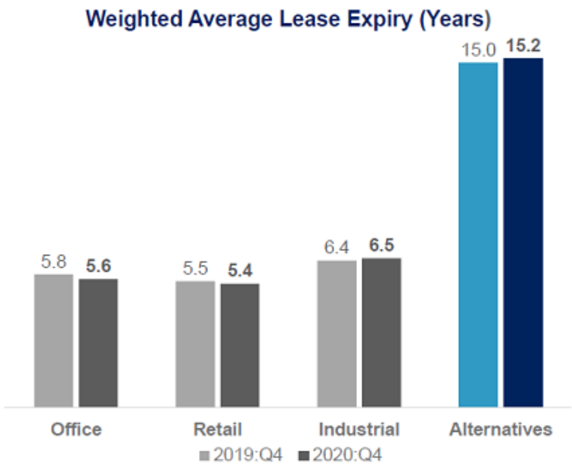
A dormant giant in Australia

Alternative real estate might only be a small part of the property industry in Australia today but on fundamentals it looks like a dormant giant.

Real estate investment is fundamentally a question of the interplay between supply and demand along with the contractual lease terms between landlord and tenant. Alternative real estate offers a higher yield than traditional real estate sectors, which means on average, investors are earning a greater spread over the risk-free rate.

At the same time, investors also enjoy considerably longer lease terms on average in alternatives, helping confidence in the security of cashflow.





Source: Real Investment Analytics. As at 31 December 2020

The mega trends

We believe five megatrends are driving the growth of alternative real estate.

1. Technology

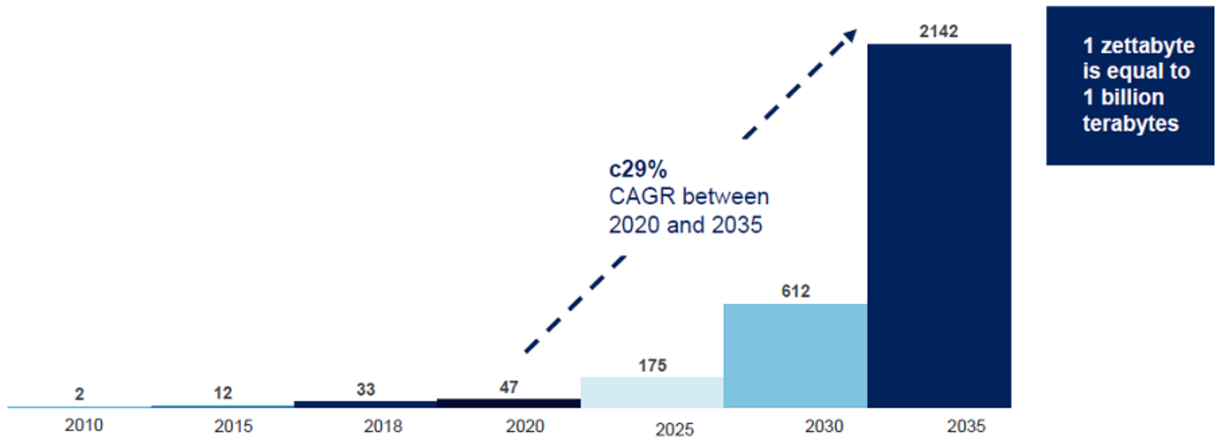
Technology, specifically data, is being referenced as the fourth industrial revolution. The growth numbers in this segment of the economy are mind blowing. Here's a download of some stats:

- There will be 1 trillion devices connected to the internet by 2030
- By 2023, mobile phone users will have downloaded 299 billion apps
- Between 2020 and 2023, business will invest an estimated US$6.8 trillion in digital transformation.

This digital economy creates immense economic value. Artificial Intelligence and 5G networks will make up an estimated $13 trillion contribution each to the global economy by 2030 and 2035, respectively.

But the continued growth of technology also creates another form of value – data. Internet traffic is forecast to hit 7.2 petabytes per second at peak times by next year. To put that into perspective, that's five times higher than 2017 and equivalent to nearly 2 million movies being uploaded and downloaded every second.

Actual and forecast amount of data created worldwide 2010-2035 (in zettabytes)



Source: Statista Digital Economy Compass 2019

This data needs to be stored securely and accessible with minimal latency from somewhere and that need is fuelling the growth of data centre real estate demand. A widely used line is "data is the oil of the 21st century". If that's accurate, our question is who will be the John D Rockefeller of data?

2. Demographics

The world is experiencing a rapidly ageing population. Dubbed the 'Silver Tsunami', the number of individuals aged 60 years and above will double by 2050. In the US, 10,000 people will turn 65 every day – a statistic that will hold true every day through to 2030, filling the MCG every 10 days.

As people age, their needs change, driving demand for aged care, healthcare and hospitals and retirement living. Of particular interest in this sector is the growth of the manufactured housing sector.

Manufactured housing is a way to build retirement and lifestyle communities that offer more space and lower prices than traditional housing, specifically designed to come with community and lifestyle benefits for an ageing cohort. They are modern, low maintenance homes often in resort-style settings with swimming pools, tennis courts, bowling greens and even marina berths, all at a lower price point than a standard rental dwelling.

3. Life science

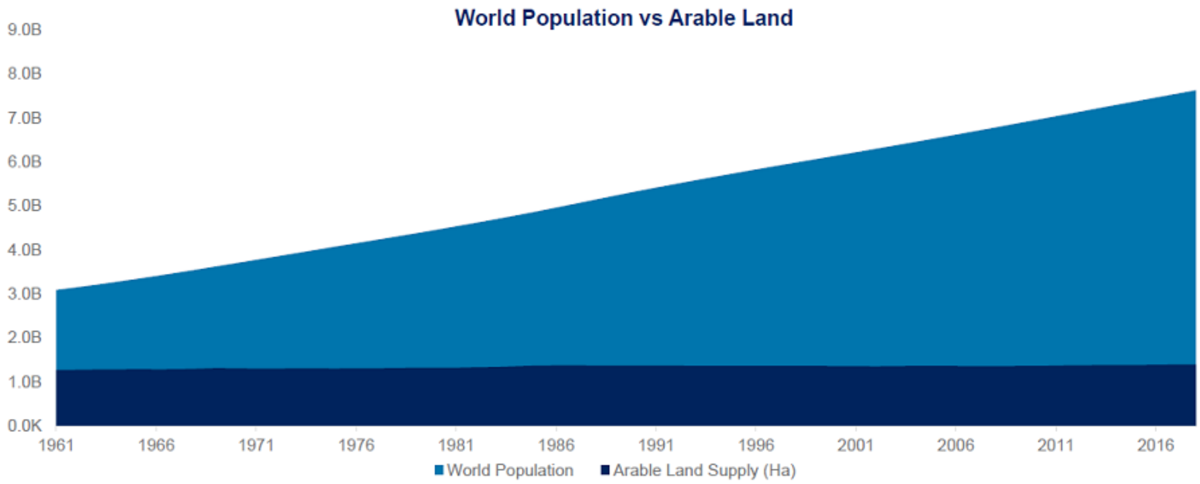
The ageing population, a renewed focus on fighting global disease and an increasingly health aware society is also driving the opportunity for alternative real estate assets in the life sciences, which aims to treat disease, extend life expectancy and improve human health outcomes.

The life science market has been at the forefront of all our minds recently as the industry races to solve the COVID-19 pandemic. We are proud to be invested in companies that provide the space for the firms developing the most promising COVID vaccines like Pfizer, Moderna and Johnson & Johnson.

But the opportunity in life sciences will last well beyond the current pandemic. Some 10,000 diseases plague humanity, of which approximately 500 have been addressed with medical treatments.

This creates an incredible runway of growth for the life sciences industry and underpins the real estate fundamentals of this alternative real estate asset class. Life science has been the real estate market darling in the US for many years and is growing fast in Europe and the UK, with a growing interest here in Australia.

4. Food security



Source: Food and Agriculture Organization of the United Nations, OECD Stat. As at 30 June 2021.

Since 1961, the global population has more than doubled. Arable land, i.e. land that can be used for agricultural purposes, has remained relatively fixed, however, the water used to irrigate these lands have become scarce.

This has significant implications for farmers as relatively fixed land supply, dearer water and a growing demand for various foods has meant a requirement to do more with less. As a result, Australian farmer productivity and efficiency has had to increase substantially to meet a hungry global economy.

Additionally, water markets have had to advance to create greater efficiencies and ensure farming operators have the water necessary to effectively irrigate their crops; the onset of the water entitlement market in Australia has supported this and means operators can buy perpetual rights to an exclusive share of a water resource they need.

A real example of these trends can be seen in the cattle industry. Meat consumption over the last 20 years has more than doubled. Efficiencies in Australian cattle operations have had to increase substantially as a result and, because of these productivity increases, the value of agricultural land has benefited tremendously.

Farmland values have increased some 12.9% over the last year and 10.6%(CAGR) over the last five years, reflecting a willingness by farmers to pay more for productive farming operations.

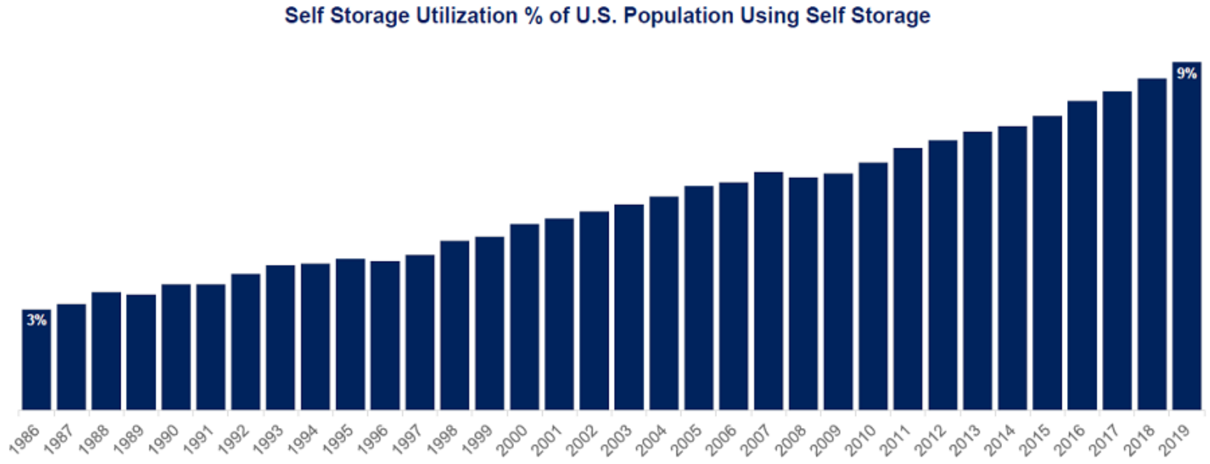
With its competitive advantages in operations of cattle, nuts, vineyards and other cropping areas, Australia is well placed.

5. Everyday life

Alternative real estate assets are also benefiting from changes in everyday life in the western world, including rising demand for child-care and rental housing. However, we believe the standout opportunity in this space is self-storage.

The idea that households or small business might need somewhere to store their excess possessions and inventory is a relatively new phenomenon, but it is being driven by four seemingly unstoppable secular trends known as the 'dreaded four D's' – death, divorce, downsizing and dislocation.

These life events mean the self-storage industry is somewhat insulated from certain economic cycles. It also benefits from its historical fragmentation, allowing larger players to buy smaller operators at reasonable prices and improve the efficiency of returns by introducing better technology to optimise operations.



Source: Public Storage Investor Day, May 2021.

How do you use real estate today and how different is that to yesterday?

The societal and economic trends sweeping the world are a reminder of how the real estate market is evolving. These trends impact all aspects of our lives and real estate is no different. It must grow and change in response to the needs of society.

These are exciting times for listed real estate which not only offers exposure to these underlying trends but does so in a way that offers liquidity for investors with assets that are traded on public stock markets five days a week around the world.

Alternative real estate has come to dominate REITs in the US. Will the 'Liquorice Allsorts' box of opportunity do the same in Australia?

James Maydew is Head of Global Listed Real Estate at AMP Capital, a sponsor of Firstlinks. This article has been prepared for the purpose of providing general information, without taking account of any particular investor's objectives, financial situation or needs. For a list of sources and important disclaimer information, see the here.

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Bonds yields up, shares up … or is it shares down?

Warren Bird

The world's bond markets and stock markets not only attract vast sums of money, but also a lot of financial commentary in newsletters and newspapers.

In many of those commentaries, there's a presumption that both bonds and stocks should always trade in an overtly consistent and predictable manner – stronger economic growth means higher yields and higher share prices, while slower growth means the opposite.

When this doesn't happen, analysts often fall over themselves to argue that one market is 'right' and that investors in the other should be paying more attention. Even without the overlay of a titanic clash, analysts are prone to discuss contrary price action in the markets as if they're responding with different mindsets.

I saw an example of this recently in the Australian Financial Review. It was an article mostly about US bond yields, which were said to be falling because of concerns that COVID and expected tighter policy were combining to reduce the economic growth outlook. However, it finished with the following statement:

"Equity markets appear decidedly more upbeat than the bond market … The S&P 500 reclaimed a record high on Monday and the S&P/ASX 200 Index hit a fresh peak on Tuesday."

However, bonds and shares are two very different asset classes, so why should they trade in a correlated fashion? Standard portfolio optimisation theory relies on different asset classes being uncorrelated, otherwise the eggs aren't being placed in different baskets.

What's going on here?

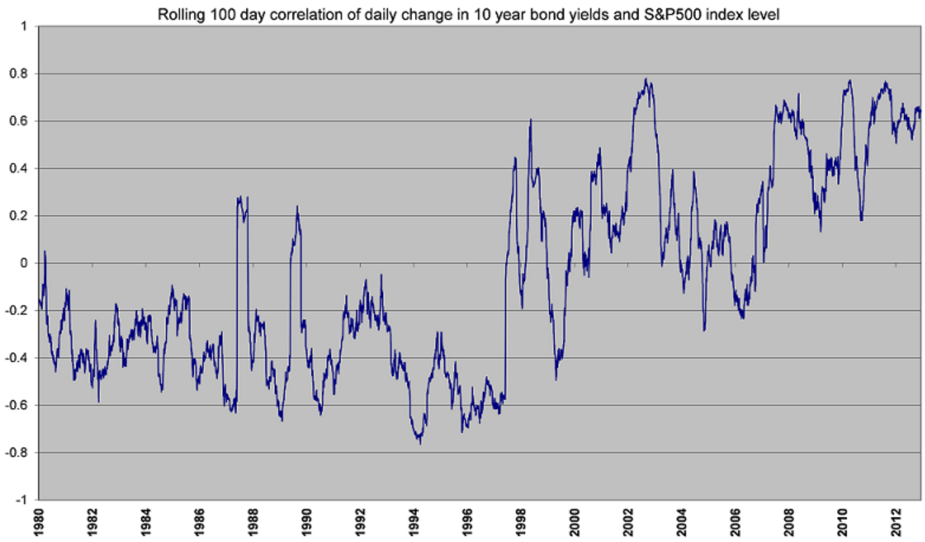
Correlation history

A clue can be found in the history of the correlation between these markets. From here on I'm focused on the US which dominates daily trading in all markets.

In recent history, we find that there has actually tended to be a positive correlation. That is, yields and stock prices move together in the same direction.

The following chart shows the rolling 100-day correlation of daily changes in 10-year US Treasury yields and the S&P500 index since 1980. Clearly, for just over half of the last 40 years, the correlation was negative. Then from 1998 until 2007, the correlation fluctuated quite markedly perhaps with a slight positive bias but nothing significant.

Since 2007, however, the correlation has been positive and, to be honest, that makes it look like the last four decades can be split in half – 20 years of negative correlation then a shift to generally positive for the last 20 years. That's certainly sufficient evidence to convince a lot of people that, right now, stocks and bonds should be expected to trade in the same direction most of the time.



Source: Bloomberg, Federal Reserve Bank of St Louis

However, I suggest that just because there's been a positive correlation so far in the 21st century, that doesn't mean that it's going to stay that way.

Taking a longer-term view shows that the recent period is actually a rarity. In an excellent paper written in 2014, Ewan Rankin and Muhummed Shah Idil of the Reserve Bank of Australia studied "A Century of Stock-Bond Correlations". They demonstrated that the short-term correlation between US stock and bond markets has always fluctuated considerably but has mostly been negative during the past 100 years.

The main exceptions were during recessions, when bond yields and share prices both fell, thus creating a positive correlation. It's only since the GFC that this positive correlation has been evident for a prolonged period and they concluded that the current experience reflects the severe impact of the GFC on the uncertainty that surrounds expectations for economic growth.

That is, the market is behaving as if we're in a recession, even when growth has been positive.

It's not a battle! Nature of the two asset classes

Even so, it's incorrect to depict periods when the markets move in different directions as meaning that traders in one market have it 'right' and those in the other are 'wrong'. It's not a battle!

In reality, both bonds and shares are always responding to the same set of information in an appropriate way for the time, circumstances and nature of the asset class. Every time during my career that I've looked into what's going on there's usually a perfectly good explanation about why two different asset classes 'seem' to be moving in conflicting directions. Not always a simple explanation, but a good one.

That explanation is usually found in the different inputs to the valuation of different asset classes. Bonds have fixed income for a limited period of time, whereas shares are perpetual cash flow entities.

Bonds thus respond to changes in macroeconomic trends and central bank policy settings in a consistent manner: stronger growth = tighter policy = higher yields, and vice versa. Note, however, that even within the bond market, not all securities respond identically. The yield curve is not constant, as long-term and short-term bonds can respond to different degrees to the same cash rate change. The curve tends to steepen during periods of falling cash rates and flatten when policy is being tightened.

So if different bonds react differently, why should we expect a different asset class to behave itself?

Shares factor these same changes into their valuations in a more complex manner. Changing bond yields feed into the discount rate for valuing earnings, but unlike bonds the earnings of shares can also vary. So sometimes when bond yields are rising share prices will also rise because there’s a stronger economy driving better earnings growth, but sometimes shares will fall because of the higher discount rate.

There can also be other factors at play. Sometimes, stock markets might validly look at profit-enhancing micro trends when the bond market is looking at the macro consequences.

Finally, there can be timing differences because the behaviour of each market is part of the information that the other market needs to price in. The main players in bond markets are more closely watching short-term data trends and predicting the central bank's next move more closely than company analysts.

Once bond yields fall, then that is sometimes the signal to equity market participants to shift their behaviour too. But the bond market doesn't always get its central bank calls right, so stock market players have an appropriate natural wariness about reacting instantly to what the bond market is doing. And bond market traders need to respect the stock market’s direction as well.

Conclusion

The idea of a tussle between stocks and bonds is often used by analysts to create a story and to sound impressive. In reality, both markets are reacting to the world in their own way rather than being engaged in a struggle for supremacy.

When these markets move in different directions, it’s always worth digging a little deeper to understand the dynamic that’s playing out between what are two different types of assets. Both markets are usually ‘right’ (if there is such a thing) and I prefer to think of it as being more of a dance than a battle.

Warren Bird has 40 years experience in public service, business leadership and investment management. He currently serves as an Independent Member of the GESB Investment Committee and was, until recently, the Executive Director of Uniting Financial Services, one of Australia's oldest ethical and ESG fund managers. This article is general information.

It's the middle of reporting season: what's really happening?

Hugh Dive

For equity analysts and fund managers in Australia, Christmas comes twice a year, every February and August, when most Australian listed companies reveal their semi-annual profit results. Companies also guide what growth in profit, revenue, profit margins or dividends that shareholders can expect over the following financial year. However, Covid-19 has seen fewer companies commit to guidance given the uncertainty around lockdowns and the increase in class action lawsuits by litigation funders keen on profiting from negative deviations in company earnings.

This can be a stressful time for a fund manager. When companies reveal unpleasant surprises, the company's stock price tends to get sold down hard. Alternatively, it can be enjoyable when the company reports a good result that validates the investment case.

In this piece, we will go through how Atlas approaches each day during reporting season.

Firstlinks
a Morningstar company

Before reporting season

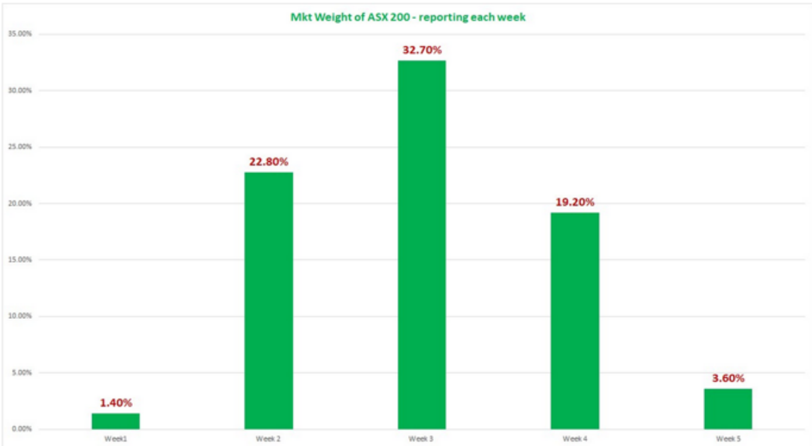
In the lead up to reporting season, Atlas reviews all the stocks in the portfolio and considers the key factors and financial metrics that investors will be looking for on results day. We compare our forecasts to the consensus analyst forecasts. We are trying to identify which companies are performing ahead of expectations and, more importantly, which companies have the potential to disappoint.

The spread over the month

Companies listed on the ASX with a June year-end have until the last day of August to release their financial results, otherwise, they are suspended from trading on 1 September. However, results are not released evenly throughout the month as companies tend to avoid reporting either in the first or last week of the month, preferring the middle weeks.

There are days when several large companies report on the same day and often at the same time, which often results in the market making swift and not well-considered decisions as to whether the result was either good or bad. Frequently we see a stock trading down on what Atlas considered to be a favourable result, only to see the company's share price recover the following day after investors have digested the financial reports.

This chart shows the distribution of results during the August reporting season, with the week starting 16 August being the heaviest. Wednesday 18 August 18 will be challenging for analysts with CSL, Coles, Dominos Pizza, Fletcher Building, Deterra, Santos, Supercheap Auto, Tabcorp, and Vicinity Centres reporting.



Source Coppo Report

On the day

Generally, companies post their financial results with the ASX around 9am. This gives investors an hour to digest the facts and figures before trading on the stock exchange begins at 10am.

During this period, we will be combing through the profit and loss, balance sheet and cash flow statements, comparing our forecasts to what the company actually delivered. It is also important to compare how a company has performed against their peer group. For example, in isolation, Coles report reporting a slight decline in sales and a steady profit margin could signal a great result if Woolworths and Metcash reported significant decreases in sales and shrinking profit margins.

Company management will then formally present their results to shareholders on a conference call or in-person during the morning, generally between 9 am and midday. These presentations are directed towards the institutional investment community and are effectively closed to the media and public, and can take between one and two hours.

The management team gives greater detail on the factors contributing to the profit result and explains any potentially contentious issues. The most informative part is always the question-and-answer session, which allows investors to gauge how confident management is in tackling the most controversial problems coming out of their financial accounts.

Typically, it will only be the sell-side (broker) analysts asking management questions, with the large institutional investors such as fund managers or super funds saving their questions for behind closed doors. The problem with this is that in addition to writing research, some sell-side analysts want to protect their relationship with the company and keep on its good side for future lucrative investment banking deals. Frustratingly this can sometimes see soft questions being served up for management or avoiding the hard questions when the management has made some mistakes.

After the presentation of the results, we will generally have a quick discussion to see if there have been any fundamental changes to our thoughts and discuss the market reaction. The immediate market reaction can often be misleading, as most of the trading on results day is done by hedge funds or high-frequency traders rather than long-term fundamental investors.

Lunch with the company

Before Covid-19, one of the benefits of being a good client of one of the investment banks was the opportunity to have lunch with the company management team, though there have been few of these events since 2019. These events were formerly held in the bank's boardroom and are fully catered events, though it is rare to see anybody accepting a glass of wine with their steak or fish. Many fine bottles of wine from the cellars of the investment banks get opened, offered around the table by waiters and then returned to the sideboard with one glass poured out. Analysts are genuinely concentrating on what is said.

Whilst this may seem to offer institutional investors an advantage over retail investors, new insights are rarely gained in these events. They are essentially a group meeting of rivals trying to understand what others think about the company. Further, if you know the company well or have a particularly insightful question, an analyst will save that for a one-on-one meeting with the company.

Often several large and complicated companies report on the same day, so unless an individual company has had a particularly good or bad result, it is poor time management to spend 1.5 hours over lunch picking through the financial accounts of a company that has performed as expected.

Immediately afterwards

Over the following week, the company will then organise individual one-hour meetings with their largest institutional shareholders both in Australia and overseas. Before these meetings, it is essential to be well prepared, as this is frequently the best forum to understand whether you should buy more of a company's stock or completely sell out.

During our meetings with the management teams, we will generally seek clarity (on behalf of our investors) on specific issues that we feel weren't covered to our satisfaction at the formal presentation. While some of these meetings can be quite hostile or very friendly, they are a valuable forum for both parties to give feedback on how our client's capital has been managed in the past and how that capital should be employed in the future.

I have been in these meetings where management has raised a potential strategy that seemed aggressive and quite alarming. In one case, I left a meeting with management to immediately begin selling down the fund's position after it became clear that the company's prospects in question were grimmer than they indicated on the prior call.

After the management meetings and subsequent to reviewing the financial results of a company's competitors, Atlas is then in a position to determine what changes (if any) are made to our valuation of the company and whether the security's weight in the portfolio is still appropriate in light of competing investment opportunities.

Hugh Dive is Chief Investment Officer of Atlas Funds Management. This article is for general information only and does not consider the circumstances of any investor.

'Do nothing' is good financial advice worth paying for

Rodney Horin

The Financial Services Royal Commission, which made headlines in the financial media two-and-a-half years ago, rightfully castigated many financial institutions that were charging clients ‘fees for no service’. In other words, they had failed to deliver services to clients despite charging fees for those services.

Do nothing is often the best strategy

Financial advisers today face a similar and not-unrelated conundrum of convincing ASIC that advice to ‘do nothing’, or maintain a current positioning in the market, is indeed valuable advice, often more valuable than telling clients to buy or sell shares.

Many clients understand that ‘stay the course with your current portfolio’ is advice worth paying for, but some do not. ‘How’, they argue, ‘is telling me to do nothing good advice? I’m already doing that. I don’t want to pay ongoing fees on a portfolio that doesn’t change.’

What such people fail to realise is that many of the world's great fortunes have been made by investors who undertook thorough research (or took advice from an advisor) before investing for the long-term in companies with consistent earnings growth and good management, and then riding for years the resulting increase in share prices, ideally receiving some dividends along the way.

Charging a fee as a percentage of funds under management is now the most common way that advisers charge clients. It allows advisers to be completely objective, aligning the advisers' interests with the clients' interests. The old brokerage model, where advisers were paid only when clients bought or sold shares, did not align those interests.

Advisers who transact for a living – earning brokerage only when their clients trade shares – are outdated and ethically questionable. The days of 'churning' shares to maximise brokerage are well and truly over.

Holding and patience comes with rewards

One of the world's greatest investors, Berkshire Hathaway's Warren Buffett, is fond of saying: '*Our favorite holding period is forever.'*

Early investors in Apple, Microsoft, Google and Amazon who resisted the temptation to sell during difficult times or during market dips have made once-in-a-century fortunes. Those who sold out early and never bought back in can only look on with wonder and regret.

In Australia, there are similar case studies. CSL listed on the ASX in 1994 at (adjusted for the 3:1 share split in 017) 76c per share. The share price hit $16 in October 2001 before falling below $4 in April 2003. Pity the investors who sold out then (admittedly making more than five times their money), then missed out on the subsequent share price appreciation from $4 to $300. Commonwealth Bank listed in 1991 at $5.38 a share; its share price today is around $100, and it still yields 2.5%.

The sharemarket gyrations during the pandemic are another interesting case study. Investors who panicked and sold in March last year have missed out on one of the great rallies in the All-Ordinaries Index – from 5,006 on 24 March 2020 to 7,600 today, a rise of more than 50%.

One of the great challenges faced by advisers is convincing clients that they do not need to transact regularly to maximise portfolio performance. Many retirees in particular have too much time on their hands and don't know how or when to sit on their hands. Those who insist on trading shares should set aside a small part of their portfolio to satisfy the itch. Investors who trade in shares are generally too quick to take profits, and too prepared to let their losses run.

Royal Commission was counterproductive in some ways

Following the Royal Commission fee payment regulations for stockbrokers and advisers and their retail clients in many ways work against the 'long-term investment' approach. Advisers must send to all retail clients who pay ongoing fees an annual Fee Disclosure Statement which outlines:

- fees paid by the client in the previous year (in dollar amounts, not percentages)
- services actually received by the client, and
- services that the client was entitled to receive.

The advice 'Maintaining your current portfolio' may appear a little weak on a Fee Disclosure Statement, despite the fact that most advisers provide many other things including advising on corporate actions, forwarding research notes, having regular market discussions and providing warning on potential company concerns.

The obligations have become so onerous that some advisers have decided that they can no longer act for retail clients because they cannot satisfy the regulations, choosing to deal only with wholesale/sophisticated investors, for whom disclosure obligations are far less onerous.

The disclosure pendulum – introduced to protect retail clients from unscrupulous advisors – has arguably gone too far, and has hurt many retail investors.

These retail investors fall short of satisfying the requirements of being classified as wholesale/sophisticated investors and do not wish to be invested into model portfolios or managed funds. They wish to seek advice, digest it and make their own decisions. These are 'self-directed' clients who prefer to pay an annual fee for access to an adviser.

Government has made advice harder to receive

The Government, which wants Australians to become self-funded retirees, has put in place regulations that make this increasingly difficult.

For advisers, the costs and obligations of advising a retail client with $100,000 to invest is the same as for someone with $1 million to invest. Many older advisers and brokers are simply leaving the industry. According to Financial Standard Magazine, 450 financial advisers in Australia left the industry in the month of June 2021, reducing total numbers to 19,544. At the end of 2018, before the Royal Commission, adviser numbers in Australia peaked at about 30,000. During the March 2021 quarter, 1,017 advisers left the industry, while only 538 new advisers registered.

Many retail investors who would benefit from financial advice can no longer find an adviser.

Rodney Horin is CEO of wealth manager and aged-care adviser at Joseph Palmer & Sons.

Digging deeper into planning for retirement spending

Don Ezra

"Three steps to planning your spending in retirement" was published by Firstlinks on 7 July 2021, having appeared earlier as the leading article in the (London) FT Money edition in April. Judging by the 14,000 reads on Firstlinks, it was helpful to many readers but they also had comments and follow-up questions.

Here I'll respond to three of them:

- flexible withdrawals
- using equity dividends for safety
- tax implications.

First, as background, let me summarise the approach I described that I use for my wife and myself.

I identified two independent financial risks: that we might live longer than most people of our age, and that our equity investments might drop in value early and stay low for a while, making us withdraw spending money from a depleted pot.

To reduce the chance of each to no more than 25%, we selected a planning horizon of 31 years (based on our ages), and invested five years of withdrawals in short-term securities (our insurance bucket), because historical statistics suggested that a falling equity market recovered in real terms within 5 years 75% of the time.

We calculated the sustainable annual after-inflation and before-tax withdrawals that went with this combination and invested everything that was not in the insurance bucket in a global equity index fund (our growth bucket).

There were lots more points, but that's the essence of it.

Flexible withdrawals

I appreciate the Australian comments that I've over-thought the issue, and that my analysis and introspection must make retirement impossibly difficult for me. "Lighten up," I was told. Invest in well-run companies and the rest will take care of itself.

Thanks for your concern. I'm actually thoroughly enjoying retirement – particularly because of my analysis. The worry is over. I re-examine our position every year, and adjust our withdrawals a little bit, as I'll explain in a moment. The other 364 days, I'm happy.

With no insurance bucket, and 100% in well-run companies (tough to identify them in advance, isn't it, and it's too late after the badly run ones reveal themselves), that wouldn't have worked if, for example, we had retired at the start of 1973 (the worst-case historical test, and worse than I'm planning for, obviously, but still very instructive).

I used US stats and found that the first two years of equity real returns were -8.3% and -34.2%. After 5 years the cumulative equity real return was still worse than -30%. Subtracting 5 years of withdrawals, the remaining assets were down to 33% of their original value.

What would the insurance bucket have achieved? The bucket itself would have been exhausted (slightly earlier than expected, because cash cumulative returns were -7% over the period), and the remaining assets would be down to 43% of their original value. That may not sound like much of an achievement, but future withdrawals from that point forward would have been at 70% of the original withdrawal rate, compared with 53% with the growth-only approach. Sad, but noticeably better.

A number of readers said that they use flexible withdrawals in response to changes in the market value of their growth pot. An excellent idea! I do too. But I don't vary the withdrawal in proportion to the market swing (like reducing it by 30% if the future indicated supportable withdrawal rate is 70% of the initial rate). Instead, I spread the amount of the swing (30%, in this example) over our remaining planning horizon, to smooth it out.

Spreading relies on a belief in (or at any rate a hope for) 'mean reversion', the notion that, over the long term, returns will come back to the average. But if future market declines are steeper and longer than before, the gradual declines in withdrawals won't be enough. It's a risk to be conscious of.

I wonder how the reader with a 100% equity portfolio would have reacted by the time 1975 arrived. Regardless, it's easier to cope in hindsight!

I'm reminded of the saying that *"no battle plan survives its first contact with the enemy."* That's right: no plan will ever work out perfectly. But the work that's gone into the plan will help you adapt, as circumstances change – that's why we plan. And that gives you resilience.

Using equity dividends for safety

An excellent comment said, in essence, that the safety bucket should take into account the cash flow from equity dividends, and that this would increase the size of the growth-seeking bucket. Quite right.

As an example, with a 30-year planning horizon and a 5-year safety bucket, and using my 4% real annual return assumption for equities, a 1% dividend yield used towards the withdrawal would reduce the initial size of the safety bucket by about 1/3, a 2% dividend yield would reduce it by about 2/3, and a 3% dividend yield would reduce it to virtually zero.

That ought also to increase the implied sustainable real withdrawal. And it does. But by very little, unfortunately. Even the 3% dividend yield only increases the annual withdrawal by about 2%.

Tax implications

In most countries (although not for most retirees withdrawing their superannuation in Australia), each year's withdrawal is subject to tax, so you don't get to spend it all. For many, tax will itself be a significant expenditure. So if there's a way to minimise it, that becomes important.

I have no general principles for you. It's as if you're asked to approach the taxing authorities with all your money stuffed in various pockets in the clothes you're wearing, and they say, "From Pocket A we'll take 40%, from Pocket B 20%, you can keep whatever is in Pocket C, from Pocket D …" And so on.

Naturally, before you approach them the following year, it makes sense to rearrange your money across the pockets. But finding out how to do this is difficult, and whole tribes of people make their living by getting to know the complexities and advising non-technical citizens about how to minimize the total.

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