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a Morningstar company

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Editorial

We tend to think about technology as a relentless march forward, but as writers from **Jonathan Swift** in the 1700s to **Stephen King** and our own **Peter Allen** have espoused, 'Everything Old is New Again'. In an interview in **Wheels** magazine May edition, **Hyundai**'s Chief Designer, **SangYup Lee** argues that placing all the functions in a car into a single infotainment system creates safety hazards. **Tesla** drivers, for example, cannot quickly switch on lights and wipers because they need to take their eyes off the road, delve into the screen and find the right icon.

In its electric vehicles, Hyundai is foregoing the streamlined look in the interests of safety and function:

"We have used the physical buttons quite significantly in the last few years. For me, the safety-related buttons have to be hard key. When you're driving, it's hard to control it. That's why when it's a hard key, it's easy to sense and feel it."

Tesla is lauded for its touch screen and uncluttered cabin, making buttons and switches seem old-fashioned. But the habits of how we interact with a car suggest scrolling through a screen is not a better and safer way, although no doubt car design will head in this direction.

And what is Wheels' overall verdict?

"What's beyond debate is that the Ioniq 6 is a bigger, heavier, more technologically dense vehicle that the Tesla Model 3 and while there's an argument that the Tesla does more with what it has, the Hyundai just does more full stop. Put simply, it feels a step or two forwards in terms of overall cohesion than the Tesla Model 3."

More advanced and yet it uses traditional switches and buttons.

There is a parallel in investing. One of the stockmarket's most significant developments is the growth of Exchange-Traded Funds (ETFs). They give investors easy and instant access to a wide range of investment styles, markets and thematics. The main alternatives are managed funds and platforms, which can be more inconvenient to invest in and harder to liquidate same day. It feels cumbersome and time-consuming to fill in a paper form requiring a wet signature, certified copies of an SMSF's trust deed and identification of company trustee directors.

But for some investors, the traditional managed funds are the car safety buttons of investing. The inconvenience and timing delays might force a pause at a moment of panic. Some funds allow only monthly exit with five day's notice, and others make no guarantee of liquidity. Given the weight of evidence that investor returns are generally worse than the indexes or funds in which they invest, many people need protection from themselves. An instant screen-activated ejector seat may be the wrong option.

As **Joel Greenblatt**, author, hedge fund manager and founder of **Gotham Capital**, said:

"Unless you buy a stock at the exact bottom (which is next to impossible), you will be down at some point after you make every investment. Your success entirely depends on how dispassionate you are towards short-term stock price fluctuations."

I confess in my own case, I avoid the paperwork involved with some unlisted funds, and I tend to exit my listed investments first during an asset allocation change, and leave the unlisted to chug away in the background. They are easier to ignore when they do not feature on my broker revaluation which hits my screen every moment of every trading day.

Similarly with bonds. If a five-year, fixed rate bond investment bought two years ago at par to yield 5% has fallen in price to 95, just leave it in a bottom drawer and enjoy the 5% and the surety of money back at par in three years.

Back on cars, in **Jeremy Clarkson**'s latest review of the **BMW M3**, which he describes as so rapid that it is '*eloquently violent and deranged*', there is still a place for buttons:

"But that's the thing with a modern day M3. If you push a lot of buttons, it can become as sensible as a Volvo."

So we explore many ways in which investors can be "*as sensible as a Volvo*" by protecting themselves from bad investing behaviour, perhaps by pushing some traditional buttons. Mind you, these days, Volvo no longer deserves its boring image.

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Readers may recall my article a few weeks ago I described problems with the offer of some new securities, where issuers and managers have decided to limit distribution to their own clients due to a strict interpretation of **ASIC**'s Design and Distribution Obligations (DDO). I have since been in contact with ASIC, which has give permission for this clarifying statement to be published:

"The law is designed to allow flexibility as to how offers can be structured. ASIC cannot prescribe in detail how issuers and distributors comply, as under the legislation that is a matter for them. For example, ASIC does not have the power to require a minimum number of brokers be appointed to an offer, nor can ASIC require an offer to be distributed beyond an appointed broker's client base."

So ASIC cannot fix the problem identified but DDO is supposed to offer flexibility and in my view, issuers are being overly cautious and ASIC does not require the restrictions issuers have adopted. But perhaps the interpretation is convenient for brokers to retain transactions for their own clients.

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The **ACCC** has launched an enquiry into how banks set the interest rates on savings accounts. The ACCC says:

"We are aware that deposit and savings accounts are an important source of income for many Australians, typically supplementing their income from employment, superannuation and the pension. Australian households together hold more than $1.3 trillion in savings and deposit accounts ... In many cases, banks have only applied increases in the cash rate to some of their deposit products, often with conditions attached."

They should read my book where I cover this subject in great detail.

We were contacted last week by a pensioner whose age pension is paid into an **IMB Bank** account called a Wisdom Savings Account. Given it is a *"high interest transaction account available to members 55 years or over, or members who receive an eligible permanent pension"*, it sounds like a special deal. And aren't the small banks competing hard for deposits, and hopefully looking after their loyal pensioner customers? Here are the rates:

Up to $9,999: 0.05%
$10,000 to $49,999: 1.25%
$50,000 to $249,999: 1.6%

Given pensioners are likely to hold less than $10,000 in their account, this 'high interest' account for those on a 'eligible permanent pension' is miserable. Nothing. Put that in your ACCC enquiry.

Australian banks are not alone. The largest bank in the US, JP Morgan, into which deposits are flowing as regional banks suffer, holds US$2.4 trillion in deposits (yes, trillion). In 2022, it paid about US$10 billion in interest, or 0.4%. Like IMB, many JP Morgan accounts pay 0.01%. Apple recently introduced a new savings account paying 4.2% and it will be swamped. The ACCC report will make fascinating reading.

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Tuesday's Budget confirmed the Government's intention to proceed with the proposed $3 million superannuation tax despite recent consultations with the industry. **Peter Burgess** from the **SMSF Association** immediately issued a statement:

"If the Government proceeds with the taxation of unrealised gains as proposed in their consultation paper released in late March, given many small business premises and farms are owned by SMSFs, this new tax could drive up their costs substantially at a time of unprecedented cost of living increases. We stand by our position that using a member's total super balance to calculate earnings is neither simple nor fair. By definition, a member's total super balance includes unrealised gains and a growing list of items that will need to be excluded to ensure 'earnings' for the purposes of this new tax are not overstated. This methodology discriminates against those funds who can identify and report to the ATO actual taxable earnings attributable to each member."

James Gruber summarises the relevant parts of the Budget and links to longer Budget papers from **nabtrade** and **Heffron**. Worth noting:

1. The revenue attributed to the new $3 million super tax has increased from $2 billion to $2.3 billion a year, suggesting no material change in the calculation method but some extra dollars from somewhere.
2. No continuation of the 50% discount for minimum super pension drawdowns as allowed in recent years, so SMSF trustees in particular should ensure they have enough in cash to meet higher pension obligations.
3. No mention of removing the indexing on the Transfer Balance Cap, now expected to go to a healthy $1.9 million on 1 July 2023.
4. The increase in the Superannuation Guarantee to 11% on 1 July 2023 looks locked in.
5. The instant asset write-off scheme will decrease the maximum amount for new equipment to $20,000 from $150,000. Higher limits have contributed to Australia's three top-selling vehicles being the **Toyota Hilux, Ford Ranger and Isuzu D-Max** as tradies write off their purchases. Finally, the Government really is taking away your utes.

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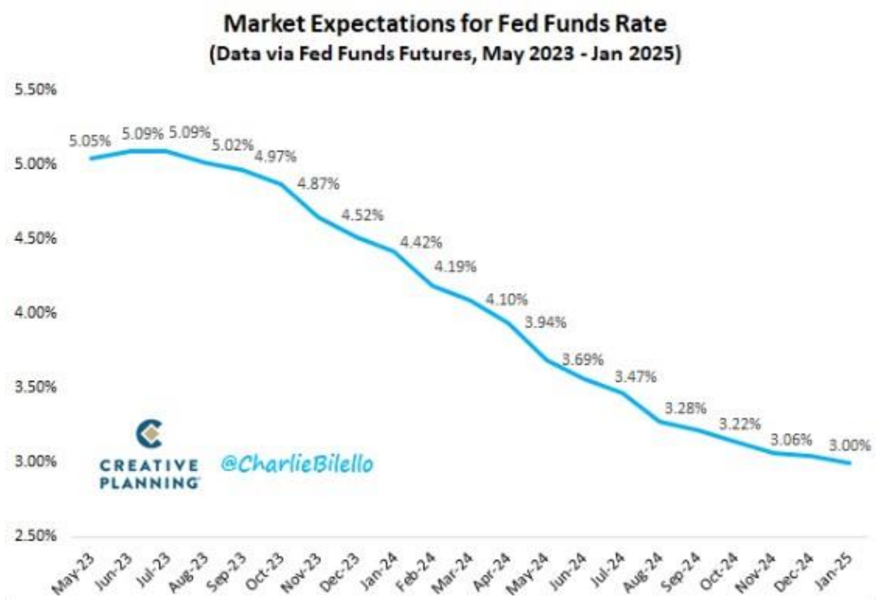
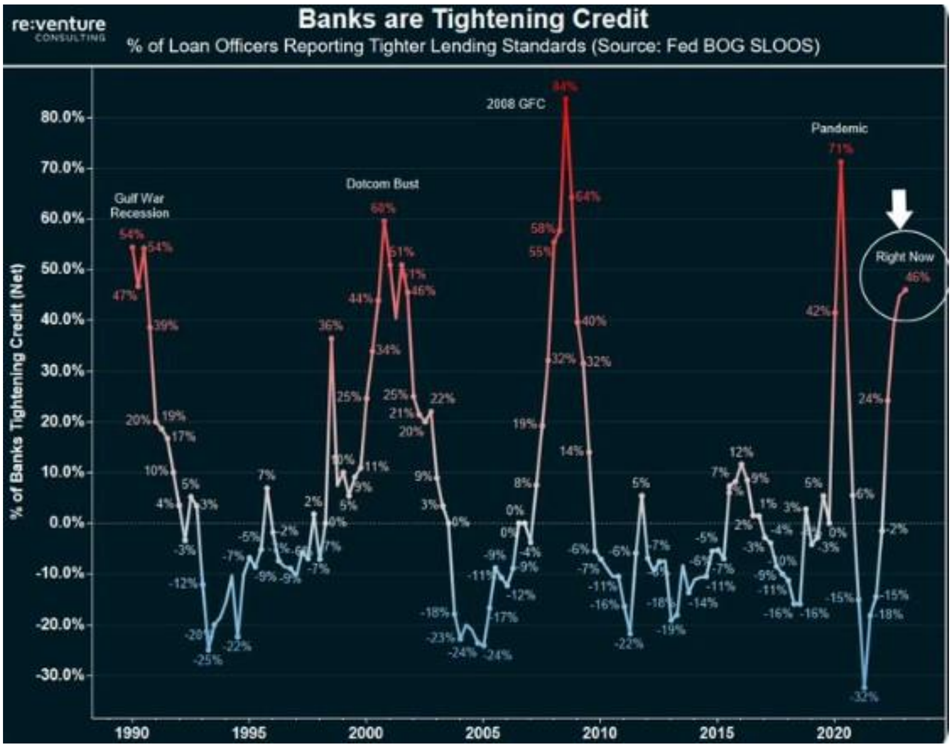
Finally, three charts caught our attention this week.

First, amid the speculation about whether further interest rate rises are necessary in Australia and the US, the market is building in an extraordinary amount of easing in the **US Fed Funds Rate**. Herein lies the dilemma for stockmarket investors. While global growth is expected to slow in 2023, the equity market often looks 18 months ahead and will take support from lower interest rates. It's one reason why the bond and stock markets are behaving differently.

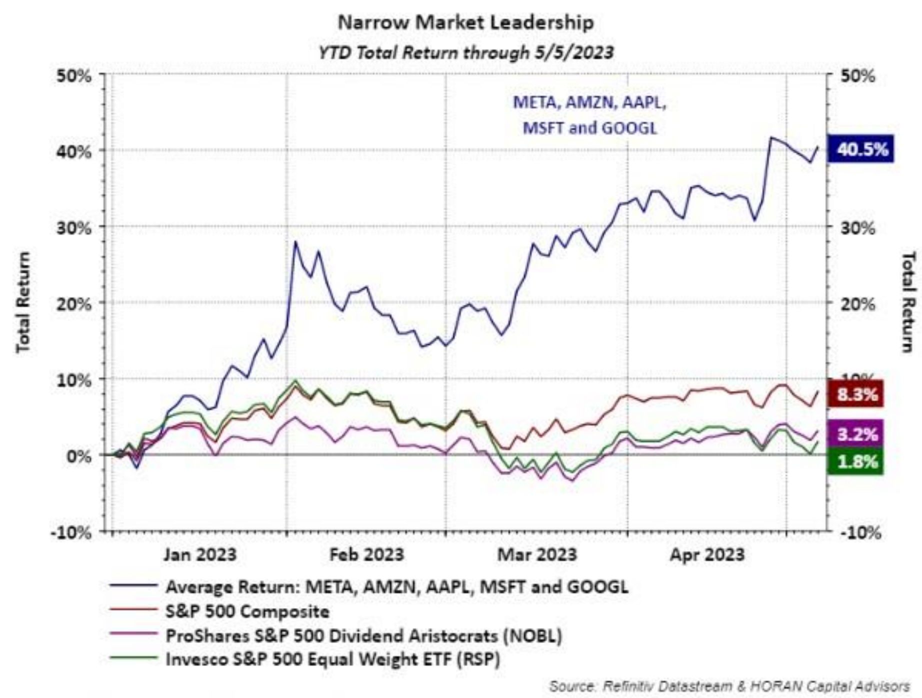


In Australia, the Budget inflation forecast for FY23 is 6%, but it falls to 3.25% in FY24, 2.75% in FY25 and then 2.5%. Real GDP growth next year is only 1.5%, and the current three-year bond rate is about 3%. There is clear expectation that central banks will subdue inflation soon.

Second, on the back of the crisis among regional banks in the US, a Fed survey of bankers showed 46% tightened lending standards in Q1 2023. That is nearing the levels during other crises.



Third, the strong run in the US market in 2023 disguises how narrowly based the winners are, with five big tech companies up an extraordinary 40% in 2023. There is lots of FOMO at play here because the Price to Earnings ratios of these stocks are back to expensive levels, with Amazon at 252, Microsoft at 34 and Apple at 29 (but Google is at 24, the same as the average for the S&P500).



Refinitiv Datastream & HORAN Capital Advisors

Graham Hand

Also in this week's edition ...

There's lots of negative press about the outlook for Australian banks with worries over declining net interest margins and a coming consumer crunch as fixed mortgages are refinanced. Yet **Hugh Dive** says the latest bank results show [the Big 4 are in fine shape](), and with the tailwind of rising interest rates and high employment levels, patient shareholders should be rewarded.

A new report from **Vanguard Australia** shows something extraordinary: many working-age Australians expect to have an annual income of almost $100,000 in retirement. What gives? Well, perhaps they have included rent as some aren't homeowners or they don't know how much is really needed in retirement. What's clear is that this expectation stands in [stark contrast to current retirees](). The full **Vanguard** report also features as [this week's White Paper]().

A high 97% of wealthy Australians surveyed by consultant, **EY**, admit they change their investment behaviour when the value of their portfolios declines. It's a frank admission although perhaps it shouldn't be so surprising when the volatility of 2022 tested even the most battle-hardened investment veterans.

Everyone knows that the ASX is heavily skewed towards banks and mining. How then do you diversify beyond these sectors but remain in an Australian share index? **Van Eck's Cameron McCormack** suggests equal weighted indices have merit as an alternative. Historically, these indices have outperformed their market capitalisation counterparts.

Hybrid securities have gained popularity, though that faith was shaken when Credit Suisse bonds were wiped out. **Yarra Capital Management's Phil Strano** says what's overlooked is that the turbulence strengthens the case for owning superior quality Australian bank T2 bonds.

Curated by James Gruber and Leisa Bell

Five strategies to match your investing to your behaviour

Graham Hand

"When you act on the emotions of the marketplace, you're making a big mistake. Stay the course, don't let these changes in the market, even the big ones, change your mind and never, never, never be in or out of the market. Always be in at a certain level."

Vanguard founder and former CEO Jack Bogle at CNBC's 'Power Lunch', September 2018.

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Many investors are their own worst enemies, achieving inferior results versus the funds or indexes they invest in due to the timing of their buying and selling. Even after deciding a level of risk that allows exposure of say 50% of their portfolio to equities, investors panic during market falls and cannot maintain an asset allocation discipline. This article offers techniques to control the natural human urge of flight in the face on danger.

In 2014, leading investment writer and founder of a funds management business, William Bernstein, gave Firstlinks permission to publish a terrific booklet called "*If You Can: How Millennials Can Grow Rich Slowly*." He advises young people to take exposure to equity markets because time is on their side. But it comes with a warning:

"Know that from time to time you will lose large amounts of money in the stock market, but these are usually short-term events - the financial equivalent of the snake and the tiger. The real risk you face is that you'll be flattened by modern life's financial elephant: the failure to maintain strict long-term discipline in saving and investing."

The tiger and the snake are Chinese zodiac signs with different perspectives on life and contrasting aspirations, and there is the main behavioural problem. Short-term volatility hits long-term goals, as many older people worry their investments will not have time to recover.

Let's see if there are ways to invest that might control bad behaviour, but first, what habits are we hoping to fix.

Evidence of poor investor behaviour

Morningstar produces a regular 'Mind the Gap' report which compares investor returns with the performance of a range of managed funds and Exchange Traded Funds (ETFs). The latest report published in July 2022 says:

"Our annual study of dollar-weighted returns (also known as investor returns) finds investors earned about 9.3% per year on the average dollar they invested in mutual funds and ETFs over the 10 years ended Dec. 31, 2021. This is about 1.7% less than the total returns their fund investments generated over the same period. This shortfall, or gap, stems from poorly timed purchases and sales of fund shares, which cost investors nearly one sixth the return they would have earned if they had simply bought and held."

Other research by DALBAR based on 30-year data indicates the average investor in the US S&P500 achieved 7.13% while the index delivered 10.65%.

Locally, the EY Global Wealth Management Research suggests Australians are more inclined than investors in other countries to exit markets when their portfolio declines. The problem is, they may never get back in.

"Australian clients appear more actively aware of declines in their portfolios than those in other markets, with the vast majority (97%) saying they change investment behaviour due to declines in portfolio value, significantly above the global average of 73% ... Continued market stress is amplifying their defensive stance and as well as their appetite for both switching and adding to their portfolio."

Modifying investor behaviour

Here are five ways to modify behaviour with the aim of improving long-term outcomes. Some people may consider these actions inappropriate, but they should be read in context. They are not suitable for everyone.

Behaviour 1. Panicking when the market falls because of fear it will drop further

Solution 1: Invest in a fund or structure that is time-consuming to exit

In every market on any day, there are reasons to sell. Even in bull markets where stocks run ahead for years, there are down periods where bad news suggests the bear may start clawing at returns. It is in these down periods where damage is done. As writer, hedge fund manager and founder of Gotham Capital, Joel Greenblatt, said:

"Unless you buy a stock at the exact bottom (which is next to impossible), you will be down at some point after you make every investment. Your success entirely depends on how dispassionate you are towards short term stock price fluctuations."

Consider what happens when the market falls 5% or more in a single day, equivalent to today's S&P/ASX300 level of about 7,250 falling by 310 points. This index is worth $1.6 trillion, and the headlines would scream 'Market collapse costs Australian investors $80 billion.' Investors worry that the next day will repeat the fall and they sell to manage their losses.

Here is a chart published by BlackRock in 2022 using Morningstar data showing the largest one-day losses in the S&P500 since 1950 and the return one year later. In almost every case, the investor who reacted missed an excellent recovery.

Day	S&P 500 decline*	Return 1 year later*
10/19/1987	-20.5%	23.1%
3/16/2020	-12.0%	69.0%
3/12/2020	-9.5%	61.8%
10/15/2008	-9.0%	20.8%
12/1/2008	-8.9%	35.9%
9/29/2008	-8.8%	-4.1%
10/26/1987	-8.3%	23.5%
10/9/2008	-7.6%	17.8%
3/9/2020	-7.6%	43.6%
10/27/1997	-6.9%	21.5%
8/31/1998	-6.8%	38.0%
1/8/1988	-6.8%	15.3%
11/20/2008	-6.7%	45.1%
5/28/1962	-6.7%	26.7%
8/8/2011	-6.7%	25.2%
Average	*-8.9%*	*30.9%*

It is usually argued that liquidity is good because it gives flexibility to respond to market changes and personal needs for cash. The development of listed funds such as ETFs is a welcome alternative to the tiresome paperwork still required to invest in some unlisted managed funds. Application forms for SMSFs requiring certified copies of the trust deed and identification documents for trustee company directors can be cumbersome and time-consuming.

But it can work to the benefit of investors if exiting a fund at least forces some paperwork in contacting the fund administrator, rather than jumping to an online broker account and exiting in a instance.

A recent example was the immediate collapse of prices on a wide range of capital instruments when Credit Suisse defaulted on its hybrid bonds. Similar bonds fell heavily for a few days while investors sorted out whether other central bank had forced their banks to include clauses where shareholders ranked ahead of noteholders. When the expected hierarchy of repayment was confirmed, the market recovered well but anyone in a listed note fund who sold quickly missed the bounce.

Some funds may prevent a panic sale by:

- Requiring a completed redemption form to be mailed to an administrator.
- Allowing redemptions only at the end of the month with five days' notice.
- Closure to new investors so existing investors know if they exit, they will not be allowed back in.

Behaviour 2: Judging your own results against others

Solution 2: Tread your own path as only you know your needs, worries and risk appetite

Investing is like posting on Instagram. People only tell their followers about the good times. The photos from the holiday ignore the hours stuck in airports, dragging heavy bags around looking for a hotel and the daily search for a decent place to eat. Online, it's all smiles and fun. The investing equivalent is buying Apple or Tesla or Afterpay in the early days, loading up on equities at the bottom of the pandemic, selling before the GFC hit or exiting fixed rate bonds before the rate rises of 2022. The disappearing small tech company is forgotten, while the insider tip from a mate rarely works out.

It's better to decide on your own plan, what works for you and avoid comparisons.

Guy Spier is a fund manager and author of '*The Education of a Value Investor*', but this is not a typical 'how to' book. It's more about his personal investing journey to learn what works for him, including moving away from the noise of Wall Street to a quiet village outside Zurich. He says:

"Following my move to Zurich, I focused energy on this task of creating the ideal environment in which to invest – one in which I'd be able to act slightly more rationally. The goal isn't to be smarter. It's to construct an environment in which my brain is not subjected to quite such an extreme barrage of distraction and disturbing forces that can exacerbate my irrationality. I hope that I can do it justice here because it's radically improved my approach to investing, while also bringing a happier and calmer life … The constant barrage of bad news could easily have exacerbated my irrational tendencies, when what I needed most was to screen out the noise and focus on the long-term health of my portfolio."

He has developed what he calls his Personal Scorecard.

"You should judge yourself by your own personal standards and proactively work towards self-improvement rather than indulging in comparisons with the standards and accomplishments set by other investors … Investing has a way of exposing our psychological fault lines. However, you have to live your own life rather than follow the dictum put forth by famous names."

Behaviour 3: Worrying about running out of money

Solution 3: Allocate to cash and high-quality bonds to cover several years of income needs

Faced with the current greater uncertainty than in the halcyon decade leading up to 2020, Australians are now increasingly protecting their wealth at the expense of returns. The recent EY research says:

"According to the survey, over the past two years there has been a shift in the leading financial goals of Australian investors, with protecting wealth against losses and inflation now the top priority (58% in 2023 compared to 38% in 2021). Ensuring adequate income has dropped from the number one position in 2021 (64%) to fourth spot this year (27%), behind growing investment returns (46%) and wealth transition (28%)."

Back to author William Bernstein, quoted in *My Money Journey*, explaining how he invests now he has reached the age of 75.

"I often tell people that, when you've won the game, stop playing with the money you really need. Perhaps all would be fine if I kept 100% in stocks. But I'm now in my 70s and more interested in financial survival, which is why today I keep at least 20 years of living expenses in bonds and cash investments. That won't make me rich. Instead, I've done something more important: minimized my odds of dying poor."

Flows into Australian cash and bond ETFs in 2023 are larger than into any other asset class, as this chart from BetaShares shows.

The most popular method of protecting capital in Australia is to place money on deposit with banks, especially given the government guarantee on deposits of $250,000 and less. Listed high-quality alternatives in floating rate bonds with no duration risk include the VanEck Australian Floating Rate ETF (ASX:FLOT) or BetaShares Australian Bank senior Floating Rate ETF (ASX:QPON), while better returns with a little more risk come from subordinated bonds such as VanEck's Subordinated Bond (ASX:SUBD). Cash ETFs offer rates similar to term deposits. An Australian bond fund such as Vanguard's Australian Fixed Interest ETF (ASX:VAF) offers high credit quality but duration risk exposure.

Behaviour 4: Hating fees and tax surprises but loving a bargain.

Solution 4. Find funds which are free to invest in and avoid trusts

It is not best practice to base investment decisions only on a fee or tax impact, as there is little point in saving fees or tax in a poorly-performing fund. But many investors dislike paying 1.5% annually plus a performance fee to a fund manager, and as the EY research indicates, plenty of investors focus on tax treatment.

"Meanwhile, reducing taxes has almost doubled as a goal among Australian respondents in the past two years (23% in 2023 compared to 12% in 2021) although it still remains well below the 2019 survey result of 63%."

There are many funds in Australia where investing is almost free, and recent competition in the ETF market has driven management costs even lower. Some unlisted funds are free of base management fees where the manager is paid only on performance. Here are a few examples:

- Many ETFs in Australia cost only a few basis points, or less than 0.1%, which is effectively free. The cheapest at 0.03% a year is the Vanguard US Total Market Shares Index (ASX:VTS). In Australian equities, three cheap funds are iShares Core S&P/ASX 200 (ASX:IOZ) costing 0.05%, the Vanguard Australian Shares Index (ASX:VAS) at 0.1% a year while the cheapest Aussie is BetaShares Australia 200 ETF (ASX:A200) at 0.04%. Smart beta is offered by VanEck such as global shares (ASX:QUAL) at a 0.4% fee. In other sectors, recent launches include iShares Core FTSE Global Infrastructure (AUD Hedged) (ASX:GLIN) and iShares Core FTSE Global Property ex Australia (AUD Hedged) (ASX:GLPR) priced at only 0.2%, highly competitive for these thematics

- Managed funds can also be highly competitive, such as Solaris offering a Core Australian Equity fund with a management fee of zero and relying on a 30% performance fee over its benchmark. Tony Hansen's EGP Capital is another fund which is performance fee only, and many platforms offer low cost index options.

On the tax side, a major headache often arises from trust structures used by managed funds and ETFs but not by Listed Investment Companies. The problem for a unit trust is that each year, all income received (including realised capital gains) is divided among unit holders based on how many units they hold at the time of a distribution. Unit holders must include their share of this income (which may comprise dividends, interest, capital gains and franking (imputation) credits) in their own tax return in the year it was earned.

An investment in June that receives a distribution in July may be converting capital to taxable income. For example, if someone invests on 25 June when the unit price is say $1.00 and then a 10 cent per unit distribution is made on 30 June, the unit price will fall to 90 cents (assuming no market movement) at the beginning of July. The 10 cents will be taxable income in the hands of the unit holder. The tax shock can be intense.

LICs are companies where the boards can decide whether to pay a dividend, which allows a dividend reserve to build up and smooth payments when returns may not be as good.

Behaviour 5: Losing patience with a fund manager or a share price

Solution 5: Ignore the market value of your portfolio until the end of the year

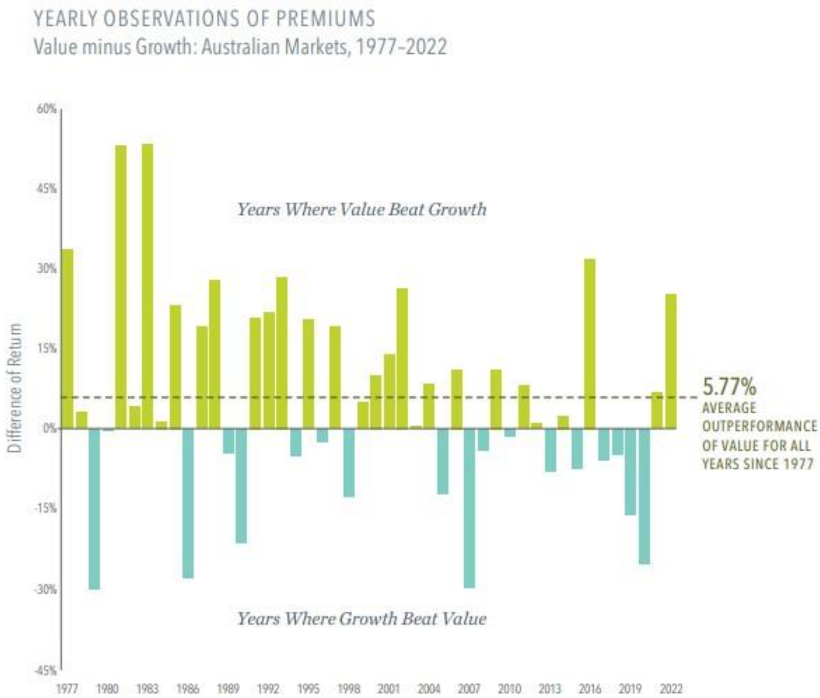
Warren Buffett says if you don't feel comfortable holding a stock for 10 years, you shouldn't hold it for 10 minutes. Although a long-term investment thesis remains in place, investors lose patience. Buffett famously said, "*Our favourite holding period is forever*", and he demonstrates this with Apple, Coca-Cola, Heinz and American Express.

I recently invested with a fund which opened to new applications only briefly and then closed again. The fund manager required me to vouch that I would be a long-term investor, although the fund is open-ended. The fund has excellent historical performance, and while this may not be repeated, I doubt I will exit this fund for at least

10 years. In fact, although they will issue a monthly report, there is no intra-month reporting and I would prefer not to know how it is going for many years.

Here are some strategies to consider:

- Placing funds with an active manager is a long-term decision, say 8-10 years. Their investment style may go out of favour for years, but you can be sure just when you give up on them, they will turn the corner. For example, over the very long term, 'value' investing has outperformed 'growth', but in most of the last 10 years, growth has outperformed value. Is now the time to get out? This chart from Dimensional shows value or growth can dominate for years before underperforming.



- Open another account with your broker, or another account with a different broker, and put the shares you expect to hold for a long term in there, and don't look at it. Sure, you will know if CBA shares are at $100 or $80, but at least the losses will not stare you in the face each day.
- When considering the purchase of a stock, buy half your initial plan. If the stock rises, you can take satisfaction that you invested at a good time. If it falls, you have a cheaper entry price. If you're not a trader, then selling for a loss a few weeks after buying is an admission that the first purchase was a mistake.

It's what works for you

Volatility is the price investors pay for the attractive long-term return from equity markets, but jumping in and out is usually counterproductive. There is nothing wrong with a conservative allocation in a diversified portfolio if protecting capital gives comfort. Know in advance how you will react and manage it before the market collapses.

Let's close with a William Bernstein:

"If I had to summarise finance in one sentence, it would go something like this: if you want high returns, you're going to occasionally have to endure ferocious losses with equanimity, and if you want safety, you're going to have to endure low returns."

Graham Hand is Editor-At-Large for Firstlinks. This article is general information and does not consider the circumstances of any person. Disclosure: Graham personally holds some of the investments mentioned in this article.

Bank reporting season: the good, the bad and the ugly

Hugh Dive

Over the past week, we have seen the major banks report results for the six months ending March 2023 and, in the case of Commonwealth Bank, provide a trading update for the third quarter of their 2023 financial year. In this piece, we will look at the themes in the approximately 1,000 pages of financial results released over the past seven days, awarding gold stars based on performance over the last six months. The results were better than expected, and most banks rewarded shareholders with dividends per share above pre-Covid levels.

Reporting season scorecard May 2023

Company	Share Price	Market Cap $B	Cash earnings per share growth (pcp)	Increase in Dividends	Net interest margin	Credit Impairment charge as % of loans	Capital Ratio	Return on Equity	Forward PE Ratio	Forward dividend yield	2023 total return
Westpac	$21.74	$ 76.3	26.0%	15.0%	1.90%	0.10%	12.3%	11.3%	10.8X	6.3%	-7.7%
ANZ	$23.83	$ 71.6	16.4%	12.5%	1.75%	0.04%	12.9%	11.4%	9.9X	7.0%	0.6%
NAB	$27.10	$ 85.1	21.5%	13.7%	1.79%	0.11%	12.2%	13.7%	11.8X	6.3%	-9.4%
Commonwealth (3Q23 trading update and 1H23 results)	$97.12	$ 163.8	10.0%	20.0%	2.10%	0.10%	12.1%	14.1%	16.9X	4.4%	-3.4%
Macquarie Full Year	$173.50	$ 67.1	6.0%	20.6%	1.97%	0.03%	13.7%	16.9%	13.3X	4.2%	4.9%

Source: Company reports, IRESS, Atlas Funds Management

The shape of the loan book

A new banking metric for investors in 2023 has been the composition of the bank's mortgage book 1) the split between fixed and floating loans and 2) when these low-rate fixed loans, primarily written in 2020 and 2021, will convert into higher rate variable loans.

During previous interest rate tightening cycles such as 1998/2000 and 2006/08, the mortgage book primarily comprised variable rate loans. Consequently, moves by the RBA to control inflation by raising rates were swiftly transmitted into the economy via higher mortgage payments.

However, according to the RBA, fixed-rate loans peaked in 2022 at close to 40% of outstanding housing credit, rendering monetary policy to control inflation a very blunt tool. The RBA's low-cost Term Funding Facility encouraged this fixed-rate lending, which allowed banks to borrow between 0.1% and 0.25% for three years. The Term Funding Facility saw $188 billion borrowed at low rates until it was closed in June 2021, with a final maturity date of June 2024. A more accurate picture of bad debts will emerge when these lower fixed rate loans have converted into higher variable rates.

In March 2023, for CBA, NAB and Westpac, approximately 33% of their loan book was fixed-rate loans, with the largest cohort of loans set to expire over the next four months. Conversely, ANZ has a much lower exposure to the 'fixed rate cliff', with only 22% of their mortgage book exposed to fixed-rate loans in March 2023. We are hesitant to award a Gold Star to ANZ for this low exposure to the 'fixed rate cliff', as 2020 and 2021 coincided with ANZ losing market share and shrinking their loan book due to internal issues in processing an unanticipated large increase in borrowing across the system.

No Stars awarded

Net interest margins

Net interest margins (NIM) were the major topic during the May banks reporting season and the focus of questions posed to management, particularly the exit NIM or the profit margin that the banks were making on loans written at the end of March 2023. Banks earn a net interest margin [(Interest Received - Interest Paid) divided by Average Invested Assets] by lending out funds at a higher rate than by borrowing these funds from depositors or wholesale money markets.

Rising net interest margins have been a source of optimism for the banks since the RBA started raising rates for the first time since November 2010 last May, moving from the cash rate from 0.1% to 0.35% (currently 3.85%). Falling interest rates reduce the benefits banks get from the billions of dollars held in zero or near-zero-interest transaction accounts that can be lent out profitably and have seen a decade-long fall in net interest margins.

However, in a rising rate environment, this pool of deposits in transaction accounts and term deposits will constitute a cheap funding source and allow bank net interest margins to expand. Over the period ending September 2022, the banks saw net interest margins expand for the first time in a decade. However, many questioned whether margins have peaked as banks slowly increase the interest rates paid on deposits due to political pressure and competition for deposits. CBA posted the highest net interest margin for the first half, with 2.1%, and the other banks reported steady to rising net interest margins for March 2022. NAB was sold off heavily on its results day after reporting that its margin had fallen in the second quarter of 2023.

Capital

In 2023 all banks have a core Tier 1 capital ratio above the Australian Prudential Regulation Authority (APRA) 'unquestionably strong' benchmark of 10.5%. This allowed Australia's banks to enter the 2022/23 rising rate cycle with a greater ability to withstand an external shock than in 2007 going into the GFC, where their Tier 1 Capital ratios were around 6%. For investors, this means that the banks have more capital backing their loans and a lesser chance that investors will face dilutive equity raisings if bad debts spike.

Interestingly, Westpac and NAB faced questions on the management calls on why they were not conducting share buy-backs to return excess capital to shareholders, with Westpac deferring the decision until October. We would be surprised if APRA granted approval for banks to conduct share buy-backs today, given the uncertain impact of significant numbers of borrowers switching from cheap fixed-rate loans issued in 2020 and 2021 to higher-rate variable loans in 2023. Macquarie Bank held the highest level of capital in March 2023, with ANZ's high capital level elevated due to a capital raise in August 2022 to buy Suncorp Bank, a deal yet to be consummated.

Show me the money!

Our table shows that all banks increased their dividends in the most recently completed reporting season. Here, bank investors benefited from the combination of sharply rising profits, benign bad debts, excess capital and a reduced number of shares outstanding due to buy-backs in 2022 from NAB, CBA and Westpac. Westpac was the only bank in March 2023 to pay a dividend per share lower than what was paid in the corresponding pre-Covid 19 period in 2019, though ANZ's dividend was 1 cent higher and NAB's matching. CBA and Macquarie posted large 20% dividend increases, reflecting record profits for both banks. If continued low unemployment and minimal falls in house prices keep bad debts from spiking, investors may see rising dividends and, indeed share buy-backs at the full year 2023 results.

Bad debts

After net interest margins, the second most important number in every bank's financial report in 2023 was bad debts, with investors looking to see if rising interest rates caused losses on loans. Low bad debts boost bank profitability, as loans are priced assuming that a certain percentage of borrowers will be unable to repay and that the bank will incur a loss on the loan. Since the 1991 recession, the normalised long-term level of bad debts has been around 0.30% of total loans for Australia's banks.

Bad debts remained low in 2023, with all banks reporting negligible loan losses; Macquarie Bank reported the lowest level of bad debts, with 0.03% narrowly ahead of ANZ. However, we do expect bad debts to rise in the future and recognise that March 2023 is too early for the banks to show significant stress in their lending book, particularly considering the low unemployment rate and higher weighting towards fixed-rate mortgages in 2022/23 than was present in other tightening cycles.

Reports of demise greatly exaggerated

The last four years have been very eventful for bank shareholders, with each year bringing a new set of worries predicted to bring the banks to their knees. In 2019 the fears centred around neobanks such as Xinja, 86 400 and Volt using fintech to reinvent retail banking and take significant market share off the major banks, with the neobanks unencumbered by legacy systems and branch networks. Over the period 2021 to 2022, these neobanks gradually handed back their banking licences and returned deposits to customers. 2020 saw capital raisings from NAB and Westpac missing their first dividend since the banking crisis of 1893, as experts forecasted 30% declines in house prices and 12% unemployment!

2021 saw the banks grappling with zero interest rates and APRA warning management teams about the systems issues they may face from zero or negative market interest rates. A problem that seems quite comical today. 2022 saw the RBA raise the cash rate from 0.10% to 3.10%, the most rapid tightening ever from Australia's central bank. In 2023, the concerns have switched to the impact of sharply rising interest rates on bad debts and the upcoming 'fixed rate cliff'.

Our take

The May reporting season showed that Australia's banks are in good shape and face a better outlook than many sectors of the Australian market, despite rising interest rates. The major banks face the next few years in a far stronger position than they went into 2007. The unemployment rate is 3.5%, significantly less than it was going into the last rate tightening cycle.

While rising interest rates will undoubtedly cause stress to many borrowers over the next 12 months, so long as employment remains strong, mortgage repayments will stay high and bank bad debts low. However, we expect the outlook for consumer discretionary stocks such as Flight Centre, Harvey Norman and AP Eagers to deteriorate as spending on Bali holidays, televisions and new cars are diverted to service higher mortgage payments.

Atlas expects the banks to outperform in the near future, enjoying a tailwind of a rising interest rate environment and high employment levels, which will see customers make the new higher loan repayments. With an average grossed-up yield of +7% and lower-than-expected bad debts, bank shareholders will be rewarded for their patience and for ignoring the current market noise.

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.

Australians' unrealistic retirement expectations

Vanguard Investments Australia

[Vanguard has released a report called 'How Australia Retires' about our attitudes towards retirement and how we feel about this phase of life. It surveyed 1,814 people, 20% of whom were retirees, and the remainder were working-age Australians. Here are the report's key findings.]

Expectations of retirement differ greatly from reality

Between working-age Australians and those already retired, there exists significant variance on the ideal age to retire, how they envision they will spend their time during retirement, and crucially, how much income will be required to fund their ideal retirement lifestyle.

Working-age Australians do not agree on an ideal age to retire. While the average ideal retirement age reported by respondents is a little over 61 years old, there is significant variation in responses across the different age groups surveyed.

On average, those participants aged between 18 to 34 hope to retire by age 59.5, those aged between 35 to 54 hope to retire by age 61.5, and those aged between 55 to 75 and beyond want or wanted to retire by 64.9

years old, a notable increase in ideal age for those entering the pre-retirement phase (over 55 years) when compared with the perceptions of younger age brackets.

This suggests that as working-age Australians edge closer to their retirement phase, their expectation of the 'ideal age' at which to retire increases. This might be a result of Australians becoming more realistic about their retirement age as they near this phase of life, as opposed to younger Australians who might be more idealistic about earlier retirement or haven't yet given retirement planning appropriate thought.

When considering their circumstances, working-age Australians agree that between 65 to 66 years old is the *realistic* age at which to retire.

On average, young Australians under the age of 35 see their realistic retirement age as 65.4 years old, those aged between 35 to 54 see their realistic retirement age as 65.7 years old, and those aged between 55 to 75 and beyond believe 66 is a realistic retirement age.

50% of working-age Australians want to retire with a yearly income significantly higher than the yearly income currently required by older generations.

When contemplating their desired yearly income during retirement, working-age Australians who are yet to retire expressed that they would like to have an income of on average $99,000 per annum (assuming today's dollar value). Those who have already retired said that they desire on average $68,000 (in today's dollar value) as a yearly income, significantly less than the desired income of current working-age Australians.

Interestingly, the figures were much lower for both working-age Australians and current retirees when asked about the minimum yearly income they think they would need in retirement, with working-age Australians indicating an average of $62,000 (assuming today's dollar value) and current retirees stating approximately $41,000 on average (assuming today's dollar value) per annum. While the yearly amount that current retirees perceive they need is significantly lower than their desired yearly income, current retirees still indicated they need substantially less than working-age Australians did, which may suggest that retirees find they can manage on a lower income than expected.

With more time to work towards their retirement goals, working-age Australians may be setting themselves higher post-retirement income targets and setting a new retirement standard. However, there may also be an element of working-age Australians' expectations of retirement not aligning to reality. This could be because:

- Working-age Australians may not be able to effectively predict what their financial wants and needs will be during retirement, especially due to retirement not being in their near or immediate future.
- Working-age Australians may not be able to envision their retirement lifestyle, therefore not being able to effectively foresee how their current incomes and expenses will translate to their retirement income and expenses, which may be leading to an over-estimation of their retirement spending needs.
- Working-age Australians are less likely to own their home compared to older generations, leading to expected rental expenses.
- Working-age Australians' expectations of retirement lifestyles and the activities they would like to differ from expectations held by older generations. For example, when asked about the lifestyle they would like to lead in retirement, working-age Australians prioritised travel (should financial considerations allow). Current retirees, however, prioritise spending time on hobbies.

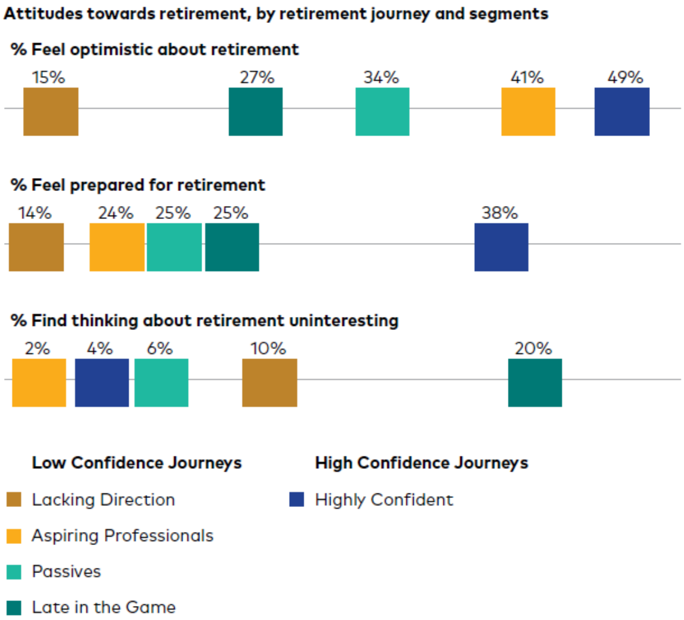
Superannuation is still the foundation of retirement savings

50% of working-age Australians view superannuation as a key part of their retirement plan but expect it to account for a smaller proportion of their total assets than current retirees.

54% of working-age Australians estimate that their superannuation balance constitutes 50% or less of their total investment balance. That is, at least 50% of that total balance is comprised of non-superannuation investments such as savings account, property they live in or investment properties, and shares and exchange traded funds (ETFs). Most notably, 1 in 4 working-age Australians highlight investment property as a key part of their financial plan.

By contrast, while only 1 in 3 current retirees consider superannuation as a core part of their financial plan, especially those younger than 65 years old, they are more likely to rely on it. Retirees are significantly more likely to expect the Age Pension to form a part of their retirement plan, and only 1 in 10 report investment property as an asset.

Despite the importance of superannuation in working-age Australians' plans, fewer than half make additional superannuation contributions to maximise their future returns.



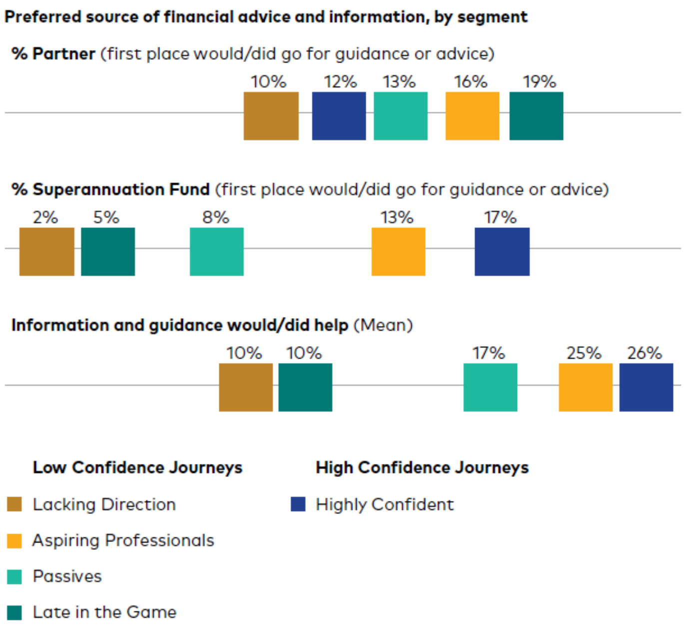
Financial information is abundant but professional advice creates value

In recent years, the financial advice industry has faced severe criticism and undergone substantial structural change following the Royal Commission into Misconduct in the Banking, Superannuation, and Financial Services Industry.

Consequently, these developments have resulted in a lack of trust in the financial advice industry, and it is therefore not surprising that working-age Australians would seek alternative sources of guidance and advice. The proliferation of social media and online forums has also spawned a wide range of channels, with some being useful hubs for information-sharing but many offering unsubstantiated information without the required regulatory authorisations and oversight.

In addition, the cost of seeking financial advice remains a barrier for many Australians and is driving a growing advice gap that may be detrimental to their financial outcomes. Almost 2 in 3 working-age Australians have never engaged a financial adviser.

Financial advisers are not the leading source of professional guidance for working-age Australians. Superannuation funds are in fact the primary source, alongside banks, accountants, and government websites.



Working-age Australians however are more likely than current retirees to consult a non-professional source, preferring to do their own research or seek guidance from their partner or family and friends. This indicates a wariness of professional advice (whether that be due to a lack of trust or as a result of high fees) or simply because friends and family are more easily accessible.

Working-age Australians are also much more likely to seek information from digital sources including podcasts, blogs, and social influencers. In contrast, retired Australians predominantly consult professional sources of guidance, such as financial advisers or their superannuation fund.

Despite the abundance of financial information online and elsewhere, the study found a strong relationship between the use of a professional financial adviser and the retirement confidence it can inspire.

Of the study participants that have received professional advice, 44% indicate they are extremely or very confident in funding their retirement.

In contrast, Australians who have not sought professional advice, only 25% report being extremely or very confident in funding their retirement.

Australians who have received professional advice are also twice as likely to have a clearer, more detailed retirement plan, and are twice as likely to feel confident that they will be able to fund their retirement lifestyle.

Working-age Australians who have developed their own financial plan are relatively likely to have prioritised budgeting and regular savings, while those with a financial plan from an adviser are more likely to prioritise superannuation contributions.

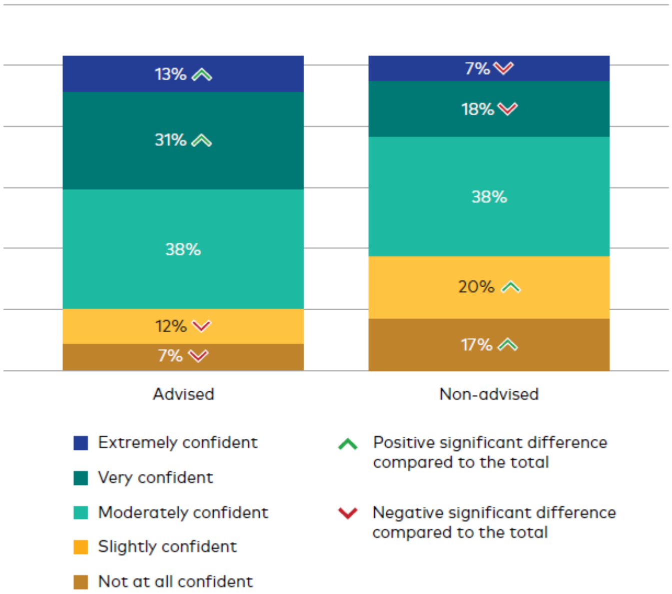
Further, those who have a more detailed plan have typically taken more purposeful action to prepare for retirement, particularly in debt management and budgeting while also making additional superannuation contributions and investing in securities and property.

Impact of professional advice on confidence in being able to fund desired lifestyle in retirement

Retirement confidence

Net Advised: Extremely/Very Confident 44%

Net Non-advised: Extremely/Very Confident 25%



Q. How confident are you that you will be able to fund the lifestyle you want in retirement?

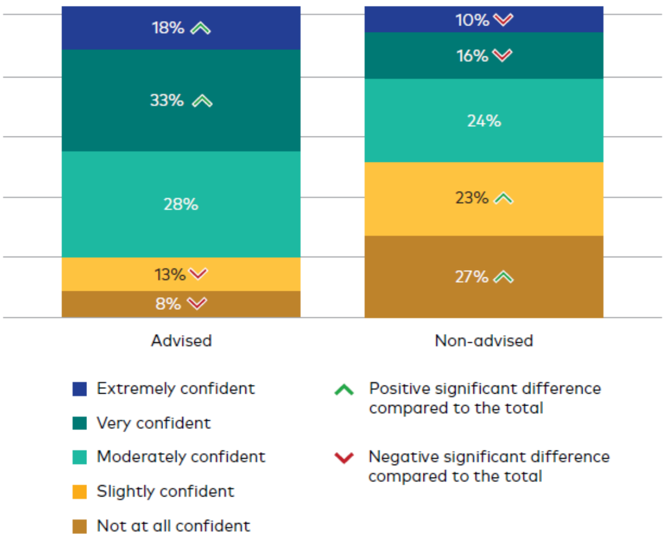
Note: Percentages within a metric may not add up to 100 due to rounding.

Impact of professional advice on financial preparation and detailed planning

Retirement confidence

Net Advised: Has an exact plan with all details/ has a good idea with most detail 51%

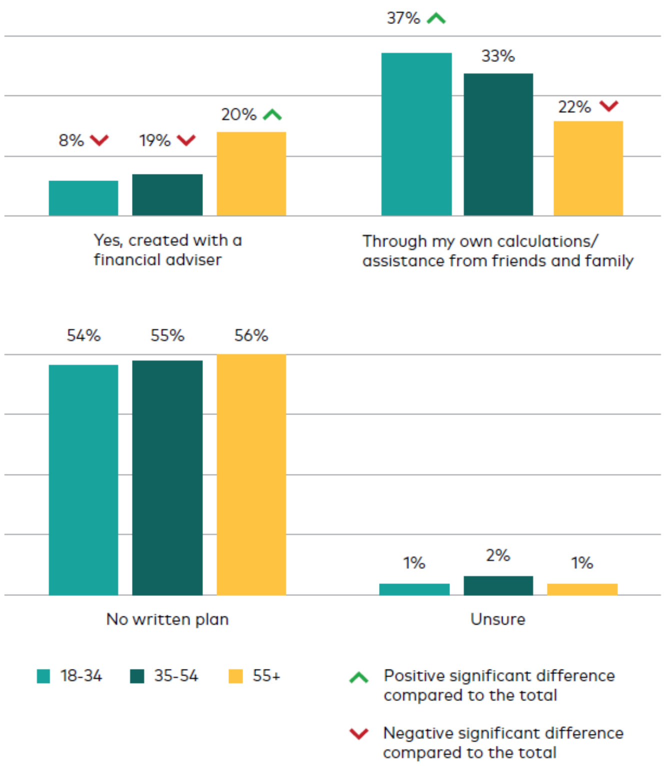
Net Non-advised: Has an exact plan with all details/ has a good idea with most detail 26%



Q. Do you have a clear plan (either formal or informal) for how you'll financially prepare to reach the retirement lifestyle you want? Base Advised n=643, Non-Advised n=1179

Note: Percentages within a metric may not add up to 100 due to rounding.

How a respondent's written financial plan was created, by age



Q: And do you have a written financial plan? Base n = 1,078

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Why equal weighting resolves Australian index skews

Cameron McCormack

An equal weighting investment strategy is different from traditional market capitalisation approaches. Equal weighting, as the names suggests, treats all the companies the same, equally weighting them so big swings in one company can't skew the index.

By way of contrast, in market capitalisation indexes, companies which make up the index are included in amounts that correlate to their total market capitalisation. The bigger the company, the bigger the proportion it represents of the index.

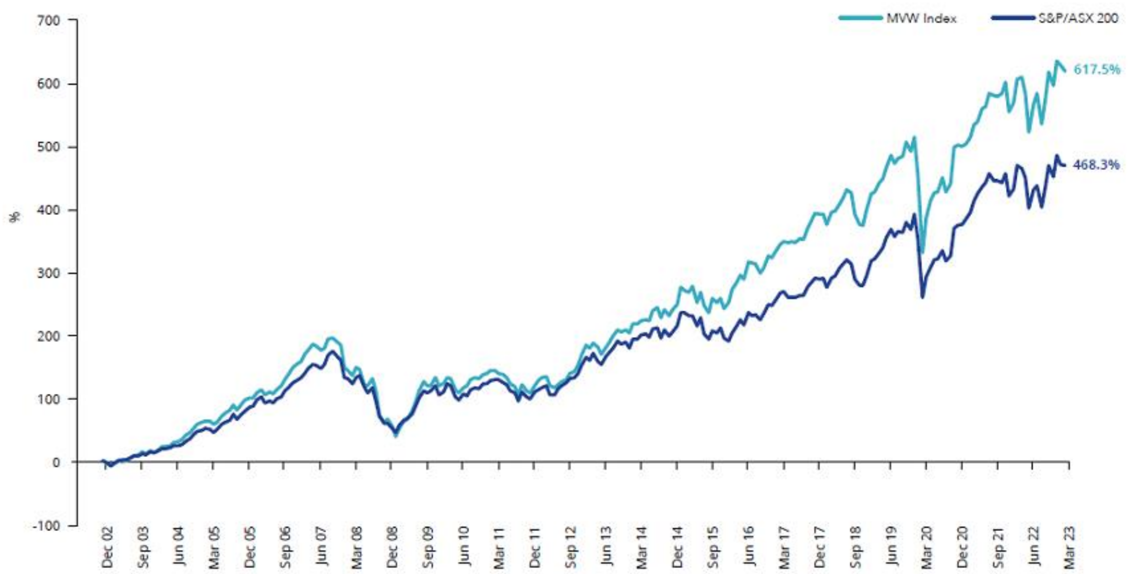
Most of the equity indexes quoted in the media are market capitalisation indexes, for example, the S&P/ASX 200 Index is a market capitalisation index. Moreover, the S&P/ASX 200 index is one of the most concentrated sharemarket indexes in the world. The largest 10 companies represent over 45% of the index.

This means that big-company constituents can shift the index more than little ones. This is great when those big companies are on the way up, but not so great when they are on the way down or have limited potential for growth.

Equal weighting offers an alternative method to investors and they have historically outperformed their market capitalisation counterparts over the long term. The following chart demonstrates this, though we always caution, past performance cannot be relied upon for future performance.

This chart shows the performance of Australia's standard equal weighted index, the MVIS Australia Equal Weight Index against Australia's standard market capitalisation weighted index, the S&P/ASX 200 Index (S&P/ASX 200).

Cumulative performance since inception of MVIS Australia Equal Weight Index



Source: VanEck, Bloomberg, Morningstar; as at 31 March 2023. The above chart represents past performance of the MVW Index and not MVW. Index performance is not illustrative of fund performance. You cannot invest directly in an index. Index returns assume dividends are immediately reinvested and exclude management fees and costs incurred when investing in the fund. Past performance of the MVW Index is not a reliable indicator of future performance of MVW. The S&P/ASX 200 Index is shown for comparison purposes as it is the widely recognised benchmark used to measure the performance of the broad Australian equities market. It includes the 200 largest ASX-listed companies, weighted by market capitalisation. MVW's index measures the performance of the largest and most liquid ASX-listed companies, weighted equally at rebalance. MVW's index has fewer companies and different industry allocations than the S&P/ASX 200.

In various studies it has been shown that equal weighting performs well because of the following reasons:

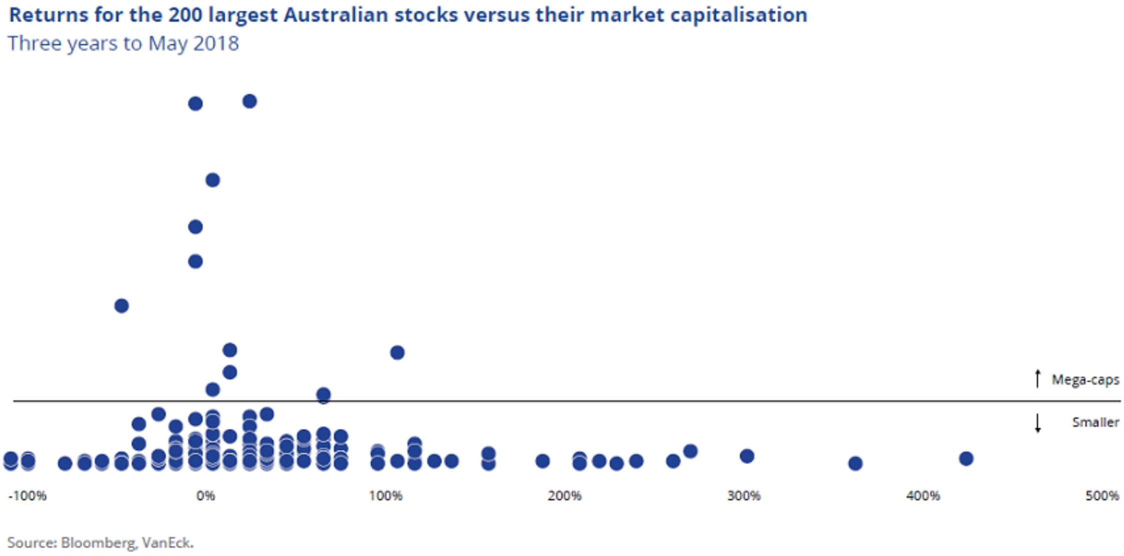
1. Higher exposure to smaller stocks rather than larger stocks
2. Higher exposure to so-called 'value stocks' meaning those stocks with a high book-to-market ratio, and
3. Better market timing as equal weighting extracts more returns when markets are rising and loses less when markets are falling.

1. Higher exposure to smaller stocks

An equal weight approach provides greater diversification by reducing concentration risk both at an individual stock level and a sector level.

A mathematical analysis demonstrated that equal weighting outperformed because of its greater exposure to smaller stocks, which outperform larger stocks. The word 'smaller' was used in the analysis with its precise meaning as a relative term. There was no suggestion that the stocks referred to in the paper were small aps. Rather, these are stocks smaller than those mega-caps who, because of their size, dominate market capitalisation indices.

The mathematical analysis in Why Equal Weighting Outperforms: The Mathematical Explanation showed that the returns from the larger caps are more narrowly distributed than their 'smaller' peers so never deliver the very high returns that will be generated by some of the smaller stocks (the paper uses the top 12 to represent the 'larger' stocks). You can see this in the figure below, taken from the paper.



We recently highlighted how this is relevant during periods of market recoveries in The road to recovery (revisited): Further analysis of equal weight performance after market declines.

2. Higher exposure to value stocks

Rebalancing an equal-weight index also injects a mild value tilt into the portfolio. In order to maintain its desired weights, the strategy will sell shares that have appreciated relative to their target weight and use the proceeds to buy those that have declined since the previous rebalance.

By assigning the same weight to each constituent, the equal weight index is simply tilting toward stocks with smaller market capitalisations and lower valuations, which have historically outperformed their larger and more expensive counterparts. Mechanically shifting assets away from companies that have become more expensive and toward those that are now cheaper can be an advantage when the market's valuation reaches extremes (either too expensive or too cheap).

According to research from Plyakha, Uppal and Vilkov[1] the higher systematic return of the equal-weighted portfolio arises from its higher exposure to the market, size, and value factors.

3. Better market timing

Research by Lajbcygier, Chen and Dempsey (2015)[2] analysing US data over a period of nearly 50 years found that equal-weighted indexing had a statistically significant positive bi coefficient, meaning that it is able to systematically 'time' the market by outperforming in down markets.

In Australia, the universe of companies is too small and too concentrated and there is a lack of variability over time. A concentrated market limits stock diversification and means investors potentially overlook the stronger opportunities among smaller companies.

Equal weighting offers investors a strategy that has historically outperformed market-capitalisation indexes over the long-term. The choice to equally weight also helps risk management and better diversify, avoiding overexposure to any single name.

Cameron McCormack is a Portfolio Manager at [VanEck Investments Limited](), a sponsor of Firstlinks. This is general information only and does not take into account any person's financial objectives, situation or needs. Any views expressed are opinions of the author at the time of writing and is not a recommendation to act.

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[1] Why Does and Equal-Weighted Portfolio Outperform Value- and Price Weighted Portfolios?, Plyakha, Raman Uppal and Grigory Vilkov January 31 2012

[2] Lajbcygier, Paul & Jeremy Sojka, 2015, "The viability of alternative indexation when including all costs" CSIRO Monash Superannuation Research Cluster, Working paper series

When markets dive, even the wealthy can lose their heads

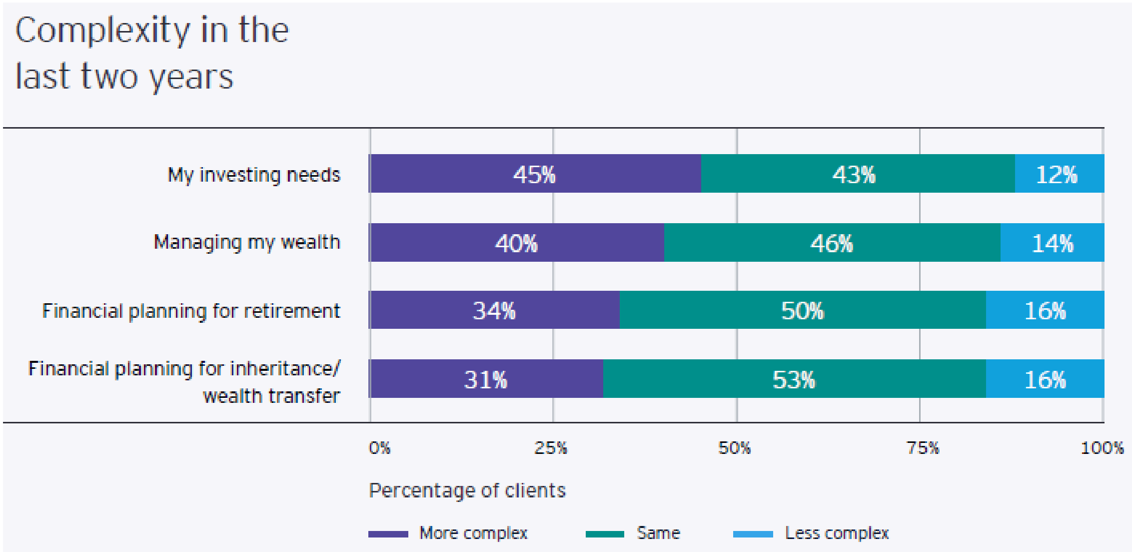
EY Global Wealth Management

[Consultancy EY has released its 2023 Global Wealth Management Research Report. It surveyed over 2,600 wealth management clients in 27 countries.]

The research shows that volatility and complexity are having a profound impact on investors' needs and behaviours. Clients of all types are seeking out additional advice and investment strategies. They're hungry for support and expertise and are increasingly willing to work with new providers.

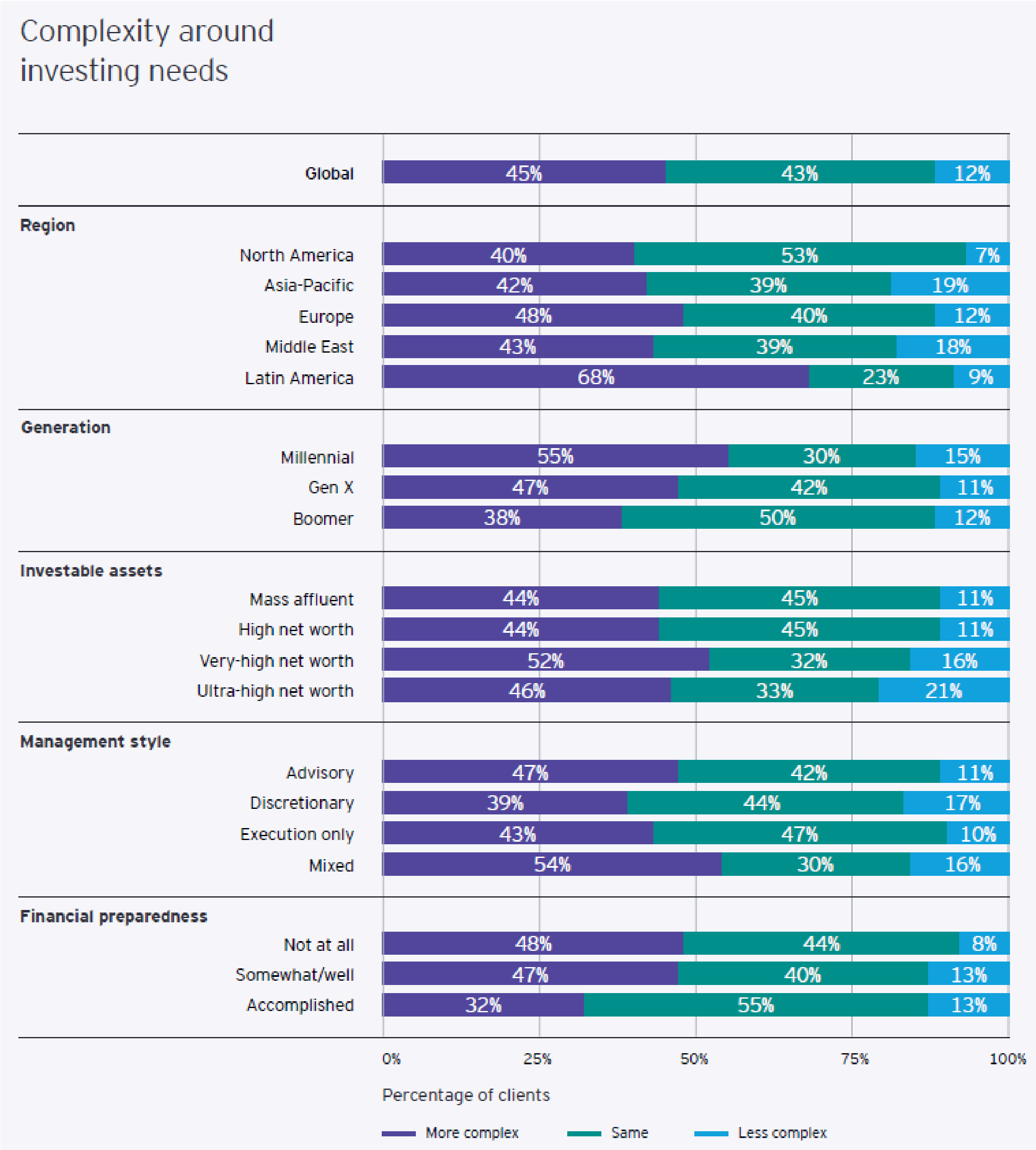
Market volatility is making wealth management harder

40% of clients think that managing their wealth has become more complex over the last two years, while only 14% say it has gotten easier.



This sense of complexity is not only in response to the political and economic shocks of recent months. It also reflects the rise of new investment products such as digital assets and the growing availability of online and hybrid offerings and the increasing complexity of the wealth management industry itself as FinTechs and other new entrants expand, and incumbents adapt their business models.

Among global clients who feel either unprepared or somewhat unprepared to meet their goals, a majority (57%) view market volatility as a reason for their lack of financial security. This rises to 69% among Boomers, who are more likely to have retired or are close to retirement.



More than a third of Australian clients (37%) think that managing their wealth has become more complex over the last two years, with 64% citing market volatility as a reason for their lack of financial preparedness.

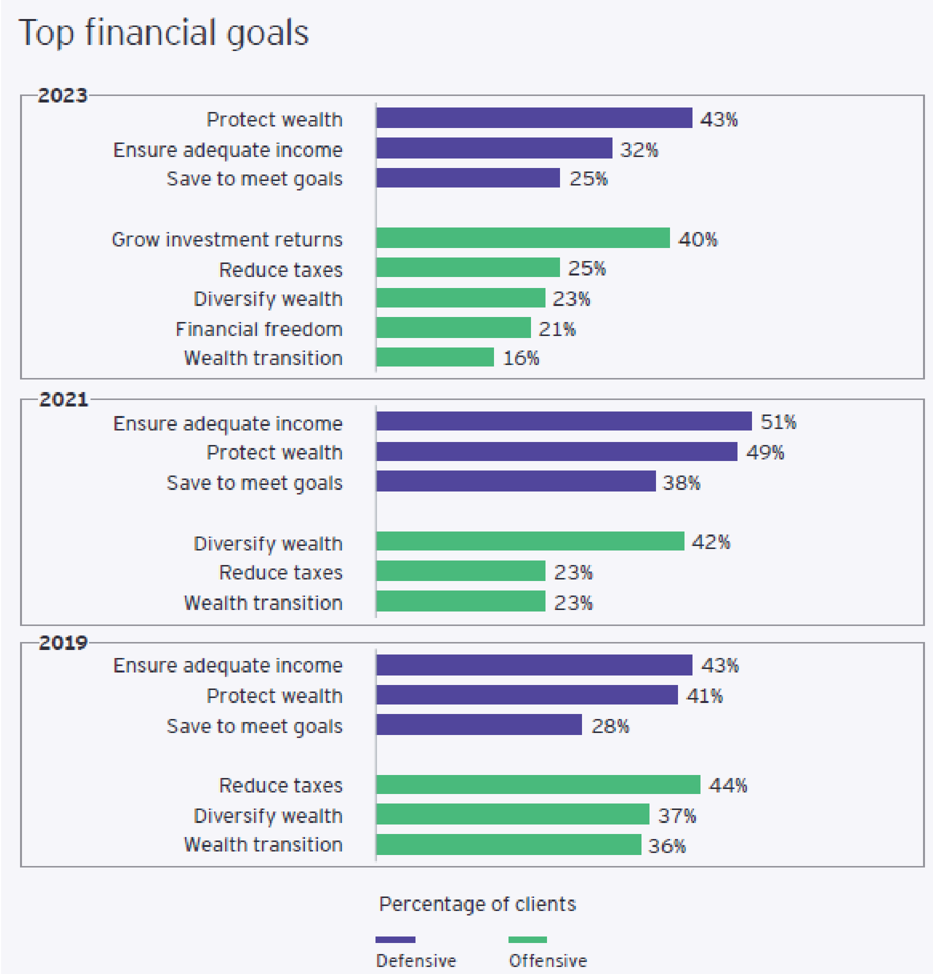
And Australians appear more actively aware of declines in their portfolios than those in other markets, with the vast majority (97%) saying they change investment behaviour due to declines in portfolio value, significantly above the global average of 73%

Less emphasis on passing on wealth

The volatility and uncertainty of recent years have reinforced the defensive focus of wealth management clients' financial goals.

Investors' three leading goals are now protecting against inflation, strengthening investment returns and ensuring financial security. Over the past two years, there has been a 30% decrease in the importance placed on purposeful financial legacy goals, such as transition of wealth to family and charity.

These are universal priorities, with limited variation between different age groups or levels of wealth. It's also notable that clients' need for protection and security is increasing their desire for expert advice on emerging threats to their portfolio — and on opportunities for recovery and growth.



Less satisfaction with newer asset classes

Overall levels of client satisfaction with traditional asset classes and strategies such as actively managed funds and passive investments are high, despite the impact of recent market volatility.

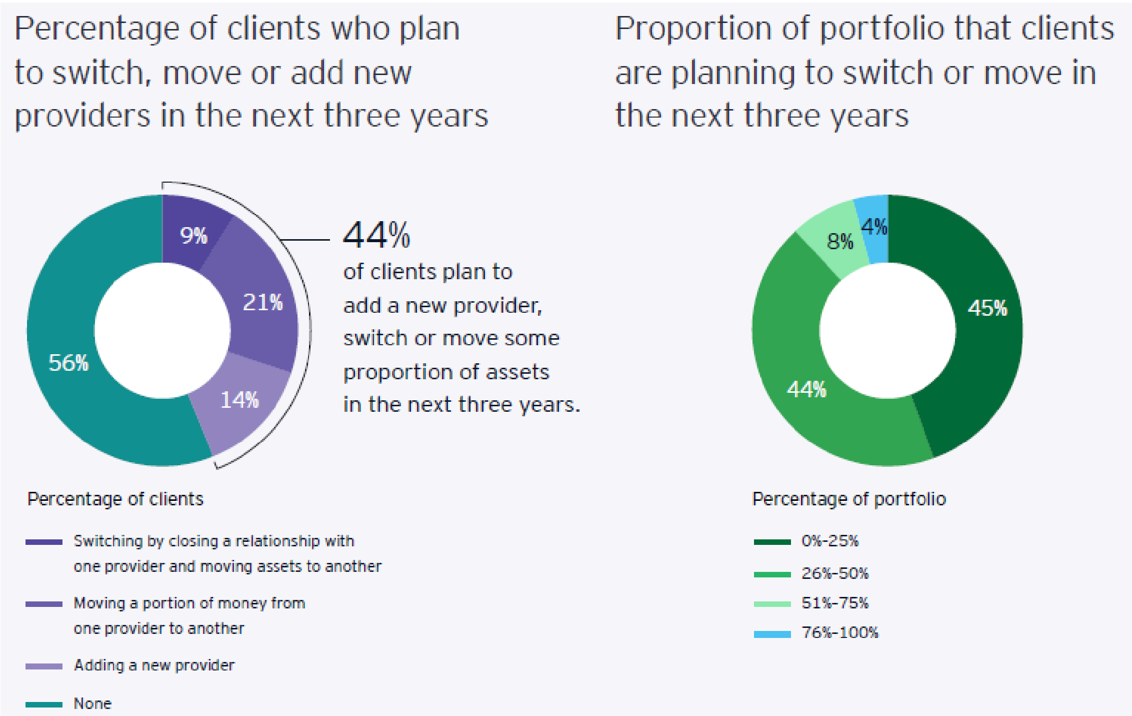
In contrast, clients are less satisfied with more innovative asset classes, including digital assets and alternative investments such as private equity or real estate.

Self-directed investors, those drawn to FinTechs by their ability to deliver specialized services at low cost, and investors with significant exposures to innovative asset classes, exhibit above-average appetite for more advice from their wealth management providers.

Appetite to work with multiple providers

Despite their defensive goals, almost half of all global clients (44%) plan to add a new provider (14%), move money to another provider (21%) or switch altogether (9%) over the next three years. As in prior years, North American clients are less likely to make some kind of switch than average (25%), but when they do move, they are likelier to transfer more than half of their portfolio compared to other regions. It is remarkable that most clients are planning some sort of switching in Asia-Pacific (57%), the Middle East (59%) and Latin America (62%).

Overall, however, the dominant theme is not outright switching but an increasing desire to spread assets between multiple providers. The research shows an anticipated increase of 12% in the average number of providers that clients expect to work with over the next three years. Millennial investors are more than twice as likely to switch (73%) than Boomers (29%), with almost one in five expecting to add a new provider. They are also more likely to shift a larger slice of their assets.



In Australia, two in five clients (41%) plan to add a new provider, move money to another provider, or switch altogether in the next three years.

The proportion of Australian clients working with FinTechs to manage their wealth is expected to more than triple over the next three years – from 8% to 28% – attracted by the sector's low charges, specialised digital experiences and low-friction switching. That growth is significantly ahead of the global average, which is expected to double from 9% to 18% over the same period.

Appetite for advice grows

The survey shows investors are hungry for advice and expertise from their advisor to interpret economic, market and political shocks. Almost half (46%) of Australian respondents indicated they are looking for more advice across investment services, which is similar to the global average (48%) but the lowest among Asia-Pacific countries where the average is 56%. Among Australian respondents, mass affluent clients signaled the clearest appetite for more advice on investment services at 57%.

The survey also found that investors have acted in similar proportions in response to market volatility, moving to active investments and seeking safety with increased allocation towards savings/deposits. Almost all Australian respondents said they change investment behaviour due to a decline in portfolio value, and almost half (48%) have moved assets into active investments in the past two years. Conversely, only 36% have taken a more conservative move towards savings and deposits.

The survey also found that half of Australian investors (51%) would seek additional financial advice, and 73% would review their financial plans in response to future volatility.

Most of the wealthy are 'maximisers'

This year, we added a behavioral science approach to the research in order to emphasize the importance of psychological factors in economic decision-making.

By measuring behavioral traits, wealth managers can glean powerful insights into client motivations and preferences that are otherwise hidden in traditional segmentation models. As providers continue to seek opportunities to improve acquisition, engagement and retention, behavioral-based segmentation will increasingly drive new paradigms of personalization in the industry.

To measure client decision styles, we constructed a scale based on theories and research from the fields of behavioral science and personality psychology. According to the Nobel prize-winning social scientist Herbert Simon, people tend to make decisions by either Maximizing or Satisficing ("sufficing" plus "satisfying").

Maximizers exhaustively examine every available option before carefully choosing the highest utility choice. Satisficers tend to make decisions by choosing the first option that is "good enough" to meet their basic criteria.

The research found that 59% of wealth management clients worldwide are Maximizers, while 41% are Satisficers. Of particular interest highlighted in this report to providers, we found significant differences between how these two groups perceive complexity, their propensities to switch providers, and their preferences for engagement frequency.

The research found that Maximizers prefer monthly advice on their financial plans twice as much as Satisficers (28% vs. 14%). Additionally, Maximizers are 72% more likely to seek a new provider when faced with overload and 55% more likely to switch providers than Satisficers. Therefore, wealth managers should prioritize offering frequent advice to Maximizers and simplify their investment options and financial plans to reduce overload. Failure to do so could result in losing assets to another provider.

The full 2023 EY Global Wealth Management Research Report can be downloaded here. This article does not consider the circumstances of any person and is subject to the disclaimers in the full Report.

Market turbulence shows strength of Australian bank T2 bonds

Phil Strano

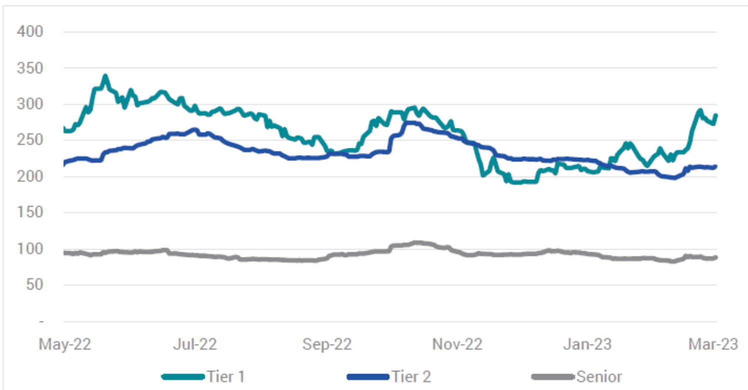
Hybrid securities have gained popularity among Australian retail investors over many years, though that was shaken when the AT1 hybrids of Credit Suisse were wiped out in March 2023. What's been overlooked though is that the Credit Suisse tier 2 (T2) bonds were not written down. And that strengthens the investment case for the superior quality of Australian bank T2 (subordinated) securities.

Since the forced merger of Credit Suisse and UBS, and the subsequent full write downs of Credit Suisse's AT1 hybrid securities, market volatility has settled. However, while $A major bank AT1 spreads have pushed out by about 0.5% (50bps), they still appear expensive compared to their USD and EUR denominated equivalents.

Moreover, $A, AT1 hybrids are also expensive compared to their T2 subordinated debt counterparts, with only about 0.5% (50bps) in additional margin (refer Chart 1), offering poor compensation for inferior credit quality and, no matter how implausible in Australia, the higher probability of impairment in a non-viability scenario.

Recall that AT1 is lower in the repayment waterfall than T2 and investors should be compensated for the higher risk. The more appropriate AT1 spread for the additional risk remains roughly twice that of T2, akin to where offshore AT1s currently trade.

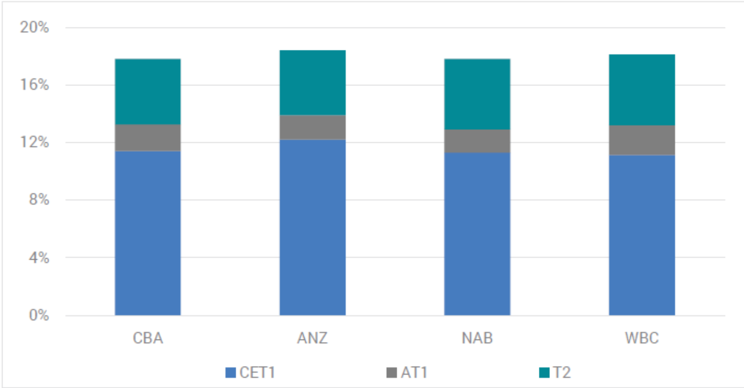
Chart 1: Australian Major Bank Spreads – 4Yr T1/T2/Senior



Source: YCM, Bloomberg.

It's worth providing a reminder of exactly what happened to Credit Suisse debtholders. While the Credit Suisse AT1s were zeroed, their T2 securities were protected and rolled into the newly merged Credit Suisse/UBS entity at par. This distinction is incredibly important, since Australian major bank T2 securities sit at the top of a large regulatory capital structure, protected from impairment by Common equity tier 1 (CET1 ~11-12%) capital and AT1 (~1.5-2%) capital (refer Chart 2).

Chart 2: Major Bank Regulatory Capital As % Of Risk Weighted Assets



Source: YCM, Bloomberg.

From a capital perspective, T2s have been de-risked in recent years, with total Tier 1 capital (CET1 + AT1) increasing by ~4% since the GFC. When we include the ~1-2% of earnings buffers which can be redirected to capital replenishment, T2 securities look safe today from impairment, given they are protected by ~14.5-15.5% in subordinated capital and earnings.

With their current ~6.0% yields, Australian major bank T2 securities remain important overweights across all our diversified Australian credit portfolios. Not only are they contributing significantly to income levels, but they are also well placed to provide capital growth opportunities when spreads eventually contract from current high levels.

Call risk has diminished for bank T2

Finally, we see the latest volatility as having positive implications for T2s, with call risk now significantly diminished from what the market speculated a mere six months ago.

Investors may recall APRA stating its desire for financial institutions to consider not calling T2 securities due to credit spreads being wider than historical levels. Not calling T2 securities would generally extend their life for a further five years and lower valuations.

After the recent bank failures in the US and the Credit Suisse/UBS merger, the argument of whether APRA will or won't permit T2 calls now seems somewhat redundant. This was further reinforced recently with APRA approving yet another supposed 'non-economic' call for BOQ's T2 securities which is likely to be replaced by a new T2, likely to be ~100bps more expensive.

Not enabling T2 calls on mere higher spreads would risk far greater economic damage in the current environment and appears to be off the table even though, as we noted at the time, APRA's initial argument held little merit.

Phil Strano is a Senior Portfolio Manager at [Yarra Capital Management](). This article contains general financial information only. It has been prepared without taking into account your personal objectives, financial situation or particular needs.

Yarra's overweight positions in T2 underpin the running yields on offer in the Yarra Enhanced Income Fund (5.9%) and Yarra Higher Income Fund (6.8%) portfolios.

What the Federal Budget means for you

James Gruber

This year's Federal Budget is expected to return to a small surplus of $4 billion for 2022-2023, the first time that the Budget has been in the black for 15 years. But the Budget is forecast to return to deficit in 2023-2024.

Key spending measures, many announced prior to Tuesday night, include:

- $14.6 billion in cost-of-living support over four years including:

i) $3.5 billion for Medicare over five years to improve access to bulk billing by tripling the incentive payment to GPs.

ii) $3 billion in one-off energy bill relief (split 50:50 with the states) for five million low-to-middle income households and one million small businesses. Households will receive $500 rebates, while small businesses will get $650 rebates.

iii) $1.9 billion to help single parents. They'll receive increased welfare support until their children turn 14 as well as increased payments.

iv) $4.9 billion over five years for increased Jobseeker payments. The higher Jobseeker rate of $745.20 a fortnight, previously only available to those 60 and over, will be extended to include people 55 and over.

v) Renters will get an additional $2.7 billion via a rise in the maximum payment rates of Commonwealth Rent Assistance of 15%.

- More support for the aged care sector, principally through a 15% pay rise for workers that will cost $14.1 billion over four years.
- Measures to help housing affordability, such as broader access to the Home Guarantee Schemes and tax changes to boost build-to-rent housing.
- $2 billion for the hydrogen industry and incentives for developers to build more environmentally friendly homes.

Budget saving initiatives include:

- $9.1 billion over the next five years by cracking down on those avoiding GST and personal income tax.
- Changes to the Petroleum Resource Rent Tax to raise $2.4 billion over four years.
- A 5% hike to the tobacco excise, bringing in an additional $3.3 billion.
- Increasing the payment frequency of super.
- Slowing NDIS growth from 13.8% per annum to 8%.

Below, AMP's Shane Oliver compares the Government's economic assumptions to his own forecasts.

Economic assumptions

		2022-23	2023-24	2024-25	2025-26	2026-27
Real GDP	Govt	**3.25**	**1.5**	**2.25**	**2.75**	**2.75**
% year	AMP	3.0	1.3	2.5	2.5	2.5
Inflation	Govt	**6**	**3.25**	**2.75**	**2.5**	**2.5**
% to June	AMP	6.2	3.0	2.7	2.5	2.5
Wages,	Govt	**3.75**	**4.0**	**3.25**	**3.25**	**3.5**
% to June	AMP	3.7	3.5	3.2	3.25	3.5
Unemp Rate	Govt	**3.5**	**4.25**	**4.5**	**4.5**	**4.25**
% June	AMP	3.6	4.4	4.2	4.25	4.25

Source: Australian Treasury, AMP

On superannuation, there are two important highlights:

- It came as no surprise that the Government confirmed it would increase the tax on earnings for superannuation balances exceeding $3 billion. Yet as Firstlinks' contributor Meg Heffron notes, the Budget indicates that the Government won't be changing how it calculates the tax:

  *"… we had hoped the Government might adjust the method used to calculate the tax (to avoid a current criticism that the proposed method effectively taxes unrealized gains), might index the $3 million threshold or might allow those who exceed it to withdraw some of their super even if they hadn't reached the age where this would normally be allowed. It seems that **won't** be happening."*

- The Government provided an update on proposed amendments to the non-arm's length expenditure (NALE) rules. It will limit the income of SMSFs and small super funds that are taxable as NALI to 2x the general expense. Fund income taxable as NALI will also exclude contributions. The changes could result in higher tax bills for SMSFs and SMSF trustees. For further details, go here:

For more on the Budget, please see updates from two of our sponsors below.

nabtrade

nabtrade's Gemma Dale breaks down the Budget and what it means for you, with a focus on:

- Taxation
- Superannuation
- Families
- Cost of living measures

Click here to watch the video or read the full commentary.

Heffron

The 2023 Federal Budget was about cost of living pressures, health and housing, so not surprisingly, superannuation didn't rate much of a mention. Meg's summary is here.

James Gruber is an Assistant Editor at Firstlinks and Morningstar.com.au