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Editorial

Most people think they want to be rich, and that means getting a high-paying, high-powered job, which allows them to buy a fancy home, car, and other possessions. Dig deeper though, and what they often want is something entirely different. What they really want is to become wealthy. Becoming wealthy means having enough income coming in, whether they're working or not. And it often means earning passive income from assets through equity in a business directly, or indirectly via the share market. Becoming wealthy like this can ultimately give people the time and flexibility to do what they want when they want.

Being rich

I once met one-on-one with a fabulously successful and rich businessman in Hong Kong. It was in 2005 when I joined a stockbroker. The broker was a growing boutique which had successfully taken on bigger investment banks like Goldman Sachs in Asia. The Chairman, Gary Coull, was a Canadian who'd founded the firm with an Australian partner almost 20 years earlier.

Not long after I joined, I got called in by a division head mid-afternoon who said: "The boss urgently wants a name for this new private equity fund that we're seeding, and he wants you and I to come up with one by close of business today". We quickly got to work, though finding a unique name that hadn't been already taken was harder than first thought.

We came up with a few naming options, and an hour later, Coull asked for me, just me, to see him in his office immediately. His office had a fabulous view overlooking Victoria Harbour, the expansive waterway that separates Hong Kong Island in the south and Kowloon to the north.

The meeting began with small talk, and it quickly became clear that the Chairman knew my background and others who'd recently joined the firm. Then, he got to the proposed names, and gave me a steely gaze. "These names are sh*t. I don't want ancient or prosaic names. This is an Asian fund, and the name needs to reflect that. Come back in an hour with better".

We did as he asked. At 2.30am the following morning, I was awoken with a text message from an unknown number: "Gruber, almost there".

Soon after, Coull got cancer, and he died a year later at the age of 52. His Australian partner had previously died at the same age.

Coull had worked day and night on his business, as I witnessed, he'd accumulated hundreds of millions of dollars, and was widely respected and lauded both in Asia and worldwide. He was also divorced, didn't have children, and died at a slender age.

Coull had all the trappings of being rich, but he didn't convert them into wealth and true financial freedom.

Being wealthy

I'm friendly with a guy in my neighbourhood who always dresses like a beach bum: casual, loose-fitting shirts, shorts, and flip-flops. Before knowing him, I'd often see him during workdays, and hanging out with his kids after school. His wife didn't work and that got me curious about what he did for a living.

It turns out the guy is wealthy, though you wouldn't know it from his appearance. In his early 40s, he's on the boards of several companies, including his own. He helps raise money for the companies and has equity stakes in each of them.

He doesn't work a lot and essentially does whatever he wants. He goes to all his kids' activities, and coaches one of their local sporting teams. He's a mad football supporter and watches many of the games on the weekend.

This bloke seems to have few of the trappings of being rich. He doesn't have a high-powered job, he doesn't have a fancy car or house, and he doesn't seek fame.

While he may not be rich in many peoples' eyes, he's undoubtedly wealthy.

Does one lead to the other?

The question is whether people need to work 24/7 in a high-paying job to attain the desired wealth and freedom. It can happen that way though doesn't need to. And one doesn't automatically lead to the other, either.

At the stockbroking firm, I knew plenty of people in their 30s who'd become rich and yet continued to work hard and play harder. I worked out that they kept going, even when they didn't need to, because they had certain lifestyles to maintain, and more cars, houses, and other things to accumulate. Many of them never got off that treadmill.

Another story comes from the father of a friend of mine, who was a top-notch lawyer. As a partner in the firm, he worked day and night, and many weekends, for 40 years. He got many of the trappings of success, though he sacrificed his family for the sake of work. That led to divorce when his two children were reaching their teens.

Nowadays, he's retired, drinks too much wine, and doesn't know what to do with himself. He never learned to convert his money into wealth and freedom.

Differences between the two

There are two key differences between being rich and being wealthy:

1. Both involve making money, but it's the way that money is made that differs. Being rich means getting a high-paying job; being wealthy means owning income-producing assets, usually via owning equity in a business, directly or indirectly. Being rich means working more to earn more; being wealthy breaks the nexus between time and money, where people earn money even when you sleep. While it's true that money from a job can be converted into income-generating assets, that's the indirect rather than the direct route to wealth.

2. Being rich means being a slave to time through work; being wealthy can allow people the flexibility to do what they wish with their time.

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In my article this week, I look at the holy grail of investing: finding stocks that can generate life-changing returns. Nividia and Pro Medicus are recent examples of stocks that have increased more than 100x over the past decade. I outline four ways to increase your chances to unearth the next 100-bagger, and the challenges that you may face along the way.

James Gruber

Also in this week's edition...

There's new data out on how SMSFs have been investing their money. The report reveals that the number of advised SMSFs has continued to rise at the expense of self-directed SMSFs. And **AUSIEX's Brett Grant** says more SMSFs are using ETFs to invest overseas and diversify their portfolios.

Dividends globally are up, while Australia's are down. In 2023, worldwide dividends increased 5%, and the fourth quarter continued the momentum, up 7.2%. The banking sector was the key driver for global dividend increases. However, **Janus Henderson's Ben Lofthouse** say Australia lagged last year due to reduced dividends from the benchmark-heavy mining sector.

The Aged Care Taskforce's final report is more than a week old, and **Rachel Lane** has had the time to go through the fine print. She's found some intriguing details, including an 'unofficial' recommendation that will see higher aged care accommodation costs for all, not just the wealthy, as well as considerable uncertainty around means-testing, and government subsidies.

There's an ongoing debate about whether passive investing is distorting markets. **Robert Almeida** from **MFS** has a different take on the issue, suggesting passive investing is amplifying the disconnect between valuations and fundamentals, with a lot of capital being allocated based on market cap rather than on which opportunities may offer the best risk-adjusted returns. He says that's not how capitalism is supposed to work and it's bad news for economies.

It's great to have **Paul Moore** from **PM Capital** contribute an article for us. Formerly of BT, Paul has been a trailblazer in global equities and has delivered strong long term returns for his clients. Today, he gives his market overview and expresses surprise at being able to still find cheap stocks, with single digit PEs and double digit dividend yields, in what he considers an overvalued global market.

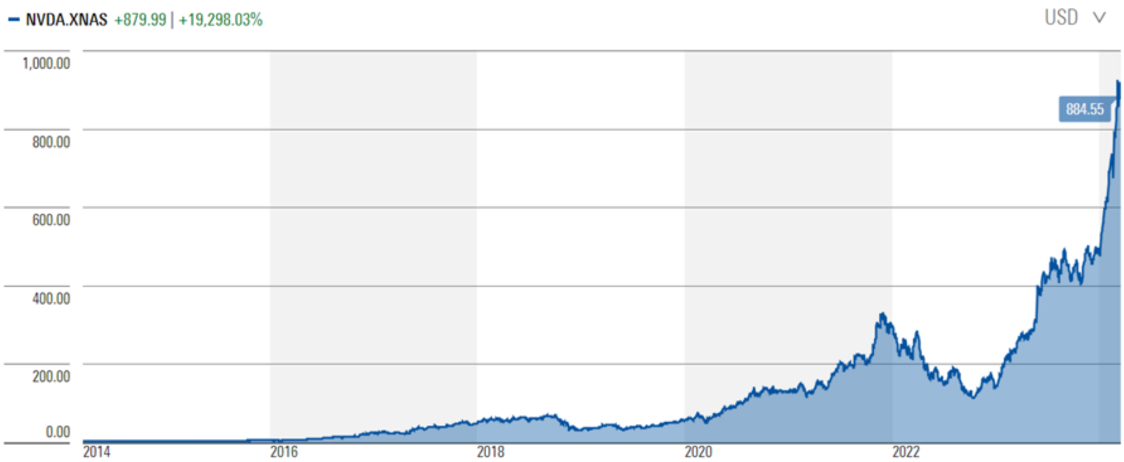
After the strong performance of global investment grade credit in 2023, **Yarra Capital's Phil Strano** says the Australian credit market is emerging as a great diversifier and alternative to investing in other 'safe haven' asset classes, including residential property.

Lastly, in this week's whitepaper, **VanEck** looks at the attractive opportunities in emerging market bonds.

Finding the next 100-Bagger

James Gruber

The holy grail of investing is to find a stock that can deliver life-changing returns. You don't have to look far to see recent examples of companies that have achieved this feat. The chart of stock market darling, Nvidia, is something to behold.



Source: Morningstar

Over the past decade, Nvidia's share price has increased 192x. In 2014, it was already a large company with a market capitalization of close to US$11.5 billion that few investors, barring institutions, had heard of. Now it's worth US$2.2 trillion and everyone is talking about it.

There are examples in Australia too. Pro Medicus' share price has risen 126x over the past 10 years. It's grown from a small company with a market capitalization of close to $80 million into a top 50 ASX stock worth $10.1 billion.

Source: Morningstar

Some people see charts such as these and they invest in the market like they would the lottery – betting on a 1-in-a-million shot at hitting the next big thing. For instance, buying into a new technology, a new pharmaceutical drug, or a new mine. That kind of speculation often leads to poor results and disappointment.

What's a better way of unearthing the next Nvidia or Pro Medicus? Here are four methods that can help find quality investments set to deliver strong long-term returns:

1. The Peter Lynch Way

Recently, Andrew Mitchell from Ophir Asset Management mentioned in a LinkedIn post that the one book he recommends to people who are new to investing is *One Up on Wall Street* by Peter Lynch. I agree.

Lynch is a former fund manager at Fidelity whose main fund returned 29% per annum from 1977 to 1990. He looked for growth stocks whose earnings were set to take off, and the book details how he identified these stocks.

One method still resonates with me. Lynch suggests investigating companies that you use every day. For example, you may own and run a small business. There's a good chance that your accountant switched your accounting software to cloud provider, Xero, up to a decade ago. Back then, Xero wasn't well known, and may have been worth exploring as an investment.

Taking the example further, you may operate this business in tourism and accommodation and know of other suppliers that are doing well. For instance, you might deal first-hand with Booking Group, which operates booking.com, and has been taking share from Expedia and others since Covid.

And your wife or children may come home one day raving about a new shop that offers a unique product or service. That could turn into the next Smiggle or Lovisa.

Lynch thinks that investors can get an edge by getting to know companies before they appear on the radars of institutional investors and brokers. And one way to do that is by keeping an eye on growing companies that you encounter in daily life.

2. The Warren Buffett way

When it comes to finding stocks that can deliver outsized long-term returns, there is no better teacher than Warren Buffett. In a recent article, Morningstar's Amy Arnott, outlines the DNA of a typical Warren Buffett company. She sees five common traits of companies which make it into Buffett's investment portfolio:

- **An economic moat.** This means a company that has a sustainable competitive advantage. For example, Berkshire Hathaway insurance subsidiary Geico enjoys a durable cost advantage by selling policies directly instead of paying sales reps.

- **An outstanding management team.** Buffett has always sought outstanding CEOs. He admired Katherine Graham, who ran The Washington Post in the 1970s, Tomy Murphy and Dan Burke at media outfit, Capital Cities/ABC, and Coca-Cola's late Chairman Don Keogh.
- **Thoughtful capital allocation.** This means companies that deploy capital to build shareholder value over time. Buffett deplores empire building acquisitions, dilutive share raises, and managers who put themselves first rather than shareholders. Instead, he likes those businesses that make thoughtful acquisitions and buy back shares when their stocks are undervalued.
- **Earnings power and financial strength.** Buffett avoids companies that use accounting tricks to fudge their financial numbers. He prefers using measures such as operating earnings, return on equity, and free cashflow, to assess a company's earnings power and strength. A famous example of earnings power comes from one of Buffett's initial investments, in See's Candies. Millions of repeat customers for its boxed chocolates and its low-cost structure means See's has been able to consistently raise prices over time, enabling growing profits and returns on capital.
- **An easy-to-understand business.** Buffett has always favoured simple business models. For this reason, he shunned tech companies for a long time. He has also generally avoided rapidly evolving industries like airlines and investment banking.

3. Find great companies in the best sectors

One shortcut to finding a Buffett-like stock is to identify the best and worst sectors to invest in. The best sectors are those that have a capacity to defy the laws of capitalism and retain high returns on capital over a long period of time. The below chart from finance professor, Aswath Damodaran, covers sectors in the US.

"Best" businesses (2013-2022)

Industry name	Number of firms	ROCE	WACC	ROCE-WACC
Tobacco	56	35.4%	6.9%	28.4%
Information Services	242	32.9%	9.3%	23.7%
Healthcare Support Services	460	28.8%	7.7%	21.1%
Advertising	362	25.9%	8.4%	17.5%
Household Products	589	24.4%	8.2%	16.2%
Computer Services	1,105	21.8%	8.4%	13.4%
Beverage (Soft)	100	20.3%	7.1%	13.3%
Retail (Building Supply)	98	20.2%	7.8%	12.4%
Business & Consumer Services	961	20.3%	8.0%	12.3%

"Worst" businesses in (2013-2022)

Industry name	Number of firms	ROCE	WACC	ROCE-WACC
Brokerage & Investment Banking	592	0.1%	5.3%	-5.2%
Bank (Money Centre)	596	0.0%	4.7%	-4.6%
Banks (Regional)	800	0.0%	4.6%	-4.6%
Financial Svcs. (Non-bank & Insurance)	1,089	0.5%	4.2%	-3.7%
Oil/Gas (Production and Exploration)	616	6.1%	9.5%	-3.4%
Air Transport	155	3.6%	6.6%	-3.0%
R.E.I.T.	792	3.1%	5.6%	-2.5%
Auto & Truck	154	5.9%	7.7%	-1.9%
Real Estate (Operations & Svcs)	730	4.6%	6.0%	-1.4%

Source: Aswath Damodaran, Professor of Finance at Stern School of Business at New York University.

Professor Damodaran aggregates each sector's return on capital employed (ROCE), which measures how efficiently a company is using its capital to generate profits. And he also calculates the cost of capital (WACC) for the sectors. Companies create value whenever they can generate returns on capital above their WACCs. The higher the spread between ROCE and WACC, the better.

As the chart demonstrates, tobacco has created the most value of any sector in the US. It's followed by the technology and healthcare sectors.

Conversely, the worst sectors to invest in are those that can't generate returns above their costs of capital. Sectors in this category in the US include investment banking, banks, airlines, and oil gas.

The importance of the above is that higher ROCE-WACC spreads result in better long-term EPS growth, and higher share prices. It's no coincidence that tobacco has been the best performing sector in the US over the past century.

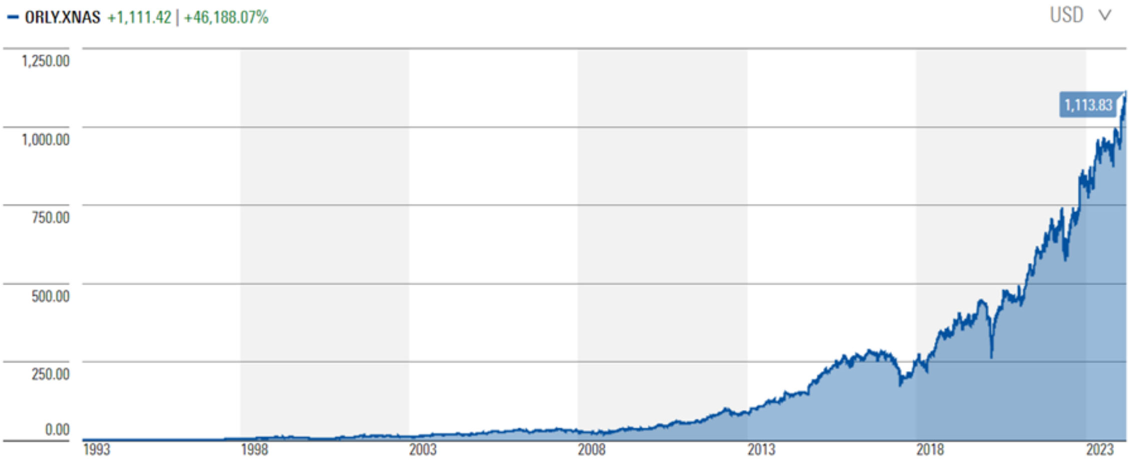
While Professor Damodaran's work focuses on the US market, it's equally applicable to the ASX.

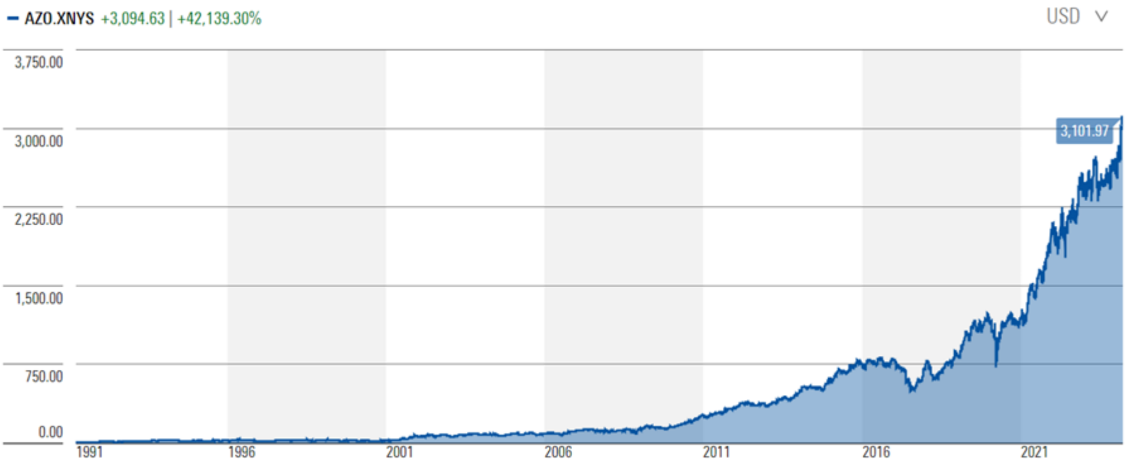
What allows an industry to produce high returns over a long time? It varies, though it can involve barriers to entry creating a consolidated industry. For tobacco, government restrictions on advertising favour incumbents as they make it hard for any new competitors to get traction with their brand. Increased taxes on smoking creates a further barrier for newer entrants to the industry.

Other consolidated sectors offering barriers to entry include payment networks with Visa and Mastercard, North American railroads, credit ratings with S&P Global and Moody's.

Banking offers commoditized products, though the industry in Australia delivered outsized returns for a long time thanks to the government's 'four pillars' policy. The sector's structure is an oligopoly which has helped returns stay above the cost of capital.

Some of the best investments have involved industries where there is slow growth, discouraging new competitors and encouraging consolidation. A great example of this is in US auto parts retailers, where O'Reilly Automotive and AutoZone have delivered spectacular long-term returns.





Source: Morningstar

Locally, examples of consolidating industries include insurance brokers, such as Steadfast and AUB, as well as funerals (Propel, and the formerly listed, InvoCare).

4. Linear stock prices

Recently, I came across a short book, *The Intelligent Quality Investor*, which looks at how to invest in the world's best companies. The book focuses on the best stock performers of the past 40 years, and what they have in common. Besides the Buffett-like qualities of high returns on capital and prodigious free cashflow generation, the book also zeroes in on the concept of linearity. To illustrate the concept, let's take the two charts below. The first is Constellation Software, a global software company, and the second is United States Steel.

Source: Morningstar

Linear charts are like the first one of Constellation Software. They go up and right and are relatively smooth. These types of charts often demonstrate companies that are consistently profitable, reinvest their profits at higher returns, and are resilient to economic downturns.

Non-linear charts such as United Steel's, tend to show companies whose profits go up and down, are often capital-intensive, and are highly susceptible to recessions or downturns.

I would never suggest that price denotes value. However, the point here is that price charts can be a useful tool to identify quality companies.

Holding onto quality companies can be the hard part

It's one thing to find the next Nvidia or Pro Medicus; it's quite another to have the patience and conviction to hang onto a stock for the long haul and let compounding work its magic.

In his book, *100 Baggers*, Chris Mayer says that the average US stock that's gone up by 100x has taken 26 years to reach the milestone. *26 years on average*.

Going back to the Nvidia chart at the beginning, despite the stock rising 192x over a shorter period of a decade, it still had multiple drawdowns, including when it dropped 65% in 2021-2022.

Few investors can withstand 65% stock price falls, and that may be the biggest lesson of all. As the late, great Charlie Munger once said: "if you can't stomach 50% declines in your investment you will get the mediocre returns you deserve".

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How SMSFs are investing their money

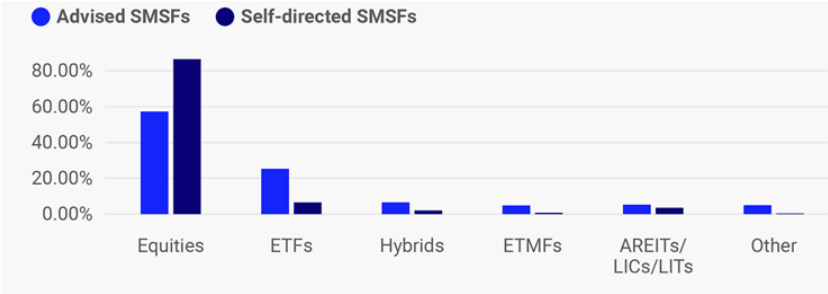
Brett Grant

In challenging trading conditions marked by rapid rate rises, inflation and geopolitical uncertainty, advised SMSF accounts have remained resilient, continuing to favour a distinct, well-diversified mix of asset classes, securities and sectors.

There was a rebound in the number of advised self-managed superannuation funds (SMSFs) over the past year. By contrast, the number of self-directed investors opening SMSF accounts declined.

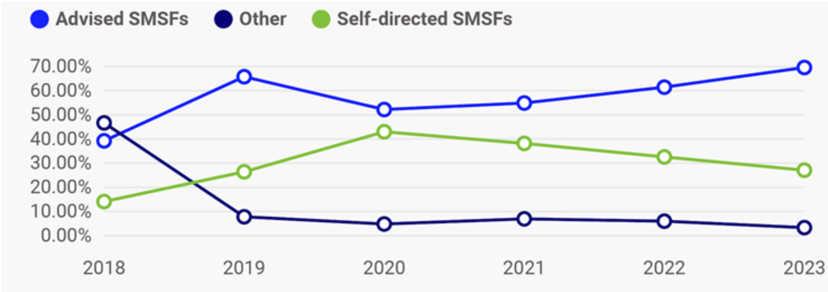
Generation X were chief among the advised investors opening new SMSF according to AUSIEX trading platform data. Their share of new accounts rose by more than 14% year-on-year to end 2023, while the share of new Baby Boomer accounts rose by a far more modest 2.1%. The share of new accounts opened by advisers for younger Millennials born between 1981 and 1996 rose 3.9% by comparison.

Figure 1: Holdings of SMSFs



Advised SMSFs are more diversified across asset classes in comparison with their self-directed counterparts and diversification away from ordinary domestic equities continued in favour of ETFs. (Source Data: AUSIEX, Feb 2022).

Figure 2: New SMSF Accounts Created by Segment (trend)



The proportional growth in new advised SMSF accounts rose again in 2023 (Source: AUSIEX)

By contrast, the number of new accounts created for self-directed SMSF investors across Generation X, Millennials and the Interwar generation all fell sharply year on year.

Figure 3: New SMSF accounts by generation and gender

		Advised		Self Directed	
		2022	2023	2022	2023
Baby Boomers	Female	14.03%	12.08%	10.44%	11.04%
	Male	**42.01%**	**42.69%**	**33.28%**	**39.79%**
Gen X	Female	7.48%	6.20%	8.48%	6.88%
	Male	**18.79%**	**22.69%**	**27.08%**	**26.88%**
Interwar	Female	4.00%	2.69%	3.10%	2.08%
	Male	7.14%	7.02%	9.46%	6.04%
Millennial	Female	**0.94%**	**1.80%**	**2.28%**	**1.88%**
	Male	5.61%	4.82%	5.87%	5.42%

Gen X males increased their share of overall advised SMSF accounts created, whilst Millennial females also saw a positive year on year change. (Source: AUSIEX)

Advice results in different portfolios

When it came to portfolios, advised SMSFs showed a preference for a broader range of securities than self-directed peers, most notably for exchange-traded funds as advisers appeared to diversify and minimise volatility from their client portfolios.

A large majority of SMSFs allocated capital to financials and materials – two sectors that make up more than half the market capitalisation of the S&P/ASX 200.

Notably, however, advised SMSFs appeared to have a materially different allocation to the healthcare and consumer staple sectors than their self-directed peers.

The diversity of ETFs now available is not only allowing advisers to build desired client exposures more efficiently but also gain access to international markets. This was evident in the ETF strategies employed by advised SMSF accounts in 2023 where specific exposures and global strategy ETFs were in relatively higher usage compared with non-SMSF non-advised clients.

The rise of women-directed SMSFs

The data also revealed that women are still less likely than men to hold an SMSF account overall.

There are already indications of greater interest from women in investing into SMSFs, with the proportion of AUSIEX holdings accounted for by female primary account owners increasing from 18.8% to 19.6% over the course of 2023.

Women-directed SMSFs had higher average monthly holdings than men throughout 2022 and 2023, recorded larger trade sizes and traded fewer securities.

Female SMSF clients with AUSIEX accounts did trade less than males in 2023 and traded less security types but had a higher average trade size (+1.3%) than their males peers over the same period (6% in 2022). On a per account basis, female SMSF accounts had a higher monthly balance (3.5%) than male SMSF accounts in December 2023 and in each month through all of 2023 and 2022.

Female advised SMSF accounts favoured ordinary shares in 2023 (49.12% of total trades (Males were 51.14%)) followed by ETFs (19.73% (Males were 19.12%)) and local call options (10.8%). This was also markedly different to their self-directed (non-advised) female SMSF counterparts, who showed a significantly stronger preference for trading ordinary shares only, with ETFs making up a much smaller proportion of total trades.

Advised female SMSF accounts also had the highest allocation to hybrid securities (7.6%) across all accounts (SMSF/non-SMSF and self-directed and advised).

Generation X females are another business opportunity for SMSF advisers as a relatively low number (compared to males) seek advice for SMSF investments, with this cohort also accounting for a declining share of new SMSF accounts created year on year.

Increased financial independence and longevity means more females are likely to need advice than ever before in the coming decades. Some research such as Boston College's Center on Wealth and Philanthropy suggest that women may inherit more than men from the Baby Boomer and Interwar generations from now until 2040, creating a large portion of potential clients for SMSF advisers. Various studies suggest 60% to 70% of wealth in the US and UK, respectively, is likely to be inherited by females over the coming years and it's reasonable to expect a similar trend in Australia.

Increased use of ETFs

The numbers show advised SMSFs are heavy users of ETFs relative to their self-directed counterparts. This was evident in the ETF strategies employed by advised SMSF accounts in 2023 where global equity ETFs, US specific exposures and global strategy ETFs were in relatively higher usage compared with non-SMSF non-advised (retail) clients.

This suggests advised SMSF accounts may be utilising ETFs as a tool for gaining international exposures via local listed markets.

Brett Grant is Head of Product, Marketing & Customer Experience, at leading wholesale trading platform AUSIEX. This information contains general advice and has been prepared without taking into account your objectives, financial situation or needs. You should consider its appropriateness, having regard to your objectives, financial situation and needs. Investors should read the relevant disclosure document and seek professional advice before making any decision based on this information.

Australia lags global dividend bonanza

Ben Lofthouse and team

2023 saw global dividends rise to a record US$1.66 trillion, up by 5% on an underlying basis. The year ended on a particularly positive note, with Q4 dividends rising 7.2%, thanks to strength in Europe, the UK and Japan. Special dividends were larger in the fourth quarter than we had forecast and this, combined with US dollar weakness, boosted the annual headline growth rate to 5.6%, ahead of our forecast. Underlying growth was in line with our expectations for the year.[1]

ANNUAL DIVIDENDS
BY REGION (US$ BILLIONS)

Region	2020	%*	2021	%*	2022	%*	2023	%*	Q4 2022	%*	Q4 2023	%*
Emerging Markets	$103.7	-2.7%	$135.2	30.4%	$153.9	13.8%	$166.1	8.0%	$25.4	-2.5%	$29.3	15.4%
Europe ex UK	$168.8	-32.1%	$230.4	36.5%	$255.6	10.9%	$300.7	17.6%	$25.3	8.8%	$29.4	16.5%
Japan	$80.5	-5.1%	$81.8	1.6%	$73.3	-10.3%	$78.9	7.6%	$30.0	-7.5%	$32.5	8.3%
North America	$551.0	2.9%	$573.1	4.0%	$632.3	10.3%	$665.1	5.2%	$156.7	4.4%	$167.6	6.9%
Asia Pacific ex Japan	$129.2	-19.1%	$174.5	35.1%	$186.2	6.7%	$172.3	-7.5%	$25.2	6.1%	$25.3	0.3%
UK	$63.1	-39.3%	$87.5	38.6%	$89.2	2.0%	$85.9	-3.7%	$10.0	-12.0%	$12.6	26.6%
Total	$1,096.2	-11.5%	$1,282.4	17.0%	$1,390.6	8.4%	$1,469.0	5.6%	$272.5	2.1%	$296.7	8.9%
Divs outside top 1,200	$139.1	-11.5%	$162.7	17.0%	$176.4	8.4%	$186.4	5.6%	$34.6	2.1%	$37.6	8.9%
Grand total	$1,235.2	-11.5%	$1,445.2	17.0%	$1,567.0	8.4%	$1,655.4	5.6%	$307.1	2.1%	$334.3	8.9%

* % change

Banks stood out

The banking sector delivered record dividends in 2023 and contributed half the world's dividend growth, as the higher interest rate environment enabled many banks to increase their margins. In addition, lingering post-pandemic catch-up effects meant payouts were fully restored, most notably at HSBC. Emerging market banks made a particularly strong contribution to the increase, though those in China did not participate in the banking-sector's dividend boom.

The positive impact from higher banking dividends was almost entirely offset by cuts from the mining sector, whose profits have fallen in tandem with lower commodity prices.

Beyond these two sectors, whose impact was unusually large, we saw encouraging growth from industries as varied as vehicles, utilities, software, food, and engineering, demonstrating the importance of a diversified portfolio.

Globally 86% of companies either increased dividends or held them steady but large cuts from just five companies – BHP, Petrobras, Rio Tinto, Intel and AT&T – reduced the global underlying growth rate by two percentage points.

Dividends by region

From a geographical perspective, the US, France, Germany, Italy, Canada, Mexico and Indonesia were just a handful of the 22 countries to see record payouts in 2023. Although its large size meant the US made the most significant contribution to global dividend growth, its 5.1% underlying growth rate was simply in line with the global average.

Europe ex UK was a key growth driver during the year, contributing two-fifths of the global increase. Payouts from the region rose 10.4% on an underlying basis to a record US$300.7 billion total.

Japan was also a major contributor, though the weak yen masked some of the strength shown across 91% of its companies.

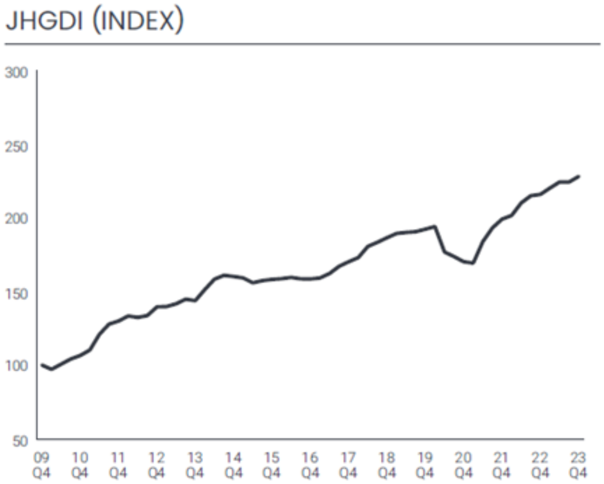
Despite impressive growth among many of the banks, emerging market dividends were flat on an underlying basis, thanks to steep cuts in Brazil and lacklustre growth in China.

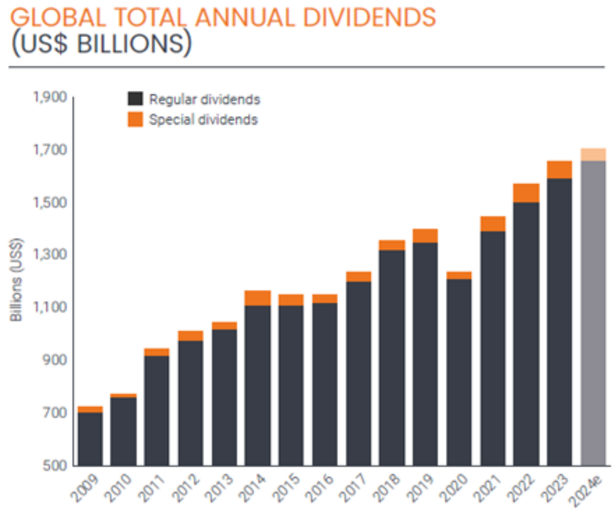
Meanwhile, Saudi Arabia is emerging as a significant contributor to global dividends, jumping ahead of the Netherlands in 2023 in the global rankings.

UK dividend growth of 5.4% roughly matched the global average as significant increases among the banks and oil producers were largely offset by lower mining payouts.

Most developed countries in Asia-Pacific ex Japan saw lower payouts year-on-year.

Pessimism over the global economy proved ill-founded in 2023 and although the outlook is uncertain, dividends look well supported – and have historically shown significantly less variability than profits. We therefore expect 2024 to show similar underlying growth to 2023, even if a likely fall in one-off special dividends reduces the headline growth rate. We therefore forecast total dividends of $1.72 trillion for 2024, up 3.9% on a headline basis, equivalent to underlying growth of 5.0%.





JHGDI (Janus Henerson Global Dividend Index)

Headline v underlying

Our headline figures are simply the total amount paid by companies in our index, expressed in US dollars. We prefer to emphasise the underlying growth rates, which adjusts the headline change to take account of the impact of exchange rates, volatile one-off special dividends and technical factors related to dividend calendars and changes to our index.

In 2023, headline growth of 5.6% was very similar to the underlying 5.0% change. One-off special dividends, which are highly discretionary and rather unpredictable, were almost unchanged year-on-year and were stronger than we had anticipated for the year. Reductions in special dividends from the oil and mining sectors were offset by vehicle manufacturers (VW and Ford) and transport group Moller Maersk.

The US dollar weakened in the fourth quarter which boosted the dollar value of Q4 payments made in other currencies more than seemed likely at the beginning of the period. Over the course of the whole year, exchange rates made very little impact, reducing the headline growth rate by just 0.2 percentage points. Over the long term, the impact of exchange rates is minimal.

FULL YEAR 2023 ANNUAL GROWTH RATE – ADJUSTMENTS FROM UNDERLYING TO HEADLINE GROWTH – BY REGION

Region	Underlying growth	Special Dividends	Exchange Rates	Index & Calendar Effects	Headline Dividend Growth
Emerging Markets	-0.1%	-0.1%	0.7%	7.5%	8.0%
Europe ex UK	10.4%	4.8%	2.2%	0.1%	17.6%
Japan	10.5%	-0.1%	-7.2%	4.4%	7.6%
North America	5.3%	-0.9%	-0.3%	1.1%	5.2%
Asia Pacific ex Japan	-6.0%	-0.2%	-1.6%	0.3%	-7.5%
UK	5.4%	-8.5%	0.6%	-1.2%	-3.7%
Global	5.0%	-0.1%	-0.2%	0.9%	5.6%

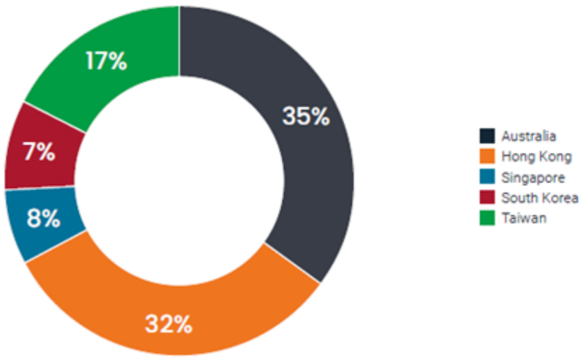
Q4 2023 ANNUAL GROWTH RATE – ADJUSTMENTS FROM UNDERLYING TO HEADLINE GROWTH – BY REGION

Region	Underlying growth	Special Dividends	Exchange Rates	Index & Calendar Effects	Headline Dividend Growth
Emerging Markets	3.5%	0.2%	4.7%	6.9%	15.4%
Europe ex UK	23.1%	-7.5%	3.7%	-2.8%	16.5%
Japan	9.8%	0.0%	-7.8%	6.3%	8.3%
North America	5.5%	0.3%	0.0%	1.1%	6.9%
Asia Pacific ex Japan	-0.5%	-1.2%	0.7%	1.4%	0.3%
UK	22.6%	0.0%	5.2%	-1.2%	26.6%
Global	7.2%	-0.6%	0.2%	2.1%	8.9%

How Australia fared

Large cuts in the dominant mining sector during 2023 wiped out one fifth of Australia's dividends and meant that collectively Australian payouts fell 10.7% on an underlying basis. Three quarters of companies grew their dividends or held them steady, but their increases were too small to offset the big cuts from mining groups. Double-digit growth from the banks and a one quarter increase from Woodside Energy made the most positive contributions during the year. With no mining companies represented in the fourth quarter, underlying growth of 6.9% was driven by the banks whose margins are expanding along with their peers around the world.

2023 FULL YEAR DIVIDENDS
ASIA-PACIFIC EX JAPAN

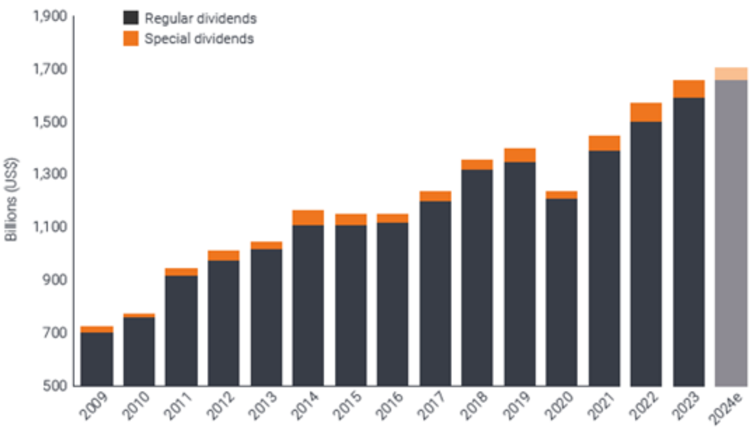


The outlook for dividends

Pessimism over the global economy proved ill-founded in 2023, although there was considerable divergence from one part of the world to another. Corporate cash flow in most sectors remained strong and this provided plenty of firepower for dividends and share buybacks. This resulted in 5.0% underlying global dividend growth for the full year in line with the long-term trend.

The outlook for 2024 is uncertain. The lagged effect of higher interest rates will continue to have an impact, with slower global economic growth anticipated and higher funding costs for companies. We are nevertheless optimistic for dividends in the year ahead. The run-rate of US dividend growth in the fourth quarter bodes well for the full year, Japanese companies have embarked on a process of returning more capital to shareholders, Asia looks likely to pick up, and dividends in Europe are well supported. From a sector perspective, even though the rapid growth we have seen from banks around the world is going to slow this year, the rapid declines from the mining sector are also likely to make less of an impact. Energy prices remain firm so oil dividends look well supported and the big defensive sectors like healthcare, food and basic consumer goods should continue to make steady progress. What's more, dividends are much less variable than profits over time.

GLOBAL TOTAL ANNUAL DIVIDENDS
(US$ BILLIONS)



We therefore expect 2024 to deliver similar underlying growth to 2023. One-off special dividends are by their very nature unpredictable, but they are unlikely to sustain the record levels we have seen over the last three years, so we assume these will fall to levels more in line with the pre-pandemic average of around $45 billion. Meanwhile, if the US dollar sustains its current lower levels against major global currencies, then we will see a small exchange-rate boost at the headline level. We therefore forecast total dividends of $1.72 trillion for 2024, up 3.9% on a headline basis. This equates to underlying growth of 5.0%.

Ben Lofthouse is Head of Global Equity Income at [Janus Henderson Investors](). Unless otherwise stated all data is sourced by Janus Henderson Investors as of 31 December 2023. Nothing in this document should be construed as advice. Past performance does not predict future returns. References made to individual securities do not constitute a recommendation to buy, sell or hold any security, investment strategy or market sector, and should not be assumed to be profitable. Janus Henderson Investors, its affiliated advisor, or its employees, may have a position in the securities mentioned.

[1]. We previously published a forecast for 5.3% for underlying growth, but after some data revisions related to the classification of special dividends in 2022, this became equivalent to 5.0%, in line with the actual outturn.

The aged care recommendations that will cost you more

Rachel Lane

In a significant development for Australia's aged care sector, the Aged Care Taskforce recently unveiled its Final Report, comprising 23 recommendations aimed at reshaping the fees and funding arrangements governing aged care. While there has been a lot of coverage of the official Recommendations, the devil is in the detail. In the Aged Care Taskforce report, there are a number of unofficial recommendations that could cost you substantially more for aged care. There is also a pivotal question that the report doesn't answer.

Refundable Accommodation Deposits to rise

Among the recommendations that didn't make it on to the official list of 23 is an immediate increase in the Refundable Accommodation Deposit (RAD) price threshold of $200,000 to $750,000 from its current level of $550,000. The report says:

"The Tune Review in 2017 recommended an immediate increase to $750,000 and indexation over time. While the Taskforce has not recommended a new maximum room price, it considers there is a need for an immediate increase in the rate and indexation over time to ensure it remains constant in real terms. The Taskforce considers implementing the prior recommendation from the Tune review is a prudent first step."

Presently, aged care facilities must obtain approval for RADs exceeding $550,000, effectively setting the benchmark for most beds at this price point. This small but significant change could take effect as early as July 1st, with the anticipated introduction of the new Aged Care Act and could see the price of many beds increase by $200,000 as a lump sum or around $16,500 per year for those who elect to pay their accommodation cost by Daily Payment.

Adding to this, the official recommendation from the Taskforce of imposing a 3% per annum levy on Refundable Accommodation Deposits (RADs), capped at 15%, would see the cost of the levy go from $16,500 per year, culminating in a deduction of $82,500 over five years, to $22,500 per year or $112,500 over five years.

RAD	Annual deduction 3%	Capped at 15%	Refundable amount after 5 years
$550,000	$16,500	$82,500	$467,500
$750,000	$22,500	$112,500	$637,500

Presently, the government shoulders 94% of residential aged care costs ($13 billion), with residents contributing 6% ($800 million) through means-tested care fees. In contemplating strategies for individual contributions to aged care costs, the Taskforce considered that the government could assume all care-related expenses, with individuals only responsible for accommodation and living expenses.

Means-testing won't just impact the wealthy

While not explicitly recommending the removal of current caps on means-tested care fees, the Taskforce suggested that the government might consider such a measure if it opts against fully funding care. Currently the amount you can contribute towards your cost of care is capped at a daily amount of $415 with an annual cap of $32,700 and a lifetime limit (across home care and residential aged care) of $78,500. Removing the annual and lifetime caps could see someone paying more than $151,000 per year in means-tested care fees, almost five times more.

The initial response to the Aged Care Taskforce Final Report has, on the whole, been very positive – after all, how could the media or the public disagree with the very simple premise that "Wealthy Australians should pay more for their Aged Care"? But who are these "wealthy Australians"? Under the current means testing arrangements, in order to be considered wealthy you simply need to have assets above $197,735. This relatively low benchmark of wealth creates what I call "aged care no man's land" for people with $200,000 or $300,000 needing to pay $550,000 for their aged care accommodation.

The Taskforce didn't provide details on the means testing for aged care, rather it hinted at a tiered approach based on pension qualification (full pension, part pension, or self-funded) and homeownership for those moving into residential aged care. The Taskforce also raised the prospect of aligning aged care means testing with pension arrangements which could see significant implications for carers and close relatives of aged care recipients, who could lose the ability to exempt the home they live in. Currently the home is an exempt asset while a 'protected person' lives there and is included in your aged care assessable assets up to a capped value of $197,735 when it is assessed.

Who pays what?

Ultimately, the funding of aged care in Australia hinges on a binary equation: how much should the government bear the burden (through taxpayer funds) versus how much should individuals foot the bill. As the government deliberates over which recommendations to adopt, it appears inevitable that the cost of aged care will go up. Ensuring that the higher price equates to better care is crucial, so is ensuring that there is equitable access, and that aged care is affordable.

Rachel Lane is the Principal of Aged Care Gurus where she oversees a national network of advisers dedicated to providing quality advice on retirement living and aged care. She is also the co-author of a number of books with Noel Whittaker including best-seller 'Aged Care, Who Cares?' and 'Downsizing Made Simple'.

For further information see: *The Final Report of the Aged Care Taskforce (2024)*, and the *Aged Care Legislated Review (Tune Review, 2017)*.

Passive investing is bad for capitalism

Robert M. Almeida

While every economic system has its drawbacks, capitalism, since its inception 700 years ago, has outperformed the alternatives. While many have been left behind at various points in time, capitalism has demonstrated its merit in allocating society's resources better than the decisions of a collective few.

But capitalism's edge in efficiency doesn't come without costs. One of its downsides is the unpredictable nature of business cycles. It seems to me that before the first quarter ends each year, most economic and financial market forecasts produced at the end of the prior year end up in the recycling bin as forecasters react to new and differing circumstances.

While this is one of the prices paid for living in a market-based system for allocating resources, why does it happen? And more importantly, what can we learn from it and why is it relevant?

A complex and adaptive system

While predicting rational decisions is possible, it's the unexpected or surprising decisions of some and the subsequent effects on the many that typically upend economic and financial market predictions.

Capitalism requires unsuppressed price signals for resources to be allocated efficiently. Those signals help create equilibrium between natural market forces, specifically supply and demand, for everything from the price of gum to the price of automobiles, to borrowing costs, to stock and bond prices. Society, from consumers, to business owners, to investors, is constantly altering its behaviour based on changes in prices.

Economists would call this a complex and adaptive system. It's complex because hundreds of millions of people make dozens of choices a day. It's adaptive because changes in prices lead to changes in behaviour. More interestingly, given humans have emotions and subconscious biases, sometimes our choices are made simply based upon the behaviour of others, influencing what may have otherwise been a rational decision. The combination of capitalism's complexity and adaptiveness often leads to radical and surprising outcomes.

Relevance for today

The policy response by global policymakers to the global financial crisis in 2008 was to reduce interest rates and inject capital into financial institutions. Rates were suppressed to historically unnatural levels for over a decade as money velocity fell and deflation risks mounted. None of this is new to you.

However, it's important to remember that interest rates represent the price of time and the cost of capital. Rates are the first hurdle that must be cleared in every capital allocation decision. Yet their price was not a function of natural supply and demand.

Years of interest rate disequilibrium blunted capitalism's price discovery process. But while we've yet to realize overdue corrections in the economy and financial markets, that doesn't mean we won't.

The socialization of capital losses in the post-GFC period beautifully paved the pathway for the massive growth of indexation. Investors are willing to pay a fee for the prospect of active managers limiting their downside, but they see no reason to do so when central bankers do the job for them.

That probably reads like a whiny, biased perspective from an active manager who's lost share to passive vehicles. Fair enough. However, with passive vehicles today representing over half of investable assets and the bulk of incremental investment capital, inefficiencies continue to grow.

When unencumbered by suppressed interest rates, financial markets push money toward enterprises with the highest risk-adjusted return on capital prospects and pull it from the weakest. This is Wall Street's version of natural selection, and it's capitalism at work.

But that isn't what's happening today. A lot of capital is being allocated based on market cap rather than on which opportunities may offer the best risk-adjusted returns. Indexing is momentum investing, accelerating the accrued financial market and economic inefficiencies leftover from the 2010s and pandemic-led stimulus.

Yes, some of the largest index constituents are high-returning businesses. But that doesn't mean they aren't wildly overvalued due to the new plumbing of finance and the growing disconnect between price and fundamentals. Perhaps more importantly, many of the companies attracting the most capital may face a significant risk of obsolescence from artificial intelligence.

Conclusion

Our capitalist system has proven the most efficient means of resource distribution. However, it requires untrammeled market forces to deliver correct price signals. When those signals are distorted, it creates problems.

Humans sometimes make irrational decisions, and as business cycles age, people tend to make more of them as they seek to get rich quick. It's important to consider that factor when managing other peoples' wealth.

Robert M. Almeida is a Global Investment Strategist and Portfolio Manager at MFS Investment Management. This article is for general informational purposes only and should not be considered investment advice or a recommendation to invest in any security or to adopt any investment strategy. It has been prepared without taking into account any personal objectives, financial situation or needs of any specific person. Comments, opinions and analysis are rendered as of the date given and may change without notice due to market conditions and other factors. This article is issued in Australia by MFS International Australia Pty Ltd (ABN 68 607 579 537, AFSL 485343), a sponsor of Firstlinks.

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Finding single-digit PE stocks in an overvalued market

Paul Moore

The most interesting high-level observation on markets at the moment is the fact that they are selling at an all-time high despite the elevation of geopolitical tension, complete confusion on the forward path of the economy, and the increasing technical skew in market indices that is no doubt a function of the never-ending march of passive investing.

Geopolitically, we have the real threat of war in Taiwan, the ongoing war in the Middle East, and the tragic war in the Ukraine.

On the economy, PM Capital's view has not changed. We always thought that the economy would sustain itself through 2024 and that there was now a higher floor in inflation, meaning that although rates have gone up enough to dampen an already slowing economy, with higher embedded inflation and an economy that was in reasonable shape, it was unlikely that rates would need to fall too much or too soon. Central bankers could afford to be patient and historically, 4% interest rates are not that high especially given higher embedded inflation.

I would also reiterate the danger of making decisions based on macro-economic forecasts. In the last 12 months, market sentiment was convinced of the imminent recession, then became convinced of a soft landing, then started talking about no landing and now economic indicators are suggesting an upturn. Who knows?

The other feature of today's markets is the unhealthy concentration of daily trading and the impact on market performance of what was the top ten stocks in the United States, then becoming the Magnificent Seven and the way it is going, likely to end up in the one and only – Nvidia.

It is interesting to note how the industry is always rabbiting on about concentration of risk yet here we are today with the greatest concentration of risk in the fewest stocks that we have ever seen. That creates the perfect opportunity for investors to diversify from that risk and take advantage of where the valuation opportunities are.

1 CBA = 3 of Europe's top banks

That brings me to my favourite topic – Valuation.

Back in October we highlighted that "when I look at our portfolio, valuations still appear to be in our favour. …the overall Price-Earnings ratio of the portfolio is in absolute terms, probably as low a number as I can recall". So, the uplift in the market from the September lows has not really surprised me.

What does surprise me is that valuations in some of our investment themes are more like what you see at the bottom of a market, not the top. Single digit PE ratios and double-digit dividend yields.

The most extreme example is our European Banks, selling on a 6x PE and a 10% dividend yield*. Here is an interesting anecdote.

CBA, the largest bank in Australia, has a market value of circa $200 billion and receives *$1 of every $10 that flows into the Australian Stock Exchange from passive funds*^. For $200 billion, you can buy some of the largest retail banks in Europe, like Lloyds in the UK, Caixia Bank in Spain, plus Intesa in Italy. The population of Australia is nearly 26 million. The combined population of the UK, Spain, and Italy is over 170 million. We are short CBA and long Lloyds, Caxia and Intesa.

Source: Morningstar

The point is that there are extreme valuation differentials in markets today and being passive (through index investing) is not the way to take advantage of them.

A further valuation anomaly

Another valuation extreme is the US dollar.

Having visited the United States twice in the last three months, it was quite stark how significantly prices have increased post-Covid and, in Australian-dollar terms, made you feel like a pauper.

Nominal prices are pretty much the same as Australia but after adding the 10% state tax, the 4% charge they now automatically put on your bill for the kitchen staff, then the 25% tip the waiter is expecting and converting into Australian dollars, the price is twice what you pay in Australia. So, an average pizza and beer at an average sports bar, is approximately A$80.

Source: Trading Economics

In another anecdote on the impact of Covid and why inflation is embedded in the system, I walked into a convenience store to get a bottle of water. I went to the counter to tap with my card and, before I tapped for the final amount, the machine asked if I would like to tip 20, 25 or 30%. No thanks…

Paul Moore is the founder and Chief Investment Officer of [PM Capital](). The information herein may change without notice, does not constitute advice or a recommendation, and does not take into account the objectives, financial situation or needs of any investor which should be considered before investing. Consider the PDS and Target Market Determination available at www.pmcapital.com.au and seek financial advice prior to making an investment decision. Past performance is not a reliable guide to future performance. The return of capital, or rate of return, is not guaranteed.

As at 29 February 2024.
^*Market capitalisation of ASX:CBA as at 19 March 2024 is $195 billion, source: ASX*

Credit trumps residential property for headache-free income

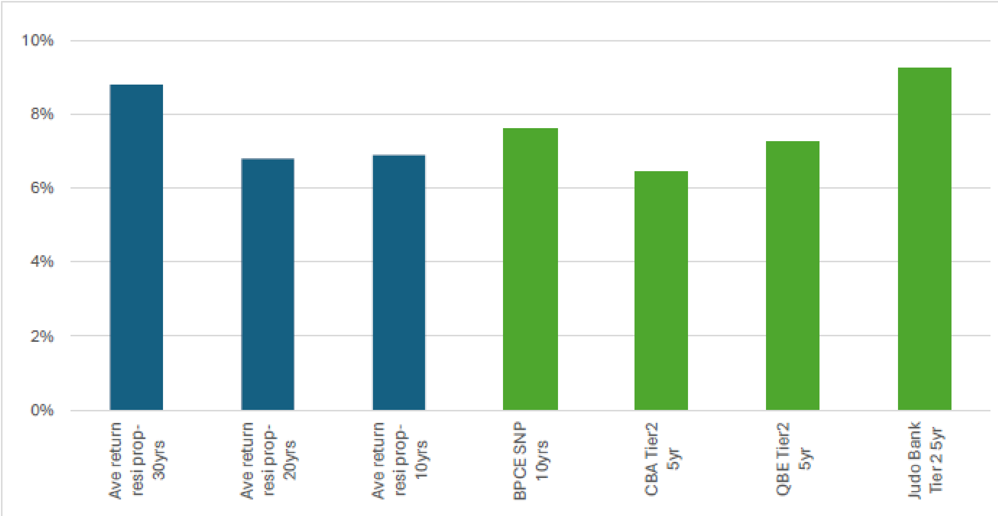
Phil Strano

Investment grade (IG) portfolios can offer returns of 7-8% and, importantly, the likelihood of any significant default cycle appears small.

Australian bond and fixed-income managed funds saw strong net fund inflows over 2023 and that trend has continued into the early part of 2024. That does not happen very often but when it does, it can produce equity like returns from fixed interest assets and with a much lower risk of capital loss. I believe investors are starting to understand that, and that's the real attraction of investment grade (IG) rated portfolios.

One interesting trend we have increasingly observed is that IG deals coming to market are offering better returns than so called ‘safe haven’ asset classes, in particular the Australian residential property market (refer Chart 1).

Chart 1: Recent credit yields vs historical residential property total returns



Source: Yarra Capital Management, Bloomberg, ABS, March 2024.

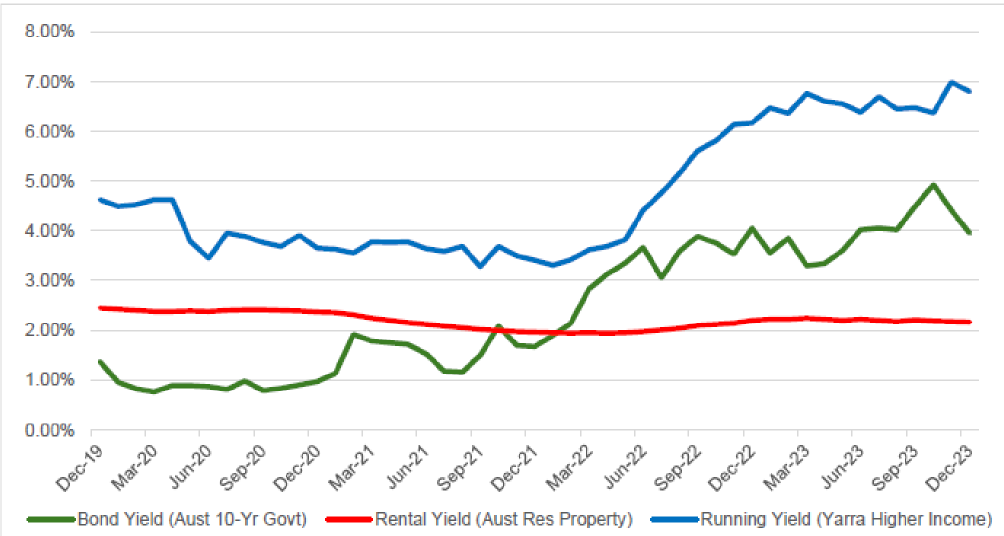
The challenge is delivering compelling risk-adjusted returns. Here we take the view that global governments will focus on maintaining stability in their economies, resulting in higher-for-longer inflation and interest rates. Under this scenario, the cost of debt would remain higher for an extended period - an excellent backdrop for credit investors. The return prospects look increasingly attractive: investors can lock in higher yields than cash and with limited interest rate or spread risk. While recent IG credit returns compare favourably to the average total returns available from equities, comparing with residential investment property paints an especially stark picture.

Credit opportunities

In terms of our investments across the Australian multi-asset credit universe, key positions have been in bank-issued Tier 2 hybrid debt (T2s) and residential mortgage-backed securities (RMBS). The market is increasingly comfortable that we're not going to have a house price crash and is factoring in an environment where central banks stop hiking and eventually start easing rates (from as early as August in Australia). We're seeing credit spreads performing very strongly because of the attractiveness of the outright yields and the comfort investors have with those IG corporates and issuers. It's a thematic that is likely to continue.

Compared specifically to residential property, we believe IG credit offers an appealing and hassle-free alternative for stable and attractive income, without the headaches associated with owning investment property. Yields of 6-7% across T2s and RMBS compare to residential property rental yields of just 2% (refer Chart 2).

Chart 2: Investment Grade (IG) credit returns vs residential property rental returns



Source: Yarra Capital Management, Bloomberg, ABS, March 2024.

While we're not suggesting holders of Australian investment property should all rush for the exits, it is worth contemplating the go-forward return profile for what is one of Australia's long favoured asset classes.

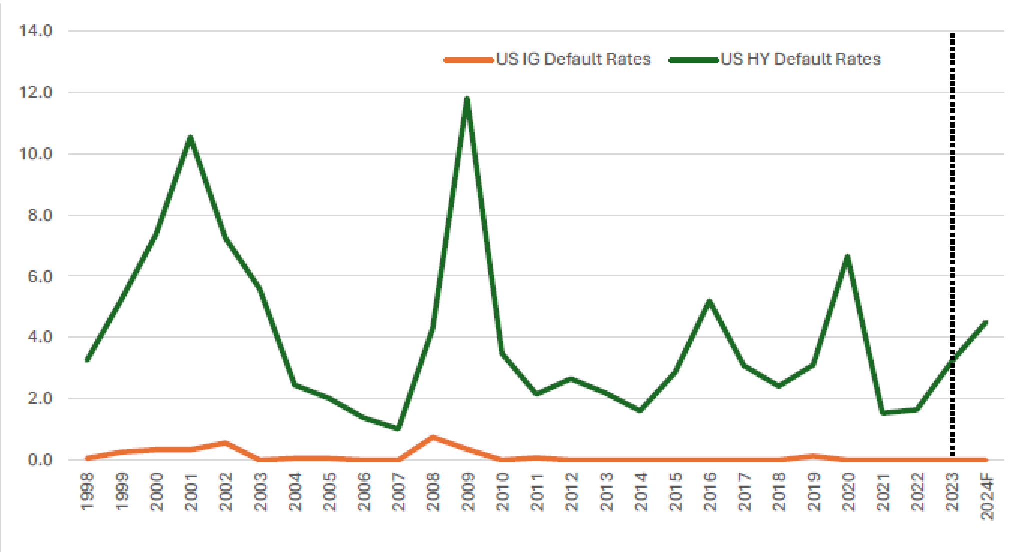
With such a significant gap in return profiles, investment property owners would need to see significant capital growth to make up the difference. And with a stable outlook for house prices, it's difficult to see that happening. Meanwhile, taxes are rising for Australian property investors and there is clearly some uncertainty around the future of negative gearing.

The outlook for investment grade credit

Looking forward, we think bank issued hybrid capital, particularly T2s, are still attractively priced and that they will continue to provide a source of strong outperformance. RMBS is still a robust sector, as we continue to see households prioritising their mortgage repayments over discretionary spending. With house prices having essentially returned to their previous peaks, and borrowing capacity determined by income capacity, it is difficult to imagine a scenario where the next leg up for house prices comes from. Finally, combined with uncertainty around the government's future tinkering to both negative gearing and capital gains tax, potential for still higher land taxes in some States, and the increasing rights of tenants, it's understandable why many property investors are more likely to be thinking of selling up rather than buying.

It's clear that investors see IG credit as a defensive play and as a security that should perform well in a recession. History has shown that rate hiking cycles by central banks often lead to a recession and so it must remain a consideration. However, even in a recessionary environment with mild negative growth, IG credit offers a compelling alternative to cash. There are parts of the credit market that are more vulnerable in the event of recession, but IG credit ratings underscore companies that can more easily service debt and, therefore, are better able to weather the negative impact of a recession on profitability.

Chart 3: Investment Grade default rates vs High Yield default rates



Source: Yarra Capital Management, Bloomberg, March 2024.

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.

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