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Editorial

This week, First Sentier made headlines with its decision to hand $14 billion back to investors. The firm, with $238 billion under management and owned by Japan's Mitsubishi UFJ Trust since 2019, announced that it would close its Australian fixed income, global credit, emerging companies, and equity income units.

The firm's global head of investment management, David Allen, was refreshingly honest in his explanation of the announcement. He told various media outlets that the units couldn't "attract enough assets at the right fees". For instance, he said the $700 million Australian microcaps team had performed well yet was too small to generate enough profit. On the equity income strategy, Allen suggested that: "More of the world has realised that you don't need to live off income in retirement. You can maximise your total return and take capital out of your investments."

The company's decision to shut down the fixed income and credit teams came as more of a surprise. Allen said that fixed income could only charge minimal fees but required larger teams to manage the assets. Thus, the fees coming in didn't justify the expanded cost base: "It's hard to get the numbers to stack up. It's a scale business…"

Allen suggested that First Sentier would instead focus on its Australian growth and small cap equities funds, as well as expand its private market offerings. Intriguingly, he pointed out that private markets don't come with the same competition from ETFs and managers could charge higher fees, making this area especially attractive.

First Sentier's announcement is the latest sign of fund managers continuing to grapple with the ETF boom and, more recently, the increasing internalisation of investment management at super funds.

ETFs may be sowing seeds for future downturn

Ironically, the news comes as the ETF boom is showing signs of froth, with more dubious products being pushed to investors.

For instance, The Bank of Montreal launched a 4x leveraged stock exchange traded note (ETN) late last year. The MAX S&P 500 4x Leveraged Exchanged Note (NYSE: XXXX) allows massively leveraged bets on the S&P 500. The product's launch raised eyebrows as proposals for 4x leveraged index products were rejected by the SEC only a few years earlier. That hasn't stopped investors from piling in, with the ETN up 33% in about five months.

Though not as geared, there have been plenty of leveraged ETFs launched into the Australian market over the past year too.

Also noteworthy is the approval of Bitcoin ETFs this year. Blackrock's iShares Bitcoin Trust, launched in January, has amassed more than US$17 billion in assets. Such ETFs have helped fuel demand for Bitcoin, whose price has propelled 51% higher this year.

Additionally, there have been a plethora of thematic ETFs launched over the past few years, some designed more for speculators than investors – including video game, Metaverse, 'future of food' ETFs.

Finally, there are more ETFs coming out where the underlying assets have nothing to do with the theme or name of the ETF. It's likely that investors often don't know the constituents of the funds that they're buying. I'll expand on this topic in a future article.

All this seems fine while markets are going up – the providers of these products and the people buying them look like geniuses. Yet this 'easy money' could well be sowing the seeds of a future downturn for the ETF industry. That's not to say that the structural growth trend for ETFs is over, but that a clean-out of marginal providers and products may be overdue.

Opportunities and challenges for investors

Newer ETFs are focusing on the most popular areas of the market, including growth, 'quality', and momentum stocks. Think large cap, tech, energy transition, electric vehicles, cybersecurity, and cryptocurrency. These are the areas where more marginal products are appearing and deserve caution.

Conversely, there are other areas of the markets that are being ignored because they don't provide the necessary popularity and/or liquidity that ETFs require. Value stocks are being left for dead because they don't have the popularity, momentum, and often liquidity to make it into ETFs. The same goes for small caps and microcaps.

The silver lining for ETF providers and fund managers

The current struggles of fund managers are likely to lead to an industry that delivers better product and better performance to its customers. And if ETFs do cool off, fund managers will be better prepared to take advantage of it.

For the ETF industry, any shakeout of marginal players and products should strengthen the hand of existing, larger providers, and sharpen their focus on the end customer.

**Full disclosure: First Sentier is a Firstlinks' sponsor*

James Gruber

In this week's edition...

How useful are the retirement savings and spending targets put out by various groups such as the Association of Super Funds of Australia, otherwise known as ASFA? Not very, according to **Kaye Fallick**, and it's reducing the ability of ordinary retirees to fully understand their retirement income options.

Rudi Filapek-Vandyck investigates why the US stock market has significantly outperformed Australia's over the past 15 years. His answer? It's because they have some incredible businesses. Not that we don't have great companies here, but Rudi says that you have to know where to look.

Bank hybrids have become popular places to park money, though it's led to these securities being priced at a premium. Does that mean investors should stay away, or sell? **Norman Denham** says that as long as banks don't pay up for term deposit funding - which looks likely for a while yet - investors will continue to pay a premium for the higher yielding, but riskier hybrids.

There's been a lot of debate about the Magnificent Seven and whether it's resulted in too much concentration in US indexes. Whatever your view, **nabtrade's Gemma Dale** says the rise of the tech behemoths poses several challenges for global investors.

The price of copper is soaring due to surging demand from data centres and renewable energy. Supply shortages could last for some time, leading to higher prices for longer, says **Man GLG's, Albert Chu**. That, in turn, has implications for the growth of AI and the transition to cleaner energy.

Global REITs have been out of favour for some time. Yet, **Resolution Capital's Marco Colantonio** says that while the office market remains a concern, the remainder of the sector is in good shape and offers compelling value, with [many REITs trading below underlying replacement costs].

Daniel Crosby says that money is fantastic, to a point. However, if we relentlessly chase wealth at the expense of other facets of well-being, history and science both teach us that it will [lead to a hollowing out of life].

Finally, in this week's whitepaper, **VanEck** presents its [outlook for Australian equities].

Uncomfortable truths: The real cost of living in retirement

Kaye Fallick

The more I write about retirement, the more I learn. And the more aware I become of what seems to be an alternate reality or parallel universe when it comes to how much money Australian retirees will actually need.

On the one side is the rather chirpy spin which paints a vision of an ideal retirement, presumably available to most, underpinned by secure funding for life.

Who wouldn't want that?

And then on the other side of the divide is a much messier affair, fraught with doubt and concerns and the ever-present FORO – the fear of running out.

The 'securely funded' camp tends to assume that everyone agrees that the regularly updated Cost of Living in retirement tables offer reliable targets for 'most' retirees. But that is a stretch at best. And potentially dangerous at worst.

The problems with retirement spending targets

This too-easy acceptance of retirement spending targets troubles me greatly.

Here's why I believe the cost-of-living assumptions and generalisations are reducing the ability of ordinary retirees to fully understand their retirement income options.

Let's start with one of the 'sunny-side up' indices – the [ASFA Retirement Standard].

It's been around for decades and is continually quoted as the 'rolled gold' standard. As such, it is rarely questioned. But it should be. Many industry insiders are in agreement that these numbers are unrealistic. There are two key problems with them, which are widely recognised, but rarely challenged. The standard offers targets for those aged 65-84 and 85+. Let's limit this discussion to the amount needed for 65-84-year-olds.

The current ASFA amounts (published March 2024) are:

	Single annual spend	Single savings needed (age 67)	Couple annual spend	Couple savings needed (age 67)
Modest	$32,666	$100,000	$46,994	$100,000
Comfortable	$51,278	$595,000	$72,148	$690,000

The modest lifestyle targets are more than modest, they are frugal. They do not allow for emergencies or expensive health care. There is another assumption, and that is that an Age Pension will be available to all above categories.

Separate to the Retirement Standard, ASFA publishes regular updates on the super account levels for various ages. [Most recently, *An update on superannuation account balances* November 2023]. Eschewing the average amounts as they can be skewed by a handful of people with very high balances (one unnamed soul has more than $500 million in his/her account!), the mean amounts tell us quite a lot.

For those in early retirement, aged 65-70, the median amount is $213,986 for males and $201,233 for females. If we add these amounts together for couples ($415,000) we can see that at least half Australian retirees will struggle currently to have anywhere near the $690,000 for couples or $595,000 for singles deemed necessary for 'comfortable' by ASFA.

The savings targets for modest lifestyles of $100,000 (both single and couple) also carry the assumption that all retirees own their own home with no debt, that they will receive a part-Age Pension and that they will spend all their capital.

There are a few problems here.

Firstly if more than half Australians (i.e. the median) have a super balance which, for couples is 415/690 or barely 60% of that needed for this comfortable goal, maybe comfortable is actually more accurately described as affluent?

It's worse for singles, with say $207,000 the median balance (for males or females) which is 207/595 means just 37% have the amount required to be 'comfortable'.

In plain language, most Australians will NOT be anywhere near 'comfortable' based upon these numbers which are called a 'standard'.

The second problem and perhaps the more important one is the assumption of home ownership. Only 82% of retirees owned their own home, according to the *Retirement Income Review,* 2020). This will now have decreased even further. So there are a group of retirees who are simply not taken into account with these calculations – the 'others' – the renters and those who live with family. Where is the standard for them?

And then of course we have a third problem; the real elephant in the room. Homeownership is automatically assuming no mortgage. How far out of date is this notion? Recent research from Professor Rachel ViforJ indicates that more than 50% of homeowners aged 55 and over have a mortgage. Many may expect to reduce this or pay it off when they reach preservation age. But that will only further reduce their super so that the median savings amount quoted above may actually decrease, rather than increase. Yes, the Super Guarantee will increase to 11.5% on July 1 this year, but that is not going to solve the problem of a $50,000, $100,000 or higher mortgage debt.

More recently, advocacy group Super Consumers Australia (SCA) decided to publish targets that it believed to be more realistic than the ASFA targets. Here are the SCA spending and super balance goals for current retirees (aged 65-69):

	Single annual spend	Single savings needed (by 65)	Couple annual spend	Couple savings needed (by 65)
Low	$31,000	$76,000	$44,000	$95,000
Medium	$41,000	$279,000	$60,000	$371,000
High	$55,000	$795,000	$80,000	$1,055,000

(savings factor in Age Pension income where applicable)

Yes, there are three levels in these targets, rather than two, which offer more nuance.

But guess what? Yes. Again, the assumption has been made that all retirees live in a home they fully own.

Why aren't mortgages factored in?

Now of course the smart brains at ASFA and SCA will know the degree of indebtedness of Australian retirees as much as anyone else. So why do they not factor a mortgage into the suggested cost of living in retirement tables? Is it too difficult to do so?

This was the question I asked Ross Clare, Director of Research, at ASFA and Xavier O'Halloran, Founding Director at SCA.

The 'short' answer from both organisations was that it is difficult to allow for very different levels of retiree indebtedness.

Xavier O'Halloran said it was something that SCA had considered addressing, but they felt a broad rule of thumb would be for retirees to look at suggested savings targets and add on the amount of the mortgage, so that individuals could better understand their income prospects. This simple calculation doesn't of course allow for interest on repayments, as O'Halloran acknowledged. He did suggest, however, that using the Moneysmart calculators would be useful for those with mortgages.

ASFA responded with a statement attributed to CEO, Mary Delahunty, which said:

"The ASFA Retirement Standard budgets focus on the housing status relevant to the great bulk of current Australian retirees and those approaching retirement.

Unlike other housing costs which continue throughout retirement, mortgage payments are highly variable, depending on both the amount still outstanding on the mortgage and the remaining term of the mortgage. For most individuals aged 65 plus who still have a mortgage, repayments are typically at a modest level.

A better approach for those approaching retirement who still have a mortgage is to add the mortgage balance to the required lump sum for outright homeowners and to compare that with their superannuation and other retirement savings and/or to have an exit strategy involving downsizing or the like."

ASFA also shared a table showing low numbers of homeowners aged 65+ with a mortgage. But as we have seen, the trend is for this ratio to change, rapidly.

Greater scrutiny of retirement targets needed

Which takes us back to the starting question, 'How useful are these retirement savings and spending targets in the real world?'

Not very, I suspect.

And why do financial journalists continue to report such standards as the norm?

I guess it's because no one can be bothered to do the hard yards and come up with something more useful. Which means the growing number of retirees who need support to manage mortgages will continue to go under the radar – and remain highly stressed about how they will cope.

Kaye Fallick is Founder of STAYINGconnected website and SuperConnected enews. She has been a commentator on retirement income and ageing demographics since 1999. This article is general information and does not consider the circumstances of any person.

On the virtue of owning wonderful businesses like CBA

Rudi Filapek-Vandyck

Year to date, the ASX 200 is up 1%. That gain, however, is yet again lagging the performance of key US indices.

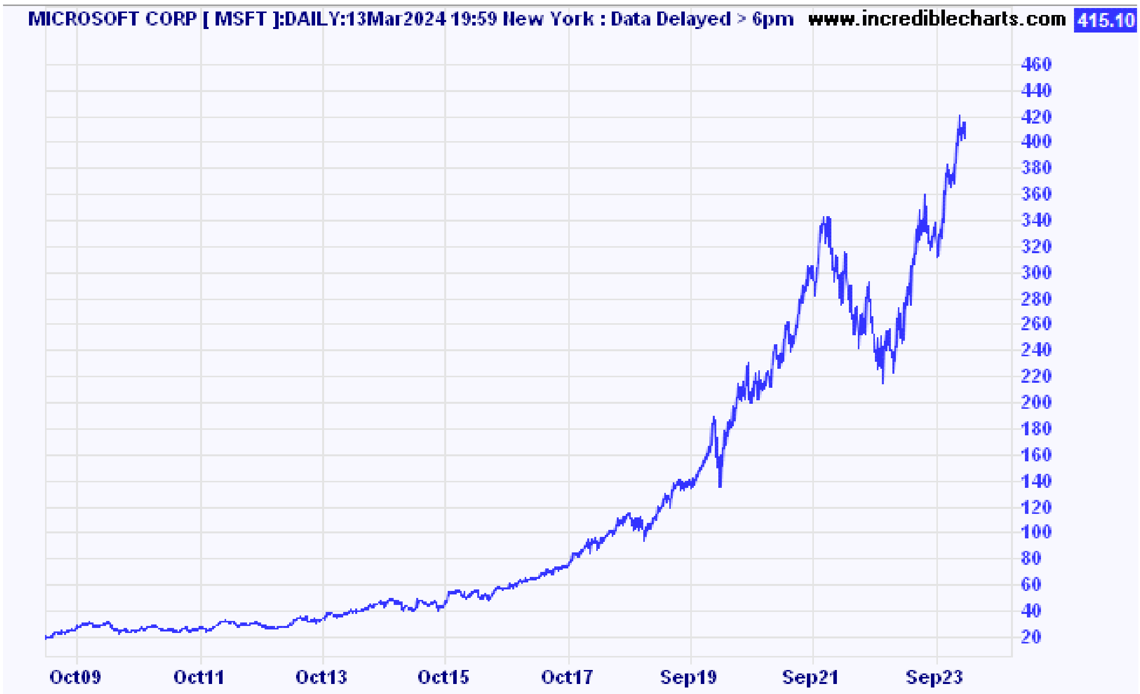
The difference in performance is not something that only happened this year. The US has been outperforming for 16 years, which is the longest streak ever. The size of the performance gap has equally never been as wide, with the gap truly opening since 2015. Both equity markets are in the global top three of best performing share markets longer term. It makes the current outperformance of US markets even more remarkable. Were reversion to the mean to kick in at some point, as it did in 2000, the local market would have a lot of catching up to do.

Is it feasible we will see that performance gap disappear and both markets converge again?

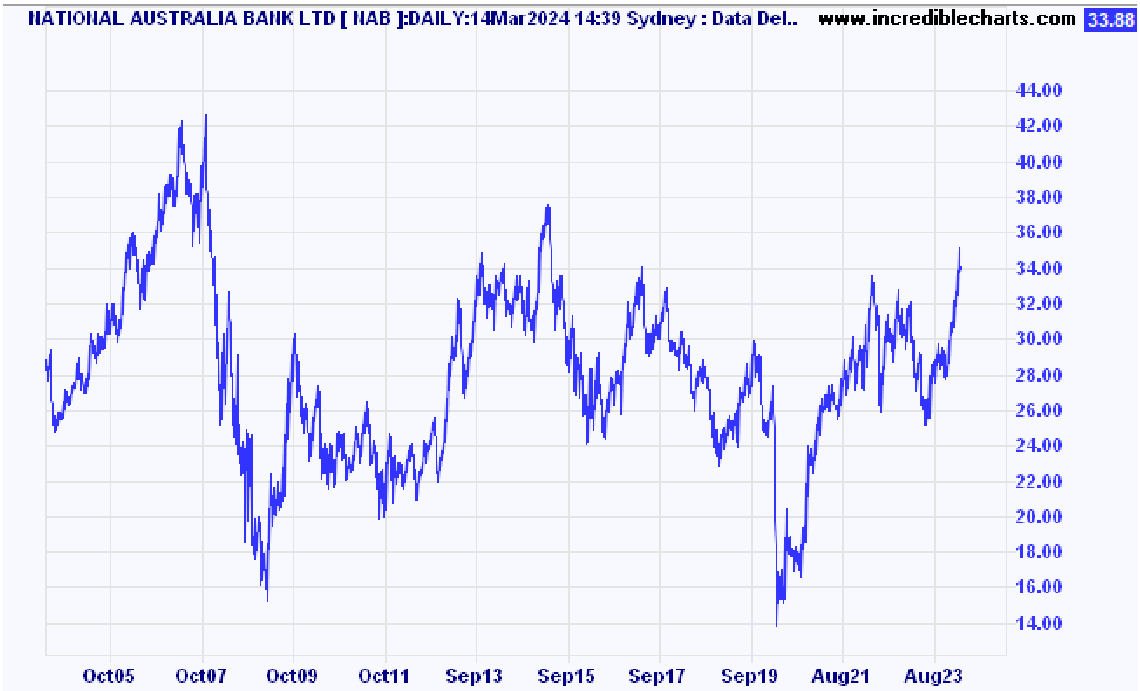
To find the answer, we need to investigate whether there is a fundamental reason as to why the US is outperforming so strongly and for so long. If we find that fundamental reason, and it remains in place, we might need to conclude there's no reversion to the mean on the horizon, not until underlying fundamentals change.

The basic basics – a visual observation

Below is a post-GFC price chart of Microsoft shares, one of index heavyweight in the US. It shows the occasional bout of volatility, and there are sell-offs along the way, but ultimately the share price moves from the bottom left-hand corner on the chart to the right-hand corner near the top. As a longer term, buy & hold type investor, this looks like the perfect stock to own. Given its strong and defined trajectory, this might also provide us with the answer we are looking for.



Let's compare with one of our major local index constituents. Below is the comparable chart for National Australia Bank (NAB).

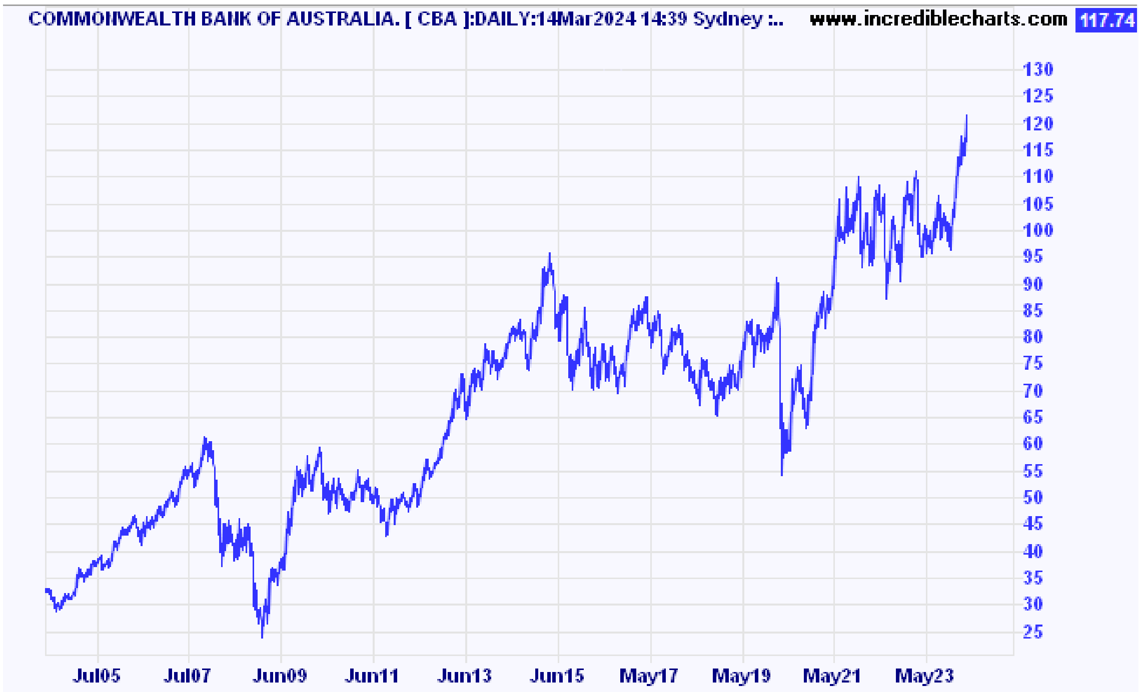


NAB shares over 16 years have gone through a lot of volatility, as have Microsoft shares, but, ultimately, they've made no real progress over that time.

Could we possibly have found the explanation for the big gap in relative performances between both markets? Some people might say Microsoft is a technology company. And NAB is a bank. That's your explanation right there. So, let's stay inside the finance sector in Australia, let's compare the banks.

The worst performer in Australia among the Big Four is Westpac (WBC). If one held those shares from the absolute bottom in the GFC (6 March 2009) until early March this year, the return amounts to 4.7% per annum on average, plus dividends, and franking. Adding dividends pulls up total return to between 9-10% per annum. Many an investor would think that's far from bad. But we are measuring from the bottom of the GFC. If we measure from a later date, when share price levels were higher, that 4.7% quickly reduces towards zero. All that's left then, on the long-term average, are the dividends and franking.

The obvious comparison to make locally is with CommBank (CBA).



Same starting point, same length of holding period, and the average return is more than 22% per annum, ex-dividends.

The difference is enormous.

If we were to compare with Macquarie Group (MQG), not quite apples versus apples, but we are inside banks and financials nevertheless, the average return climbs to 68% per year. Plus dividends on top.

I guess what we are discovering is this is not about technology versus banks.

A few additional observations:

Westpac is the 'cheapest' of the banks. CommBank is the most 'expensive', not only at the end of the holding period, but CBA has been the most expensive throughout the whole 16 years.

CommBank pays the lowest yield in the sector. Westpac pays the highest yield. Macquarie sits on both accounts closer to CommBank than to Westpac.

Worth highlighting: the cheapest stock has generated the worst return. The highest yield equals the worst return.

Comparing all four of the Big Banks in Australia, the price chart for CBA looks like that of Microsoft, while the other three don't.

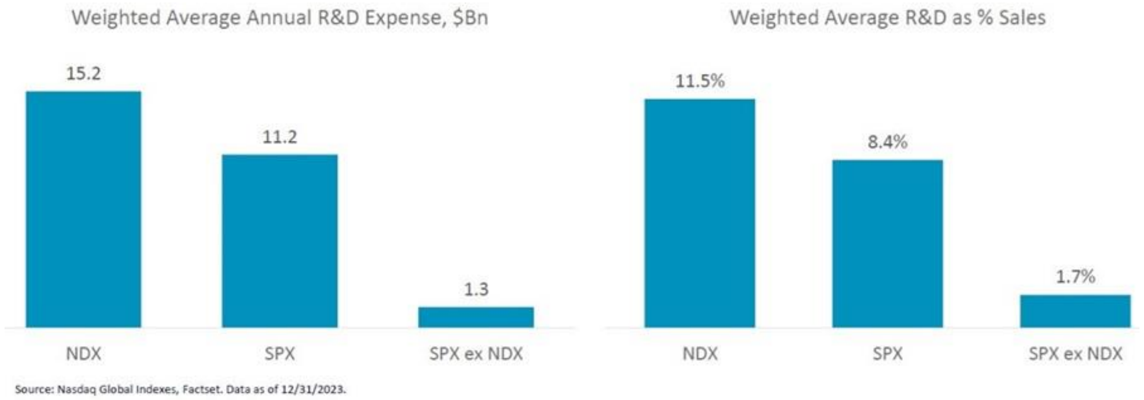
What could potentially explain the difference?

The quality in businesses

In his recent homage to the late Charlie Munger, Warren Buffett wrote:

*"Charlie, in 1965, promptly advised me: "Warren, forget about ever buying another company like Berkshire. But now that you control Berkshire, add to it **wonderful businesses purchased at fair prices** and give up buying fair businesses at wonderful prices."*

Could this be the answer we are looking for? If so, how do we identify 'wonderful' businesses? Analysis conducted by Betashares and others suggests a strong correlation exists between companies that invest and those that don't, or only a little. That correlation becomes strikingly evident when we compare Nasdaq (NDX) companies with those in the S&P500 (SPX), while removing those from the Nasdaq that are also in the S&P500.



As a percentage of sales, investments by the Nasdaq winners are significant if one also considers how large some of those companies are, like Meta, for example, or Alphabet, or Microsoft.

So… what makes a wonderful company, according to this research, is that it invests, on average, ten times as much as others, on developing new products, on reinforcing the moat, on strengthening market share, on improving and expanding products and services, etc.

At the macro-level, the world is still operating inside a slow growth environment, and we have been for quite a while. The additional key change is that we are living through an almost unprecedented time of technological advances, innovations, and changes.

Not every company is equally equipped to stay on trend with the many changes happening. This might explain why since 2015 share prices have become noticeably polarised between the Haves and the Have Nots. Certainly, AI has the potential to further polarise economies and companies.

As investors, we need to ask ourselves the question what is more important; the short-term valuation or the prospect to enjoy strong investment returns over an elongated period? Longer-term price charts for ASX-listed companies including Car Group (CAR), Goodman Group (GMG), NextDC (NXT), REA Group (REA), and TechnologyOne (TNE) are not dissimilar from CBA's and Microsoft's.

Maybe one observation to add is that investors can enjoy US-type returns in Australia, assuming the portfolio includes Microsoft-type companies. And I am not necessarily referring to the technology component of that reference.

Rudi Filapek-Vandyck is Editor at the FNArena newsletter, see www.fnarena.com. This article has been prepared for educational purposes and is not meant to be a substitute for tailored financial advice.

Why bank hybrids are being priced at a premium

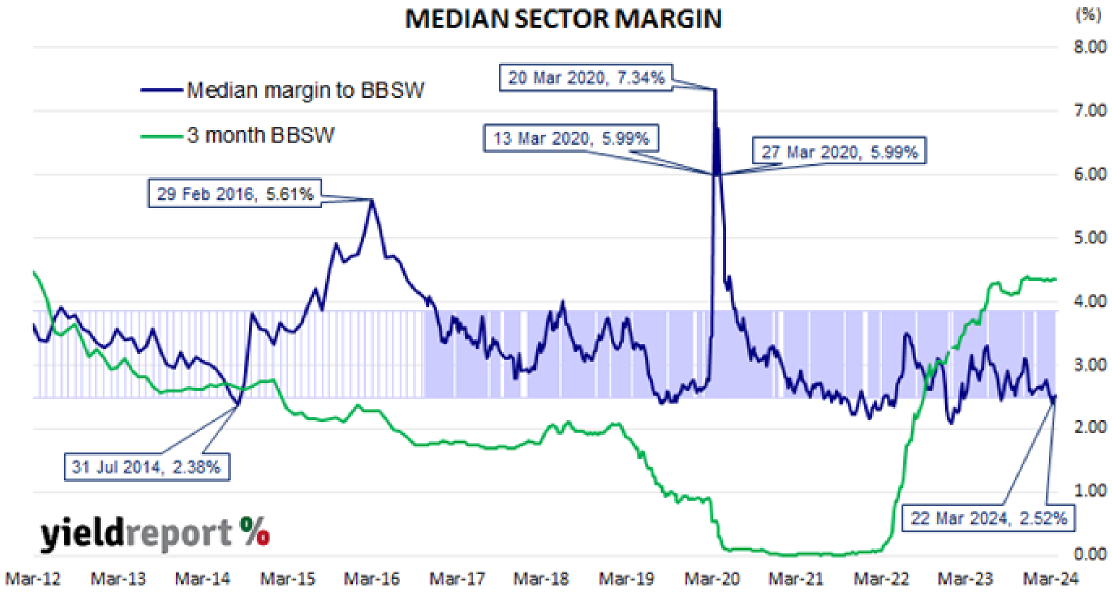
Norman Derham

As the custodian of other people's money not only are we focusing on the preservation of capital, but we are constantly seeking out relative value opportunities as well. These opportunities, which present constantly, are largely a function of a combination of the complexity of the underlying securities and the relatively unsophisticated investor base that populates the market.

To help us identify relative value we break the market down into sectors identified by term (to maturity) and issuer type. Breaking down the market in this way allows us to compare the performance of the different sectors over time as well as determine the pricing relativities of each sector.

As an example, data extracted from our data base on in early March calculated that the average weighted traded spread margin of the sector we have identified as 'short-term major bank issuer' was priced at a miserly 82bps or 0.82%. This compares with the average weighted coupon margin of approximately 3.00%. The "so what" is that a traded spread margin of 0.82%, represents a yield to maturity (YTM) of about 5.00%. No matter which way you slice or dice it this is not particularly attractive when you can "invest" in a risk-free major bank term deposit of a similar term at a yield of around 4.5%.

As a result, we instead favour other sectors comprising hybrid securities of longer term that we have identified as representing better value.



Source: Yield Report 25 March

While median traded spread margins of the broader market are approaching the bottom of the range at approximately 250bps over 90day Bank Bill Swap Rate (BBSW), the average annual coupon rate currently presents at the top of the range at approximately 7.35% (i.e 90day BBSW of 4.35% + 3.00%). The difference between the median traded spread margin and the coupon margin reflects the magnitude of the premium investors are willing to pay for annual cash flows exceeding 7%. It shows the median traded spread margin (blue line) with the green line representing 90day BBSW.

Why hybrid capital is priced at a premium

One of the key reasons why investors are paying a premium for the cash flows has its beginnings in the events of the immediate Covid period when the RBA, cut the cash rate to 0.10% and embarked on a program of unparalleled quantitative easing, all the while, risk averse households saved the proceeds handed them by the government. This meant that banks were awash with cheap money provided by both the central bank and households.

So instead of having to "pay up" for domestic based term funding, as they were required to do by the banking regulator in the post GFC era, the banks, suddenly had a surplus of it, which they chose (for whatever reason) not to lend to the broader economy. These surplus monies found their way on to the RBA's balance sheet bolstering exchange settlement account balances at the RBA by a factor of 15.

The upshot of this is that the banks have no incentive whatsoever to pay up for term deposit funding. While the ground rules were established during the Covid period, they became entrenched when cash and near cash proxies such as 90day BBSW rose as inflationary pressure began to emerge. So, as the cash rate and cash rate proxies moved higher, so too did the coupon rates on floating rate investments such as hybrids.

Granted, term deposit yields rose too, but they did not rise at the same pace as the coupon rates of floating rate instruments simply because banks were awash with term deposit funding. As long as the banks have no desire to pay up for term deposit funding - which looks likely for a while yet - investors will continue to pay a premium for the higher yielding but riskier hybrid instrument.

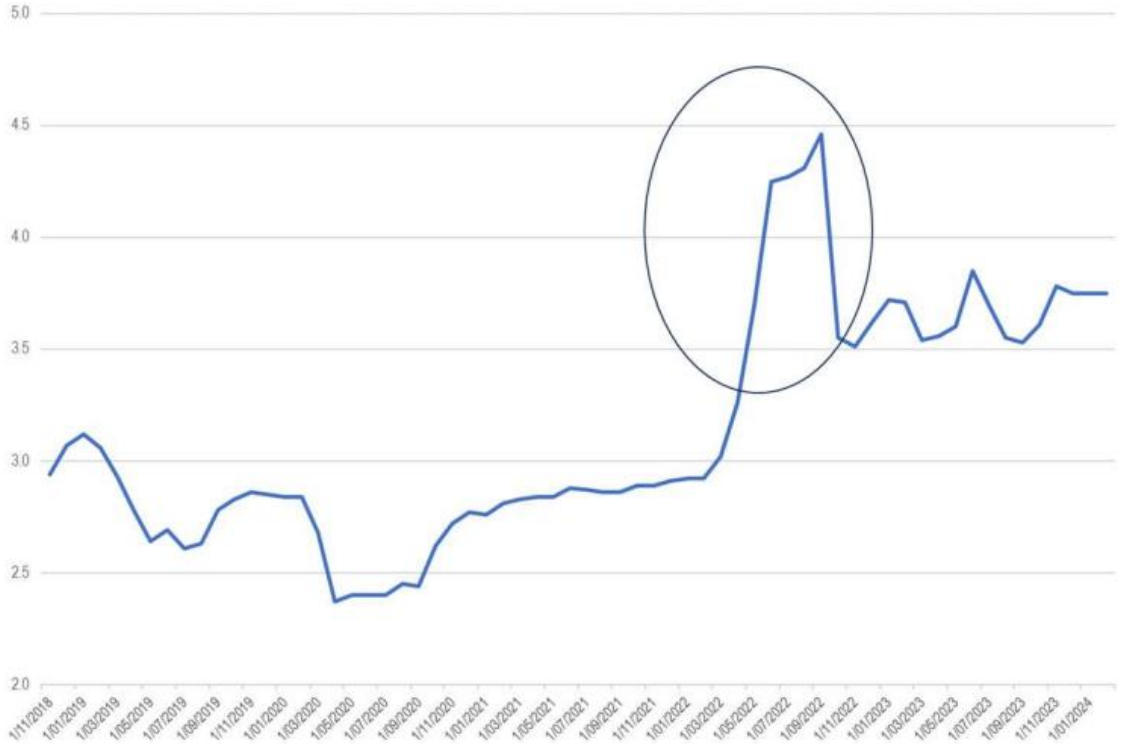
Yield differentials between hybrids and term deposits have stabilised

As it is notoriously difficult to predict the future direction of interest rates, we keep a close eye on what the broader market is thinking as a guide. While the broader market is predicting interest rate cuts, it is not predicting wholesale interest rate cuts.

One thing however, you can be assured of, is that when the RBA cuts the cash rate the banks will cut term deposit rates in lock stock which means that the margin that currently exists between the annual hybrid coupon rate and term deposit rates will likely remain as it is.

We have shown the chart below before, but it bears repeating as it is one of the key drivers of why investors are presently prepared to pay a premium for hybrid capital. The chart details the margin between the annual hybrid coupon rate (assuming a fixed coupon margin including the value of franking of approximately 3% over 90day BBSW) and the RBA's All Terms Average Special Rate. The circle highlights the period when 90day BBSW jumped sharply higher as the money markets, pre-empted that the RBA would be forced to raise the cash rate to contain inflationary pressures which were benign at the time. This was the period, readers will remember, when the then RBA Governor insisted that the cash rate would remain at 0.10% through until 2024! The margin looks (now) to have stabilised around 375bps or 3.75%.

Difference between annual hybrid coupon rate and RBA All Terms Average Special Rate (last data point 29 February 2024)



What the equity market has to say about bank equity tells a tale

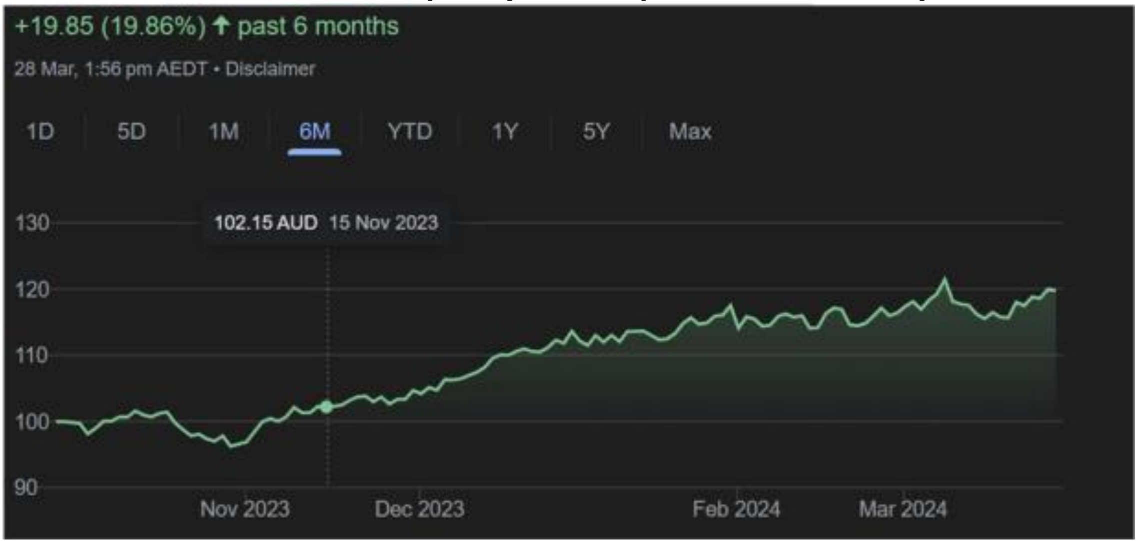
With their Tier 1 and alternative tier 1 equity (hybrid capital) now exceeding 14% of risk weighted assets (RWA), and with an abundance of funding surety, there can be no denying the balance sheet strength of the Australian banks, which are the majority issuers of hybrid capital.

As an investor in hybrid capital, which of course ranks above equity in the capital structure, what interests us is what the Australian equity market now thinks of bank equity. After a fairly benign period bank share prices have risen sharply over the last 6months or so.

The chart below is of CBA bank share price over that period. The share price has risen by just under 20%. If the equity market had any concerns whatsoever about the CBA bank, including its underlying credit quality, then the share price would almost certainly not have risen by 20% over that period. As the equity market is barometer of what will likely happen in the future it is a reasonable to say with a degree of confidence that the runway looks clear.

Perhaps investors in hybrid capital have come to the same conclusion, as they price hybrid capital, particularly short-term hybrid capital, closer to risk-free government guaranteed term deposits and senior secured instruments of the same issuer? This is yet another reason why the current premium expressed in the hybrid market is likely to stay in the foreseeable future.

CBA bank share price (last data point 28 March 2024)



A positive rerate of the Australian banking system by S&P

And finally, as a postscript, which we extracted from Westpac's Around the Grounds" commentary of April 4 on the strength of the Australian banking system published by S&P garners yet another reason for the markets to price hybrid capital at a premium and closer to more senior instruments of the same issuer. In S&P's words and in italics:

- *"We now assess the institutional framework for the banking industry in Australia at the lowest risk level on our scale, and in line with that in Canada, Hong Kong, and Singapore.*
- *Consequently, we raised our long-term issuer credit ratings on most of the non-major Australia-based banks and other financial institutions.*
- *We have also upgraded all the rated Additional Tier 1 and Tier 2 instruments issued by Australian banks and their New Zealand banking subsidiaries.*
- *Despite a one-notch improvement in their stand-alone credit profiles (SACPs), our issuer credit ratings remain unchanged on some financial institutions, including the four major Australian banks, Macquarie Bank Ltd., and two foreign-owned banks".*

Norman Derham is Executive Director of Elstree Investment Management, a boutique fixed income fund manager. This article is general information and does not consider the circumstances of any individual investor. Elstree's listed hybrid fund trades under ticker EHF1.

The Magnificent Seven's dominance poses ever-growing risks

Gemma Dale

In a recent article on Firstlinks on the extraordinary growth in the Magnificent Seven, the US' mega-cap tech giants, and the resultant level of concentration in the S&P500 and Nasdaq indices, one reader commented that the level of concentration seen in US markets is actually rather low compared to other developed markets. And also that the current level of concentration in US markets is far from unprecedented. Both these points are accurate, but are they comforting?

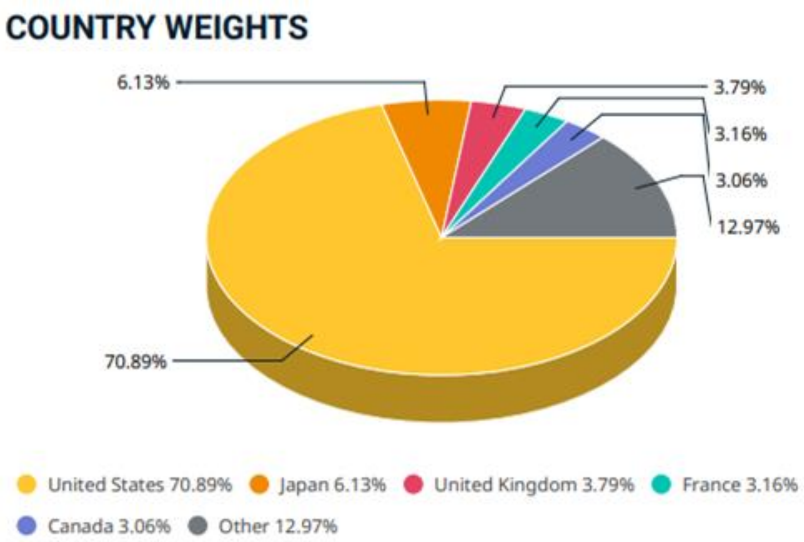
To recap, Microsoft (MSFT), Apple (AAPL), Nvidia (NVDA), Amazon (AMZN), Meta (META), Alphabet (GOOG) and Tesla (TSLA) now comprise around 28% of the S&P500; in early March they comprised around 30%. A nearly 43% year-to-date fall in Tesla has been the primary detraction, while Nvidia has gained an incredible 65% over the same timeframe. Over the past five years, these companies have delivered nearly 50% of the performance of the S&P500; they also fell, collectively, 39% during the market's contraction in 2022, nearly twice as much as the overall index.[1]

In the past, high levels of concentration in US markets have often preceded significant sharemarket falls – the tech wreck is one of the better examples. The 1960s and 70s 'Nifty Fifty' period was similar. This period doesn't have to follow the same path – in fact, Goldman Sachs has just published a paper saying that while narrow leadership in the S&P500 usually occurs toward the top of the market and is followed by a period of significant underperformance, this era's leaders should continue to outperform. Maybe this time really is different?

It should be noted that concentration at the top end of share markets outside the US is also not unusual, and the performance of a few large or mega-cap companies can significantly drive the performance of a single market. In Australia, financials comprise 30% of the S&P ASX200; while materials constitute a smaller proportion, BHP alone is more than 10% of the index[2]. The Swiss Market Index is only comprised of 20 stocks; a rule was introduced in 2017 to cap any individual stock at no more than 18% of the index when Nestlé, Novartis and Roche accounted for more than 60% of the SMI. The UK is dominated by four companies – AstraZeneca, Shell, HSBC and Unilever, which accounted for 25% of the FTSE100 at the end of February[3].

What's the big deal about the US, then?

So why does concentration in the S&P500 garner so much attention? In large part, this is because US markets dominate global portfolios; increasingly so as the US economy outperforms other developed economies, and as its tech giants dominate global demand for ecommerce, cloud technology and social media, not to mention artificial intelligence. US exposure now accounts for more than 70% of the MSCI World Index; the next highest weighting is Japan at just 6%. The top ten companies in the index comprise more than 20% of the index; Microsoft alone is larger, by weighting, than the United Kingdom[4].



Source: MSCI

TOP 10 CONSTITUENTS

	Float Adj Mkt Cap (USD Billions)	Index Wt. (%)	Sector
MICROSOFT CORP	2,970.56	4.57	Info Tech
APPLE	2,518.84	3.88	Info Tech
NVIDIA	2,231.79	3.44	Info Tech
AMAZON.COM	1,677.65	2.58	Cons Discr
META PLATFORMS A	1,077.80	1.66	Comm Srvcs
ALPHABET A	893.20	1.37	Comm Srvcs
ALPHABET C	784.52	1.21	Comm Srvcs
LILLY (ELI) & COMPANY	627.74	0.97	Health Care
BROADCOM	589.45	0.91	Info Tech
JPMORGAN CHASE & CO	579.07	0.89	Financials
Total	13,950.62	21.47	

Source: MSCI World

Admittedly MSCI World is a developed market index; for a broader comparison, MSCI ACWI (All Country World Index), which covers 23 developed markets and 24 emerging markets, may be more relevant. ACWI has 63%

exposure to the US. The top 10 stocks comprise a little less than 20% of the overall index, and includes Taiwan Semiconductors (TSMC) as a lonely non-US significant holding.

It can be a problem for fund managers

Superannuation funds and other large portfolio managers are generally benchmarked against these indices, and the composition of their global equities exposure reflects this. If a fund's performance is compared to a benchmark, then mega-cap concentration is a real problem.

This issue is playing out in real time for global asset managers. Those who have not been holding – or have even just been underweight - the Magnificent Seven have dramatically lagged those who have, and also lagged low-cost index funds. This puts their entire business model at risk – why pay an active fee when an index fund delivers a better result? As a result, many pension funds and other large institutions have been forced to buy the mega-caps at what they feel are inherently overvalued prices because their performance – and revenues - suffer too greatly if they don't.

Ultimately, any concern around concentration risk in a portfolio is linked to the principle that diversification smooths and ultimately improves returns over time. This is most relevant for long term investors – traders can afford to be highly concentrated in their portfolios because they're actively managing positions.

Long term investors – like superannuation funds - are generally looking to hold their positions for five years or more, which has the advantage of minimising transaction costs (including brokerage and tax), which can critically impact net returns. Having a concentrated portfolio over the long term has obvious risks – that you've invested in a few stocks that perform poorly, or missed those that are performing well.

This time really could be different

As an individual investor, this may not be a concern for you. If you are invested in the growth option of a retail, corporate or industry super fund, you have some exposure to this risk – but you may feel that you would like exposure to these companies and the US in particular. nabtrade's customer data is a really interesting insight into investors' views on this – the number of investors who invest in ASX200 ETFs (usually VAS) is many multiples of the number who invest in ETFs with global exposure.

The ETF with international exposure held by the most investors is Vanguard's MSCI Index International Shares (VGS) – a replication of MSCI World. Compare this to direct international exposure – more than 90% of direct international trades on nabtrade are made on US exchanges. And which stocks are most popular? Tesla, Microsoft, Apple, Amazon and Nvidia. Perhaps Goldman Sachs is right this time.

[1] Source: Refinitiv
[2] Source: S&P Global
[3] Source: S&P Global
[4] Source: MSCI

Gemma Dale is Director of SMSF and Investor Behaviour at nabtrade, a sponsor of Firstlinks. Index charts as at 12 February 2024. This material has been prepared as general information only, without reference to your objectives, financial situation or needs.

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The copper bull market may have years to run

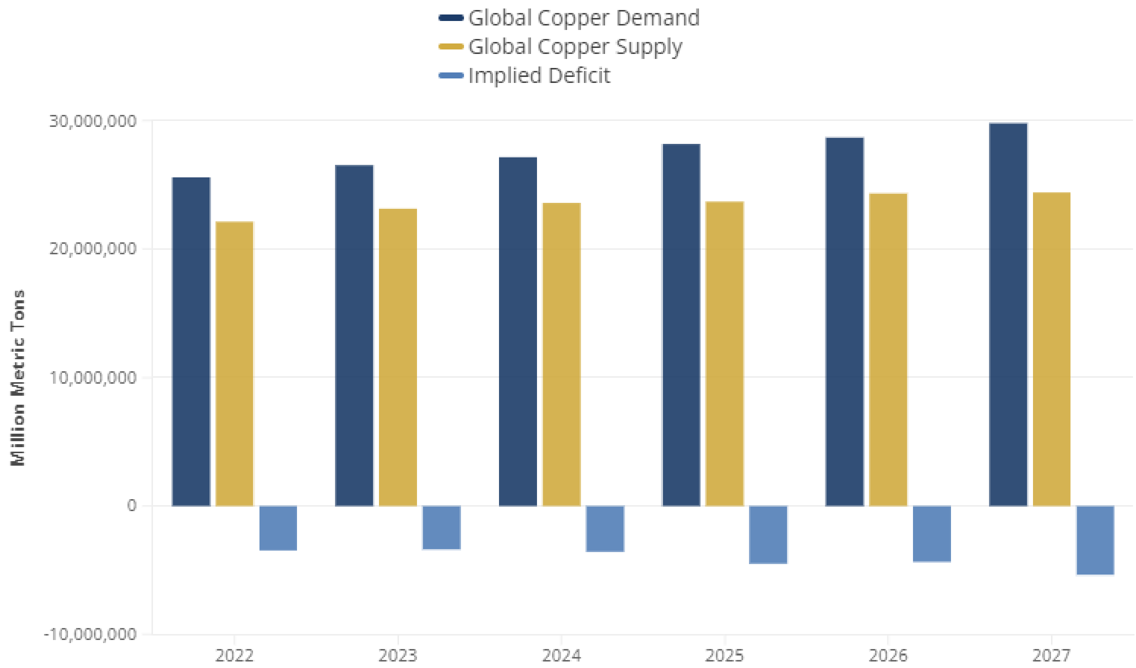
Albert Chu

Copper has been used by humans over for well over 10,000 years. More than ever, this ancient metal is a key driver behind humanity's technological progress, from AI to net zero.

However, demand for this often-underappreciated metal is outstripping supply, driving up prices and potentially hampering the pace of development. Copper is at the heart of electricity, and high conductivity and light weight make it an indispensable material in electric wiring and grids, accounting for approximately 90% of global copper usage.

AI and renewable energy have physical requirements and need infrastructure such as data centers to house and process the vast amount of data and wind turbines and electric vehicle (EV) batteries to meet sustainability targets. Electricity and copper are critical inputs into both these stories and will drive incremental structural demand in the coming years.

Figure 1: Heading for a significant copper shortage (Figures do not yet include AI effects)



Source: BloombergNEF

Data centers are a crucial component of the rapid diffusion of AI technologies and the power markets will see demand rocket as more data centers are built to support AI. A traditional rack in a data center typically needs between 10-15kW of power. Compare this to the 40-60kW of power needed for AI-ready racks with energy intensive GPUs (Graphics Processing Units) – this represents between 4-6x more power and cooling usage.

For a sense of scale – in 2022, just in the US, data centers consumed 17GW of energy. It is estimated that by the end of the decade, data centers power needs will double to 35GW. When viewing this growth, keep in mind:

1. data center buildout estimates from AI penetration are early stage and likely underestimates ultimate demand. Blackstone's COO John Gray on a recent earnings call said he expects that tech companies will invest $1 trillion over the next five years in AI and this is mostly directed towards data centers.
2. this incremental power demand will likely draw from clean energy technologies as much as traditional power sources. Even clean energy is a massive copper user.

What does this mean for copper demand?

While the physical market implications are still at an early stage for the global copper markets, the outlook provides strong secular tailwinds to demand. It is estimated that it takes close to 65,000 tonnes of copper per every GW of applied power. AI and data center usage for copper lies within two major areas:

1. actual components into data center such as power distribution, grounding and interconnections and
2. the generation of incremental electricity to power and cool the data center.

The actual copper usage will not be static as fibre is a more efficient form of connections, but more processing intensity will demand more copper usage.

If we assume that between 3-5GW of data center applied power are built every year in the US (and the AI race is hardly US only) – the potential incremental copper demand just from the US data center buildout could range between 0.5-1.5% of global copper demand. Although this might seem insignificant, even a 1% shortage could plunge the market into a significant deficit.

Renewable energies fuel copper use

Looking beyond copper applications in data centers, the need for more power will also drive incremental generation from clean energy, potentially in the form of distributed grids (think solar panels and wind turbines). Consider that it takes between 4-5 tonnes of copper to build an onshore wind turbine or solar panel to generate 1-3MW of power.

Add to that the increased roll-out of electric vehicle (EVs) batteries and the push for sustainability has an unintended consequence of eating up a finite resource. A traditional internal combustion engine vehicle uses a fraction of the copper contained in an EV – 48 pounds for a combustion engine vs 183 pounds for an electric vehicle battery. A hybrid car contains 88 pounds of copper.

As the world endeavours to achieve net-zero emissions over the next three decades, copper demand is anticipated to grow five to six-fold. However, this surge might be challenging to meet given current supply constraints.

Constraints in copper mining

Copper supply has been further strained by operational and political instability in regions where it is mined, including Congo, Kazakhstan, Mongolia, and Latin America. Over the past year, an estimated 3-5% of global supply has been disrupted due to these factors.

Moreover, copper's supply response is notoriously slow. A typical copper mine takes about 10-15 years to explore, develop and bring online. There are no quick fixes like shale wells in the oil industry, which can be operational in mere days.

As a result of these factors, the copper market is barrelling towards a significant deficit and a price surge over the next few decades that investors should not discount when looking at the potential for AI and renewable energy.

Albert Chu is a portfolio manager at Man GLG, a fund manager partner of GSFM, a Firstlinks sponsor. The information included in this article is provided for informational purposes only.

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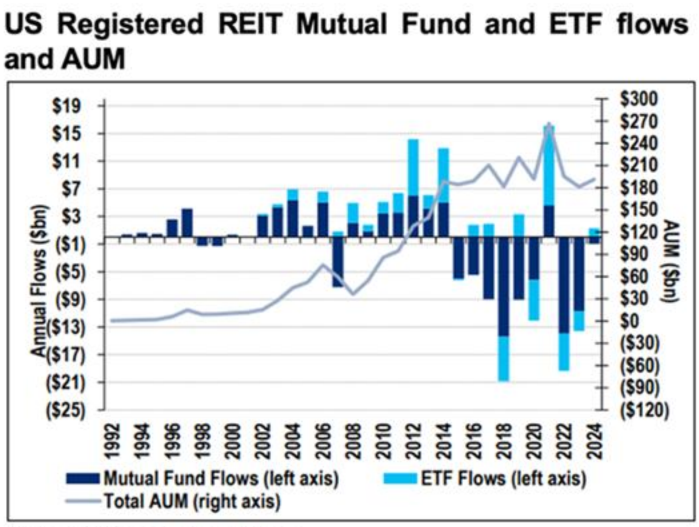
Global REITs are on sale

Marco Colantonio

It's fair to say REITs have not been flavour of the month for some time. The lacklustre investment flows into U.S. REIT mutual funds and ETFs shown in the chart below says it all.



Source: Citi Research and Lipper

You have to go back quite a way to find the last period the sector was truly in vogue. Curiously, it was arguably in the lead up to the GFC.

Reflecting on this period, the table below shows interest rates in 2007 were broadly similar to current levels, yet REITs at that time enjoyed materially higher earnings multiples.

Whilst in 2007 major parts of the REIT industry were on unstable footings thanks to higher exposure to property development, higher financial leverage, shorter term debt profiles, and greater reliance on bank lenders.

Today, as the first table below highlights despite a stark difference in sentiment surrounding the sector, broadly speaking, REIT fundamentals are very clearly in better shape than in 2007.

Firstlinks
a Morningstar company

Over the past quarter, many REITs provided guidance for calendar 2024 earnings. On average we see the REIT sector positioned to deliver approximately 3-4% earnings growth in 2024, ranging from over 10% for US healthcare and logistics REITs, to -10% for office REITs and Hong Kong residential developers.

But what's more significant is that REIT portfolios continue to demonstrate elevated occupancy levels (often above overall industry levels) which we believe points to superior quality real estate and operating platforms.

Most REITs report only modest levels of new supply impacting leasing conditions. U.S. sunbelt apartments and industrial are the exceptions where supply has been in response to elevated tenant demand in recent years.

The significant increase in avenues to sector diversify within listed REITs also shouldn't be overlooked when reflecting on the 2007 period. Active investors can now increase portfolio exposure to once-considered niche areas such as healthcare and data centre and move away from the riskier office building segment (which accounted 22% of the GREIT index in 2007 and now accounts for just 10%).

What about the uncertainty surrounding interest rates?

Interest rates may remain elevated, but if this is attributable to better-than-expected economic growth, landlords should benefit from greater pricing power in a more constrained environment for development.

The strong performance of Japanese property companies in advance of and after the first interest rate rise that country has seen in 17 years is a notable testament to these dynamics.

We are not factoring in a return to the very low interest rate regime that prevailed in the QE and post pandemic era.

Risk & Return metrics	**Feb-07**	**Mar-24**
GREITs 3 Years Total Return p.a.	30.2%	-0.2%
3 yr volatility	10.8%	19.5%
return to risk ratio 3 yrs	2.8	-0.01
GREITs 5 Years Total Return p.a.	28.1%	0.7%
5 yr volatility	10.5%	20.2%
return to risk ratio 5 yrs	2.7	0.04
Valuation and other metrics	**Feb-07**	**Mar-24**
EV/EBITDA x	21.2	18.4
Price / Earnings x	22.0	15.7
US 10 yr Treasury Yield	4.70%	4.35%
Net Debt to EBITDA (top 10 index stocks)	5.9x	5.1x
LTV (US REITs)	41%	33%
Debt maturity (US REITs)	5.5 Years	7 Years
Dividend Yield (1 Yr Forward)	3.3%	4.3%
Dividend Payout Ratio (US REITs)	83%	73%
REIT development pipeline % book value[1]	8%	4%
US Construction Start % of Inventory[2]	2.2%	1.7%
US REIT funds flows - prior 5 yr annual avg	$4.7B	-$7.4B
Net % of CRE lenders tightening standards[3]	19%	61%

Source: Factset, NAREIT, FTSE EPRA NAREIT, US Federal Reserve, Citi
Notes:
1. REIT development pipeline as % of undepreciated book value
2. US Construction Start % of Inventory (prior 10 yrs avg pa)
3. Net % of lenders tightening standards for CRE loans (last 4Q avg)

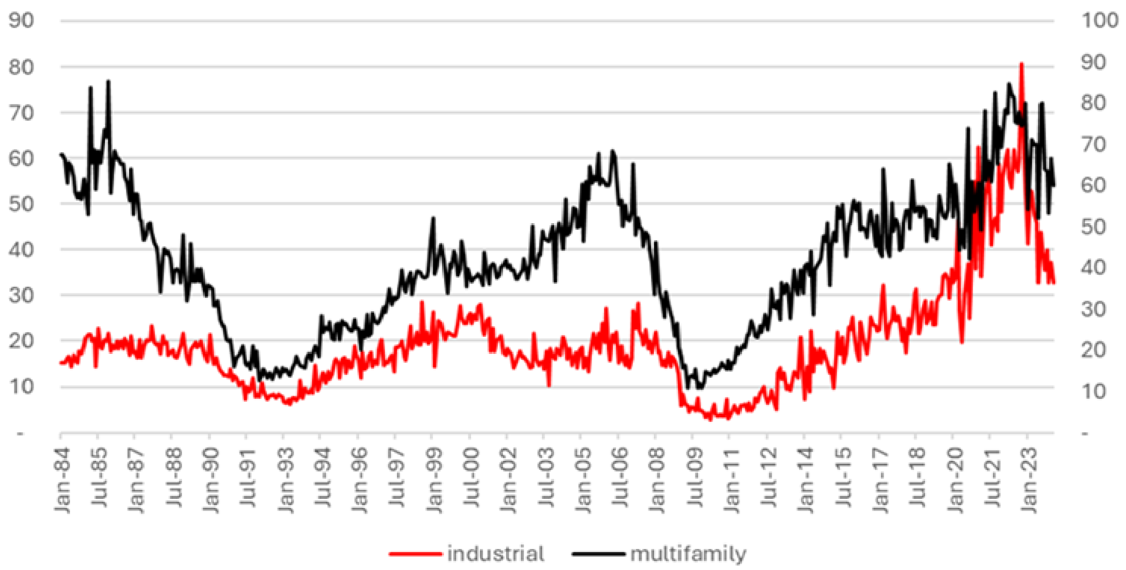
GREIT index sector exposure	**Feb-07**	**Mar-24**
Office	22%	10%
Data Centres	0.1%	8%
Healthcare	3%	8%
Industrial	7%	16%
Retail	27%	17%
Storage	2%	6%
Residential	9%	15%
Hotel	4%	6%
Diversified	27%	15%
TOTAL	**100%**	**100%**

Source: Factset, FTSE EPRA NAREIT

More importantly, for the most part, real estate demand and supply fundamentals remain favourable. Better than expected economic growth underpins tenant demand, and supply is constrained by rising construction costs, higher costs of debt and equity capital – or an outright a lack of developer finance.

While 2024 will see elevated levels of completions in the US industrial and sunbelt multi-family sectors, construction starts in these segments have fallen materially as the following chart illustrates. This should bode well for landlord pricing power, provided demand conditions do not deteriorate.

Construction starts – US industrial and multifamily



Source: Citi Research, Dodge

And when it comes to financing, the past quarter has again demonstrated that debt and equity capital remain available for REITs, enabling them to play investment offense and take advantage of the distress of others.

Perhaps the best example of profitably taking advantage of duress is evident in the Resolution Capital Global Property Securities Fund (Managed Fund (ASX:RCAP) portfolio's largest holding – U.S healthcare REIT Welltower (NYSE:WELL).

In 2023 WELL deployed US$4.8 billion into seniors housing properties at significant (30%+) discounts to replacement cost. The combination of higher interest rates, a pullback of traditional lenders, and real operational distress in seniors housing during Covid, has led to a broad opportunity set.

WELL has highlighted that ~US$16 billion of seniors housing faces refinancing in 2024-2025 likely providing further acquisition opportunities. For WELL, external growth activity has occurred at attractive yields, with the US$4.8 billion of acquisitions in 2023 yielding 7.2%, well ahead of the company's 4.9% implied cap rate. The company has rightfully leaned on equity capital to fund its investment activity, sourcing ~US$6 billion of equity capital in 2023, which has the added benefit of further improving its balance sheet.

Affinity Living at Vancouver – A seniors housing asset in Vancouver, Washington State, recently acquired by Welltower.

During the quarter WELL reported a strong finish to 2023 with 12.5% like-for-like rent growth in the fourth quarter. The company guided to 10% earnings per share growth for 2024 excluding prospective investment activity. Welltower benefits from robust growth in seniors housing, with the REIT guiding to 18% same-store net rent growth for this segment that comprises nearly two-thirds of its income.

Time to reassess REITs?

The message surrounding the Global REIT sector right now is simple – REITs are in good shape and represent good value.

They trade at or below underlying asset replacement costs, and they have good balance sheets with moderate levels of debt and modest short to medium term debt maturities.

Importantly, REITs have continued to provide investors with liquidity day in and day out.

Publicly listed REITs do not and cannot hide behind the artificial gates of private funds. These dynamics are underappreciated.

Whilst many investment trends come and go, we believe great real estate in the right location is a sensible and compelling investment opportunity in the current market. It's a sector that's going to be relevant today, tomorrow, and long into the future.

Marco Colantonio is a Portfolio Manager at Resolution Capital, an affiliate manager of Pinnacle Investment Management. Pinnacle is a sponsor of Firstlinks. Resolution's active GREIT Fund in Australia is ASX:RCAP.

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Wealth is more than a number

Dr. Daniel Crosby

This is an edited transcript from a recent Standard Deviations podcast episode by behavioral finance expert, Dr. Daniel Crosby, which offers a sneak preview of an essay from his upcoming book, The Soul of Wealth.

Even if we achieve one success after another, you and I will still fall short of the accolades earned by Alexander the Great, the legendary king of Macedon. By the age of 30, he had built up one of the world's largest empires. Geographically, he had power over land stretching from Greece to northwest India. Undefeated on the battlefield, he was widely regarded as among history's greatest military thinkers.

Towards the top on Alexander's resume was his conquest of the mighty city of Tyre. A coastal city located on an island, it was considered to be impregnable with its formidable defenses, but Alexander was determined to capture it. The Siege of Tyre was crafted by Alexander in 332 BC as part of a broader campaign against the Persians. He established a blockade during the seven-month conquest, then built a causeway, truly an engineering marvel at the time, to erect siege towers with catapults atop. Ultimately, his soldiers breached Tyre's defenses. He was said to be so heated about how Tyrians defended their city, killing a sizeable portion of his men that Alexander destroyed half the city. It was a monumental victory and sent a message to the rest of the world.

A sour victory

For a commander like Alexander the Great, surely a feeling of pride and some chest pounding was deserved. That did not happen, though. Alexander felt profound disappointment and heartache, because during the Siege of Tyre, he lost one of his most crucial generals, who was also his best friend. Hephaestion died from illness, and this devastated Alexander emotionally. It's said that their friendship was among the most enduring in history. Grieving deeply, Alexander could hardly consider the victory at Tyre a sweet win. Some accounts portray him as so grief-stricken and emotionally unstable, following Hephaestion's passing, that the once-calculating and strategic Alexander began to turn reckless. He was known to drink heavily afterward, potentially a contributing factor to his death at the early age of just 32.

While the loss of his confidant may not have directly led to Alexander's downfall, there's little doubt that the event played a pivotal role and even prompted him to make some off-center decisions. His health and well-being were in bad shape as a result of refusing to eat or drink, while he reportedly had the physician who failed to save Hephaestion executed. Alexander's military prowess also diminished in his later years as he became preoccupied with seeing himself as divine, more than just a powerful man.

So, was losing a dear friend the root of Alexander's demise? That might be a stretch. After all, there were many factors at play. One thing in life often impacts another, and a new sequence of challenges ensues. It's clear, however, that Hephaestion's death was a turning point for both Alexander and the Empire he ruled over. For 15 years, the king never met defeat. His wartime triumphs made him the second wealthiest person of all time, surpassed only by Genghis Khan. Estimates of his net worth vary widely. There weren't exactly zeros in a checking account in 325 BC, ranging between 1.6 trillion and 32 trillion. But whatever the actual number, Alexander was rich in a way that is nearly incomprehensible to the modern mind. By the most conservative estimate of his wealth, he is 10 times richer than Jeff Bezos. By that same low estimate, he surpasses the collective wealth of the 10 richest individuals globally today, people who fly to space for kicks and have private islands. And yet, with all of this opulence, all of this power, Alexander was undone in large part by something so very human, the death of someone he cared about.

What Alexander the Great's story says about wealth

His sad story tells us something very real about true wealth. We tend to chase a number as an external marker of riches, but real, soulful wealth is about much more than a number.

A tragic illustration of society's tendency to pursue numbers at the expense of values is seen in how we establish and tailgate goals as we journey through life compared to when we reflect upon our years. For those in their prime, goals generally centre around a number of predictable categories like fitness and money. According to a Gallup survey conducted in late 2022, 7 in 10 people planned to set some kind of New Year's resolution. For goals setters in 2023, the top three categories were fitness at 80%, financial goals at 69%, and career goals at 59% among those of working age. And if you're anything like me, these goals probably feel very familiar and aligned with the ones that we set and then promptly forget around the beginning of each new year.

But goals for those in reflection at the end of life look a little bit different and take on a profound shift. A 2012 study on the regrets of the dying highlighted five common sentiments. The first was that they wished that they had not worked so hard. The second, they regretted living a life that was not true to themselves. Three, they felt remorse for not having had the courage to express their feelings. Four, they wished they had stayed in closer touch with friends. And finally, they lamented not having let themselves be happier.

What do you notice? None of the things, not one, that seem to matter so much to us as we move through life make the list of what's important when the imminence of death has brought what truly matters into such sharp relief. Work, one of our primary aims in times of health, emerges as one of our most significant regrets when we reflect back on our lives.

I posed this disconnect to Twitter and received poignant replies. The short-term list is more about measures while the long-term list is more about meaning, said one individual. A financial planner remarked, we are confused creatures who don't see the truth until there is no time left.

Retirement and wealth

Those were both great observations, and the same dynamic extends to how we view retirement. For most people, retirement is their single biggest financial goal. And why not? It's a distant and somewhat ambiguous milestone that will most assuredly require vast sums of wealth to achieve. Investors tend to simply chase a bigger number on a spreadsheet, constantly shifting around those goalposts mentioned earlier, and we all too commonly fail to prepare for the other non-financial facets of retirement.

Retirement is also appealing, since we also generally don't like work. The 9 to 5 drudgery is seen as robbing us of freedom and enduring multiple Zoom meetings each day hardly sparks joy. But for all of its annoyances, work still serves as a source of engagement and socialization for many people, which has a positive impact on happiness.

Wealth is fantastic, to a point

Alexander the Great devoted his short life to the conquest of nations and hoarding treasures, eventually becoming the second richest person in history, only to have his achievements unravel at the loss of a cherished relationship. Similarly, we labor for decades to reach a certain financial milestone, only to fall into a deep malaise when we realize that other paths to flourishing may have been neglected. We spend our lives setting goals focused on career advancement and amassing wealth that, when the clarity of life's brevity is before us, seems like wasted time.

True wealth is not about finish lines or numbers, it's about using whatever material abundance we have to enrich the other more enduring paths to fulfillment. Money can buy us simple pleasures like ice cream, cherished memories on vacation with people we love, and freedom to engage in spiritual and political pursuits, all of which can bolster our joy in real ways. However, if we relentlessly chase wealth as an indent to itself at the expense of other facets of well-being, history and science both teach us that it will lead to a hollowing out of life in an impoverishment of spirit.

Dr. Daniel Crosby is Chief Behavioral Officer at Orion and a New York Times' bestselling author. All opinions expressed by Dr. Daniel Crosby and podcast guests are solely their own opinions and do not reflect the opinion of or endorsement by Orion and its affiliate subsidiaries and employees. This material is for informational purposes only and should not be relied upon as a basis for legal, tax and investment decisions. The opinions are based upon information the participants consider reliable.