

Business



November 2020

Expanding your perspective on business, investing, your clients and the world we live in.



Welcome to Business IQ

WELCOME TO the special edition of Netwealth's Business IQ magazine.

At Netwealth, we recognise the importance of knowledge and discovery as a tool for growth and innovation. Throughout the years we have examined technology and cultural trends that face an industry that is constantly evolving.

We often look overseas as a stimulus for new ideas, insights and opinions. Together with our partners and leading wealth practitioners we have travelled to global financial centres such as New York, Hong Kong and London and visited technology hubs such as Tel Aviv and Silicon Valley.

In 2020, our travels were put on hold, however with the help of our partners we have taken some of the best global ideas and have co-created a magazine, this special edition of Business IQ.

Collaboration is one of Netwealth's core values and we are pleased that we can bring you content designed to stretch the way you think about investing, business, your clients and the world we live in. These articles are arranged within themes, such as practice management, investment strategy, infrastructure investing, property investing and emerging markets. We even have content relating to healthcare, fintech and insurance.

I hope you enjoy reading Business IQ, which is part of our ever-expanding library of resources - that include articles, white papers, podcasts and webinars - designed to be enjoyable and expand your perspective on business and life.

Matt Heine

*Joint Managing Director
Netwealth*



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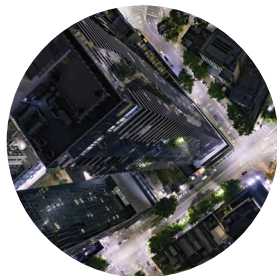
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Engaging clients through AdviceTech

AdviceTech empowers businesses to create, foster and maintain stronger relationships. Most firms will invest more in client-engagement AdviceTech this year than last, and client engagement will be the area most affected by AdviceTech over the next five years.

FOR AN industry that depends almost entirely on satisfying interactions with individuals, there is a surprisingly low penetration, among financial advice practices, of advice technology (AdviceTech) that focuses on improving client engagement.

Around 20 per cent of advice businesses say client-engagement AdviceTech is not a part, or is only a small part, of how they engage with clients. Fewer than one in ten businesses say it is pervasive in every interaction they have.

But the good news is that the vast majority of advice businesses invested more in AdviceTech in the 2019-20 financial year than they invested in the previous year, and this is the highest level of investment intention recorded in the past three years.

More than half of all advisers surveyed for the 2020 Netwealth AdviceTech Research Report believe client engagement is the process that will be most affected by AdviceTech in the next five years.

That's great not only for advice businesses, but also for clients, for whom well-implemented client-engagement AdviceTech may mean interactions are more likely to happen at a time and in a place that suits them. It also improves the likelihood that these interactions are less time-consuming, are more focused on what they need, and could even lead to better advice outcomes.

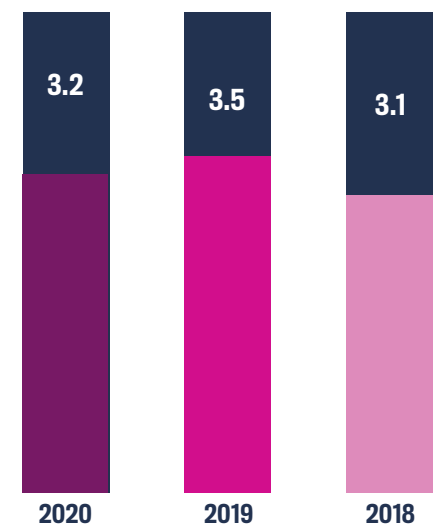
Empowering advice businesses

Engaging clients takes many forms, but the common aim of AdviceTech in this area is to empower businesses to create, foster and maintain relationships with existing clients and prospective new ones.

The suite of commonly-employed client-engagement AdviceTech includes:

- *Email, newsletters and marketing automation technology, such as Mailchimp*
- *Online client meeting tools, such as Skype*
- *Online/mobile advertising, such as Google Adwords*

How satisfied are you with your CRM AdviceTech?



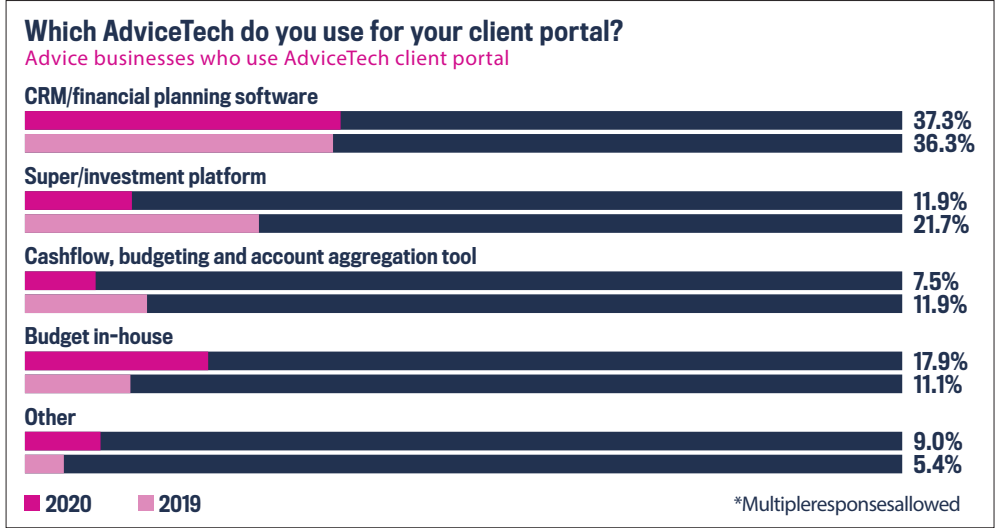
Source: Netwealth 2020 AdviceTech survey, n = 304



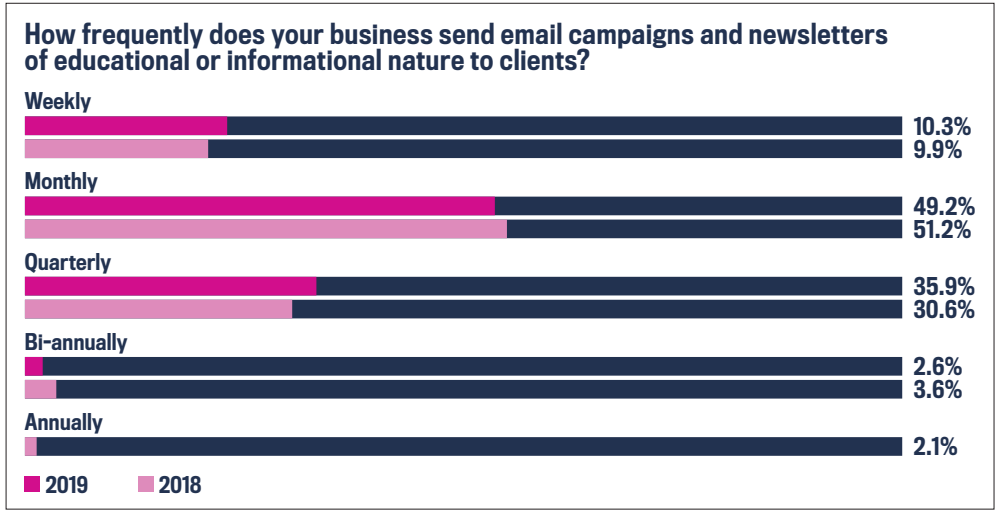
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PER CENT

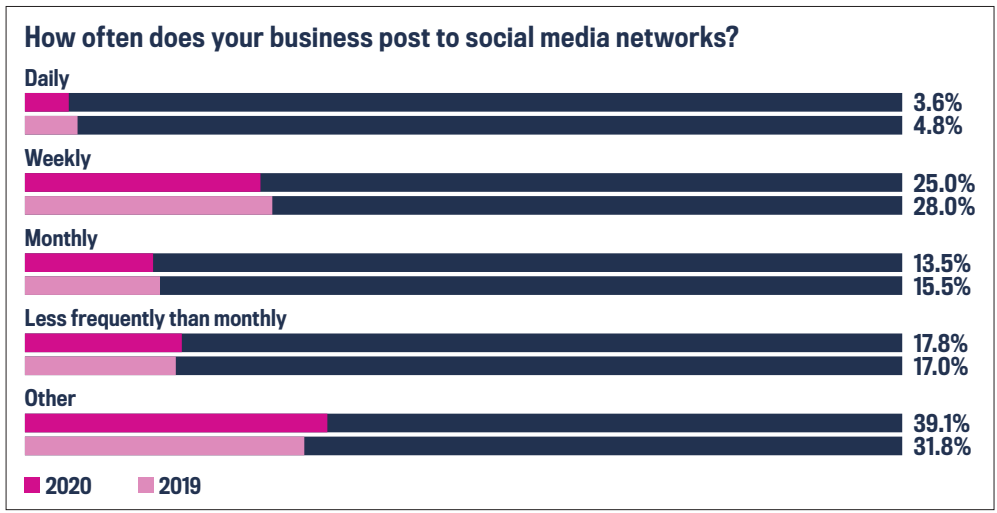
of advice businesses
post to Instagram,
up nine per cent from the
previous year



Source: Netwealth 2020 AdviceTech survey, n = 83



Source: Netwealth 2020 AdviceTech survey, n = 195



- Social media networks, such as Facebook
- Client feedback tools, such as AdviserRatings
- Client portal technology
- Client presentation software
- Tools to manage the website and blogs
- Customer relationship management (CRM) tools
- Digital signature tools, such as DocuSign.

Managing relationships

Far and away the most commonly used client engagement AdviceTech is a customer relationship management (CRM) tool. Most advisers use the inbuilt CRM capability of their planning software (such as Xplan) to organise, manage and analyse customer information and interactions.

Overall, almost a quarter of advice firms provide an online client portal, via a mobile device and/or computer. Leveraging the firm's existing CRM or financial planning tool is the most common way they give clients secure access to engage and manage superannuation, investments or bank accounts.

Most advice firms use AdviceTech to send client email campaigns and information, including educational materials, in newsletters to clients. Website content is generally updated at least once a quarter, with around 36.8 per cent updating at least monthly.



ENGAGING CLIENTS TAKES MANY FORMS, BUT THE COMMON AIM OF ADVICETECH IN THIS AREA IS TO EMPOWER BUSINESSES TO CREATE, FOSTER AND MAINTAIN RELATIONSHIPS WITH EXISTING CLIENTS AND PROSPECTIVE NEW ONES

Yet, about 30.6 per cent rarely or never update content at all.

Around 18.4 per cent of firms that use social media regularly have responded to the effort it takes to maintain a social media presence by outsourcing management to an external agency. This enables them to maintain an active presence without having to commit internal resources to maintenance and update activity.

Whether outsourced or not, most advice businesses are active on Facebook, and a smaller proportion are active on LinkedIn. Instagram and Twitter are used less commonly.

Of those businesses that use online or mobile advertising, most spend less than \$500 a month, but a few outliers spend a lot more - including some that spend up to \$10,000 a month.

No need for big spending

Client-engagement AdviceTech does not need to be expensive, nor even massively sophisticated or difficult to get hold of.

For example, the most commonly used online client-meeting tool is Skype - and that's free.

More than half of the advice firms that actively use client-feedback AdviceTech

use Survey Monkey, and there is a free version of that tool available.

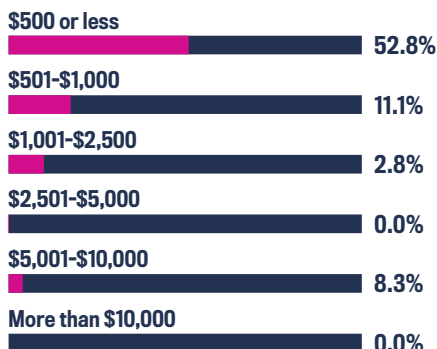
PowerPoint is the most commonly used client presentation software - it's not free, but it is widely available.

Even so, improved client engagement and communication, and improved customer satisfaction, are ranked among the five biggest benefits advice practices gained from intelligent implementation of AdviceTech in the 2019-20 financial year.

With increased spending in this area expected in the current financial year, advisers and clients alike look set to continue to benefit. ■

How much do you typically spend per month on online or mobile advertising?

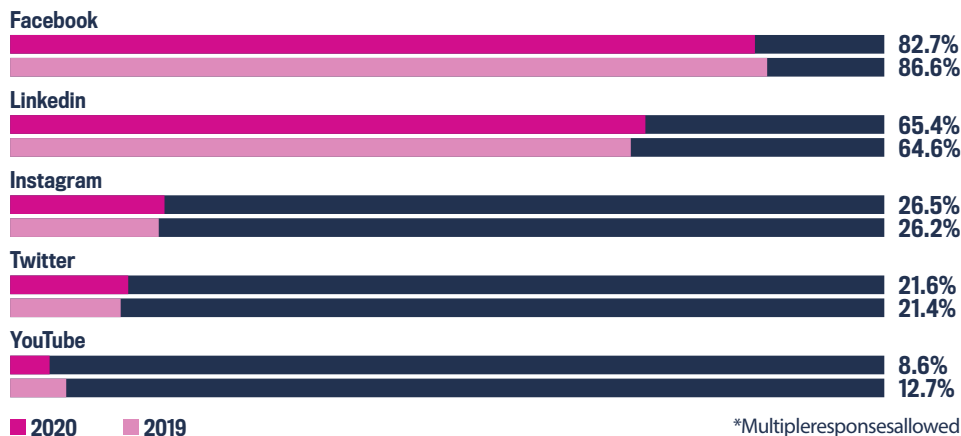
Advice businesses who pay for online or mobile advertising



Source: Netwealth 2020 AdviceTech survey, n = 36

Most popular suppliers

Advice businesses who post to social media networks



Source: Netwealth 2020 AdviceTech survey, n = 381

Evolving advisers don't fear change.

THEY EMBRACE IT!

The perfect storm continues to grow as the advisory industry continues to transform. This spells opportunity for those advisers who are committed to continuously embracing change and evolving their approach.

NEARLY EVERY aspect of the advisory industry is undergoing some form of transformation today - whether demographic shifts, capital market regime changes, rising regulatory pressures, or technological disruption.

This can be a daunting prospect for many advisers: the activities that brought them to their current level of success are unlikely to help them reach the next tier of performance.

However, for those advisers who embrace new approaches and re-engineer their businesses, the rewards can be tremendous - for them and their clients.

The changing investor population

Demographic trends are having a huge impact on advisers' businesses. On the one hand, many advisers' most lucrative and long-standing clients are ageing and approaching retirement.

These clients' planning needs are changing - custom income plans and guarding steadily shrinking nest eggs against investment mistakes they won't have time to recover from - and they require more time from advisers at precisely the time that their value to the adviser

The inflection point: The key challenges facing advisers today



Changing investor population



Shifting capital markets



Rising regulatory scrutiny



Disruptive technology

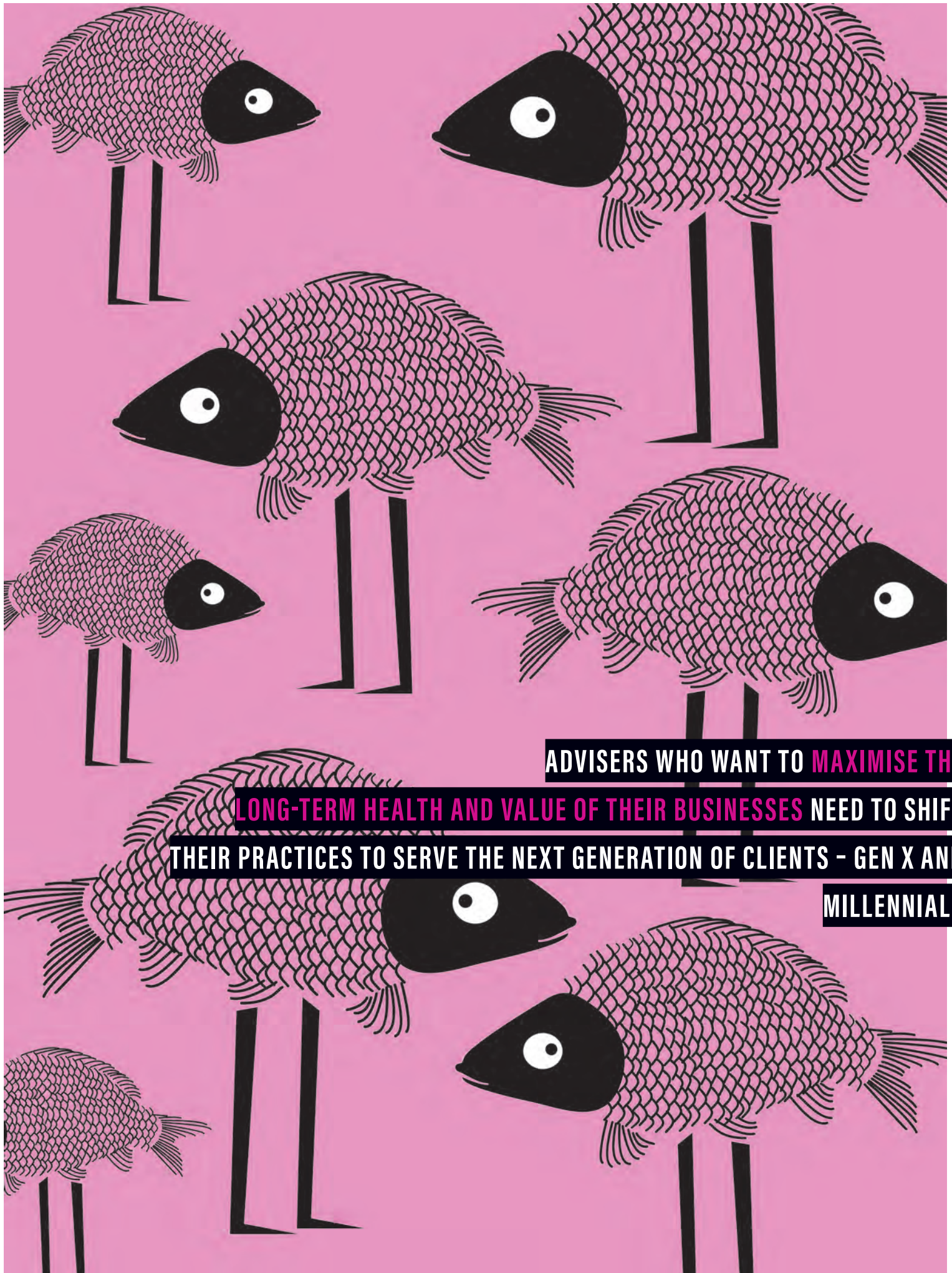


Value of an adviser

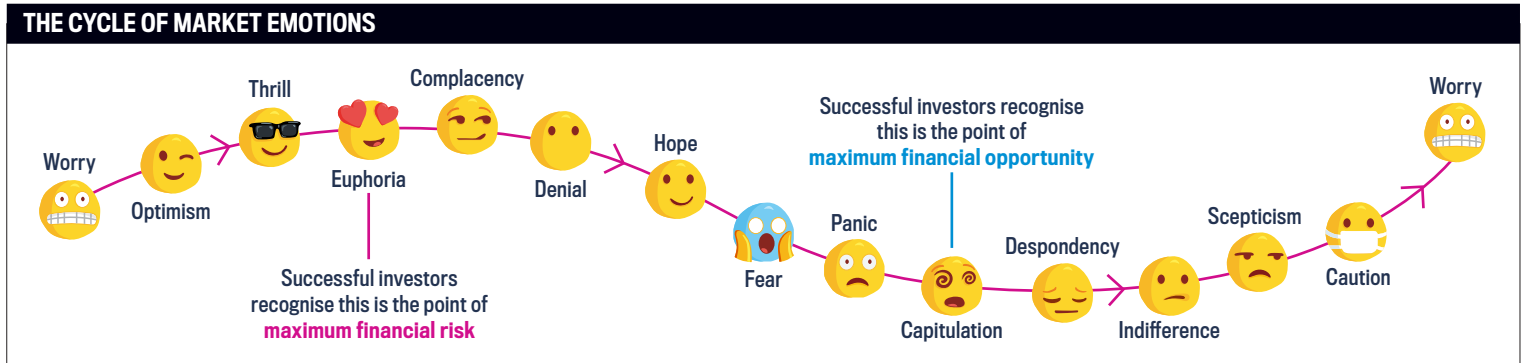
(in terms of an ongoing revenue stream) is declining. At the other end of the demographic spectrum, advisers who want to maximise the long-term health and value of their businesses need to shift their practices to serve the next generation of clients - Gen X and Millennials - who have different client-service expectations and investment goals from previous generations. Advisers who can deftly thread the needle of these complex demands on their time and resources will build successful businesses.

Shifting capital markets

The current extended bull market has been a blessing and a curse for many advisers. After all, what's not to like about steadily upward-moving markets? It's great! Except, it weakens investors' emotional resilience to market volatility. That resilience is like a muscle - which hasn't been exercised in several years. While the investment crystal ball remains foggy about when the next recession will begin, how deep it will be, and how its impact will be felt in capital markets,



**ADVISERS WHO WANT TO MAXIMISE THE
LONG-TERM HEALTH AND VALUE OF THEIR BUSINESSES NEED TO SHIFT
THEIR PRACTICES TO SERVE THE NEXT GENERATION OF CLIENTS - GEN X AND
MILLENNIALS**



future-minded advisers are preparing their clients to anticipate the potential emotional impact of renewed market volatility. For instance, they are introducing their clients to the concepts of investor behaviour, reviewing their financial goals, circumstances and preferences and ensuring their portfolios are positioned accordingly.

Emotions can be such a threat to an investor’s financial health, it is important to be aware of them. The cycle of market emotions helps investors understand and be aware of the negative consequences of impulsive and irrational reactions to emotions. When things are great, we feel that nothing can stop us. And when things go bad, we look to take drastic action.

Rising regulatory scrutiny

Governments around the world have responded to the Global Financial Crisis and the growing retirement crisis by increasing regulation in the financial services industry.

While this may have strained many advisory firms, the regulations also create an opportunity for advisers to distinguish themselves. The events of 10 years ago caused many within the industry to broaden their focus beyond excess returns—and to shift their concern to investor-desired outcomes instead. In other words, the focus shifted from simply beating a benchmark to actually listening to a client’s objectives.

“I want to be able to save enough money for retirement” or “I want to have an impact on the health of my community” became guiding lights, as advisers focused more on the client behind the portfolio, rather than seeing the portfolio as digits on a spreadsheet.

We’ve seen this at the adviser level, at the institutional level and among financial professionals across the board. Simply put, this evolution—this innovation—boils down to doing

right by the investor, as opposed to focusing strictly on making money.

“What’s the client objective we’re trying to achieve?” is starting to become the rallying cry for more asset management shops and advisers alike. It’s no question that this is a win-win for all. Those who continuously improve their business - adopting a client-centric approach, streamlining product inventory and implementing a team-based approach - are likely to have a long, bright future.

Disruptive technology

Technological innovations have not left the advisory industry untouched. To some, robo-advice and fintech can appear threatening.

After all, many of these technologies purport to do what advisers do: create investment portfolios aligned with a client’s goals and risk tolerance. However, here again advisers have an opportunity to differentiate themselves.

Many advisers deliver much more to clients than simply an investment portfolio. They offer comprehensive wealth management - for instance, deep, ongoing discovery of the client’s financial goals, circumstances and preferences, financial planning, and behaviour coaching - that requires a level of emotional sophistication that machines are not able to replicate and that many investors don’t entrust to machines.

At the same time, advisers have an opportunity to intelligently incorporate technological innovations into their business. Improving the efficiency and productivity of some back and middle office functions, and delivering on many clients’ desire for greater accessibility and personalisation of services online, can create great value for advisers and clients alike. Technology can play a vital role for advisers: facilitating efficiency, effectiveness, and differentiation.

The value of an adviser

Fees and trust are top-of-mind for many investors, and for advisers it can be difficult to explain what goes on behind the scenes to prepare, deliver and implement advice.

This can lead to either challenging conversations or an opportunity for advisers to embrace and help their clients understand the value they deliver.

For the majority of advice businesses, clients are their most persuasive advocates, so articulating the tangible benefits of advice to clients is essential. By demonstrating to clients how an adviser’s value exceeds the fee charged, advisers can improve client engagement and satisfaction, especially in times of continued focus on advisory fees and natural customer scepticism about delivered value. Our ‘annual value of an adviser’ report looks holistically at the real value advisers deliver for their clients - from the knowledge and expertise required to help clients build personalised portfolios, to the support they provide when market conditions change, and the range of additional wealth management services they offer, such as tax and estate planning.

In our 2019 report, we examined the various components of an adviser’s value proposition and estimated that advisers deliver value of at least 4.4% or more every year to their clients beyond investment-only advice. This value is a meaningful differentiator in a time of regulatory scrutiny and the challenging market environment.


The bottom line

The advisory landscape today is not what it was even 10 years ago - let alone what it will look like in 10-plus years’ time. This creates challenges, but also opportunities, especially for those advisers who are committed to evolving and continuously improving their practice. Focusing on those areas of the business that will drive growth in the future is critical. Advisers need to run their advisory business like a CEO, adopting a client-centric approach, aligning product inventory with clients’ desired outcomes, demonstrating their value and taking a team-based approach. This will help advisers not only survive today’s disruptions - but thrive in the future, as the industry continues to evolve. ■



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BlackRock

by Jessica Amir
Professional planner for BlackRock

Building better portfolios:

TECH THAT EASES THE BURDEN

A complex and rapidly changing world demands a new approach to portfolio construction. BlackRock shares its latest thinking on building better portfolios for improved outcomes.

BlackRock

SIMPLY MAPPING out an investor's risk profile and applying a traditional portfolio framework once formed the basis of a wealth manager's task, but the pace of technological change has opened up new ways for advisers to think about how to run their businesses more efficiently.

Indeed, the onslaught of rich, high-quality information, combined with powerful software, is facilitating the shift to more efficient and considerably more transparent wealth management operations.

At the centre of this technological evolution is the rise of model portfolios and powerful investment platforms, which are giving wealth advisers the ability to execute extremely cost-effective, tailored and scalable portfolio solutions.

Model portfolios provide a combination of professionally-researched managed investments, which blend various asset classes, investment managers and investment styles to achieve diversification.

In addition to the traditional menu of investment options, the evolution of investment platforms has given advisers access to various model portfolios, allowing them to reduce administration and the compliance burden of managing multiple clients.

"Aside from the unbelievable amount of time these types of models save, they also mean we can offer much more engaging and valuable services," says Trent Crothers, a financial planner at Quadrant Financial Planning in Victoria.

"We can never control the markets - they will do what they will - but we can really control strategy and now clients can see what it is they're actually holding. It's changed how we do business and made it much easier to manage more people and their specific needs."

Goals-based engine

Goals-based investing focuses on what people hope to achieve with their money - objectives such as retirement security, purchasing a home or covering school or university fees - drive investment strategy.

While this is certainly not a new idea, the advent of model portfolios and their corresponding investment platforms allows wealth managers to focus acutely on those goals, rather than become bogged down in administration.

That said, these technological advances haven't occurred in a vacuum.

A big demographic shift is also pushing the goals-based approach to the fore. Baby Boomers around Australia, and in most developed nations across the world, began to leave the accumulation stage of investing and instead were looking to fund their retirements.

Funding a lifestyle became more important than accumulating wealth for the future. As such, wealth advisers began to receive more and more goal-based demands, which coincided with the rise of data collection and assessment.



New solutions

Rather than view risk as outperforming or underperforming a benchmark, wealth advisers are rapidly adapting their offerings from simple product selection to portfolio construction.

And they are using advanced exchange-traded-fund (ETF) model portfolios to do the bulk of the heavy lifting.

Model portfolios are a diversified system of mutual funds or exchange traded funds that are grouped together to provide an expected return with a corresponding amount of risk. Rather than individually select shares, or even funds, the wealth adviser will establish a portfolio of ETFs that offer a timely and transparent way for a client to reach their investment goals.

Josh Persky, portfolio strategist, multi-asset strategies group, at BlackRock Investment Management (Australia), points to three main evolutions within the business of wealth management that have facilitated the rise of the ETF model portfolio.

These are:

- *a shifting regulatory environment*
- *low-cost products in response to a low-growth world, and*
- *a clear, consistent level of transparency.*

"Everyone knows the wealth advisory landscape in Australia is changing," Persky says. "The technological advancement is inevitable and many advisory firms are really changing their focus from product selection to portfolio construction."

BlackRock has found that ETF model portfolios are the second-fastest-growing business within its multi-asset strategy arm, which now manages more than \$US200 billion (\$269 billion).

"It's happening very quickly and once advisers do make that shift, they recognise their business performance suddenly picks up and they can become more aligned with their clients' needs," Persky says.

Rather than choose one actively managed fund over another, or one stock over another, advisers are finding they need to put together strategies that work towards goal-based outcomes, in response to a technologically-savvy client base.

"Clients are not looking for a product as such. Instead they're looking for something that helps them meet their goals," Persky says.

"And the compelling and engaging solutions? That's where technology comes in. Digital solutions are nibbling at the edges of traditional wealth advisory businesses."

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OnePath

Could change be the new black?

In years past, advice practice success was driven off the back of industry-tested business models and strategies that required time and rigour. As we enter 2021, the focus has undeniably shifted from business stability to agility and creativity. Questions are being asked among the community as to how we take our fundamentals and shift to face an environment where the consumer and external industry forces have become increasingly unpredictable.



IF CHANGE is the new black, is your business ready to wear it comfortably?

As champions of best practice, Zurich found an increasing number of practitioners wished to understand how the leading practices are managing the relentless pace of change and reframing their businesses accordingly.

To garner a deeper understanding of how both full service and risk focused practices are adapting, we benchmarked our most successful advice partners and sought to connect the traits, models and behaviours that have seen these practices thrive in challenging circumstances.

Key indicator:

40% net profit margins and a 45% increase in revenue over the past three years are tell-tale signs that, under the weight of change, the “high performers” are managing just fine, the demand for insurance remains

high and it's clear they are pivoting disruption to maintain steady growth.

In fact, it turns out these practices aren't just comfortable in change, they are change junkies, entrepreneurs who distinguish themselves by partnering a well-manicured infrastructure, with a crystal-clear customer vision.

Their innate curiosity amplifies their agility, enabling a scenario test culture, where testing and learning is inherent in their strategy, with outcomes closely monitored.

Through this approach, we can see that, once a positive outcome is achieved, the focus turns to how efficiently it can be implemented. Technology is seen as an enabler, with automation of repeatable tasks driving the ability to think creatively.

Danielle Visser, Risk Strategy Specialist Zurich says: “It's the aggregation of incremental, seemingly insignificant automations that has seen many of these firms evolve from early adopters to

CHECKLIST

- 1** Do you have the fundamentals down?
- 2** Have you automated your repeatable tasks?
- 3** Are you confident enough to freestyle your business into tomorrow?
- 4** Could change be something you could wear comfortably?

strategic operators who can lead their enterprise and clients into the future.”

While systems and technology are indeed the electricity, they are motivated by a culture that seeks to amplify what matters to their customers, with their best interests the compass for all business decisions. Practices with a clear, focused customer-experience proposition are rewarded over time with higher revenue, retention and satisfaction.

With fundamentals polished, these change leaders can freestyle with confidence, guiding clients through an advice journey that provides them with the security and growth they sought initially, as well as leaving them with an experience that amplifies what's valued by their niche. ■

i Contact Zurich to hear more about the *Entrepreneur Exchange* and the *Advice Outliers thriving in this new Evolution of Best Practice*.

The rise of thematic investing:

INVESTING IN MEGA-TRENDS

Thematic investors aim to identify long-term transformational trends that irreversibly change the world. This article explains the benefits of a thematic approach, and looks at three themes your clients can access through ETFs traded on the ASX.

“A GOOD hockey player plays where the puck is. A great hockey player plays where the puck is going to be.”

This quote, from the great Canadian ice hockey player Wayne Gretzky, sums up the difference between conventional approaches to investing and thematic investing.

Traditional approaches have an inbuilt bias to the past, with the highest portfolio weightings typically committed to the largest companies, which are often those that have reached a certain level of maturity. This approach implies a view that today's winners will also be tomorrow's winners. Thematic investing, by contrast, is forward-looking. Thematic investors try to identify long-term transformational trends, and the investments that are likely to benefit if those trends play out.

Focus on structural themes vs cyclical themes

Thematic investing focuses on structural, rather than cyclical trends.

Structural themes play out over the long term, and tend to be one-off shifts that irreversibly change the world, driven by powerful forces such as disruptive technologies or changing demographics and consumer behaviour.

By contrast, cyclical themes are typically short/medium term, and tend to revert, driven by forces such as rising/falling interest rates, or higher economic growth.

An example of a structural change is the emergence of e-commerce, which has fundamentally shifted the way goods and services are bought and sold.

Why take a thematic approach?

Aside from the benefits of being forward-looking, thematic investing offers several other advantages:

- **Long-term** - because themes play out over the long term, the timing of entry and exit points is less important than it is when investing based on shorter-term economic cycles.
- **Unconstrained** - thematic investing ignores geographical boundaries, sector classifications and style biases, meaning you and your clients are unconstrained in looking for opportunities.
- **Potential for alignment with your clients' philosophy or values** - thematic investors can tilt their portfolio towards a specific theme that resonates with them, such as environmental, social, or technology-focused themes.

How to invest thematically

Once you have identified a theme, you need to decide how to position your clients to benefit from it - who will the winners and losers be as the theme plays out?

A high-risk/high-reward strategy is to invest in one or several companies you think will benefit from the trend. However, picking winners is notoriously difficult. For every Amazon or Netflix, there are hundreds, even thousands, of companies trying to exploit the same opportunities that fail.

Thematic ETFs

One option for gaining exposure to an investment theme is via an ETF. Exposure is gained via a basket of securities rather than trying to pick 'winners'.

Most thematic ETFs track indices that have been constructed to measure the performance of companies that participate in the particular trend. Investing in a theme via an ETF offers a number of benefits, including:

- **Cost effectiveness** - using an index-tracking ETF typically involves lower costs than an actively-managed fund.



\$500

BILLION

The estimated value of the robotics industry by year 2025



Source

- ¹ Cybersecurity Ventures, 2019 Cybersecurity Market Report
- ² Past performance is not an indicator of future performance
- ³ BetaShares, as of end December 2019

- **Diversified exposure** - the security selection part of the process is taken care of, as the ETF typically invests in a broad set of companies from around the globe that provide exposure to the theme.
- **Transparency** - your clients can see the portfolio their ETF holds daily.

On the ASX, there are ETFs that offer exposure to a number of themes, including robotics and artificial intelligence, and cybersecurity.

THEME #1
Cybersecurity

As more of the world's information moves online, so too does the opportunity for cybercrime. As a result, cybersecurity has emerged as one of the fastest-growing segments in the broader technology sector, with global cybersecurity-related spending predicted to exceed \$1 trillion over the five years to end 2021.¹

This makes cybersecurity one of the most durable long-term technology themes, presenting a compelling investment case.

COVID-19 has given additional impetus to the cybersecurity theme, given the increased reliance now, and likely into the future, on the digital economy and interactivity online, brought on by the pandemic.

The BetaShares Global Cybersecurity ETF (ASX code: HACK) is currently the only ETF available on the ASX offering specific exposure to the cybersecurity sector. Launched in 2016, HACK aims to track the performance of the Nasdaq Consumer Technology Association Cybersecurity Index, before fees and expenses, and provides exposure to a portfolio of leading global cybersecurity companies, including well-known names like Cisco and Palo Alto, and smaller, fast-growing innovators including CyberArk and Itron.

As of 30 September 2020, HACK had just under \$263 million in funds under management (FuM)

The chart to the right shows **HACK's sector allocation** as of 30 September 2020.

As well as being a simple, cost-effective way to gain access to the cybersecurity thematic, HACK also helps ease the stock-picking burden by offering your clients exposure to a diversified portfolio of cybersecurity companies in a single ASX trade.

Over the year to 30 September 2020, HACK returned 20.36% after fees, and from inception in August 2016 to end of September 2020, HACK returned 17.87% p.a. after fees.²

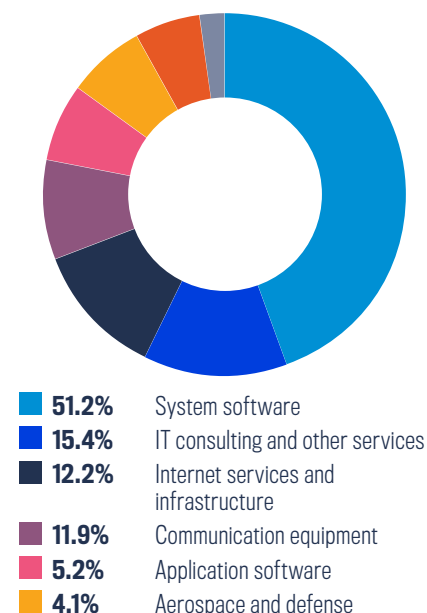
THEME #2
Robotics and artificial intelligence (AI)

Robotics and AI is a theme that capitalises on more than one trend.

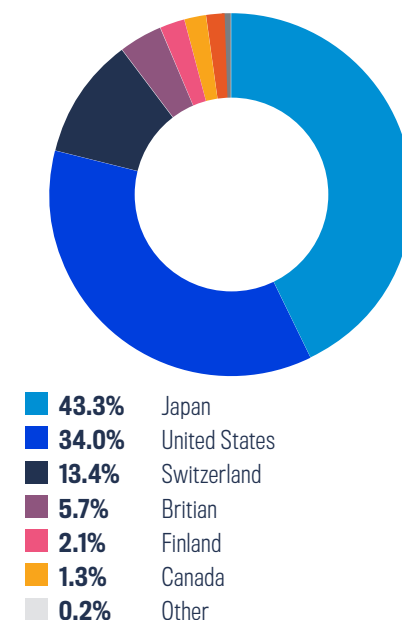
Most obviously, technological advances have resulted in robots being capable of things that were the preserve of science fiction just a few



HACK's sector allocation³



RBTZ country breakdown³





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The BetaShares Nasdaq 100 ETF (ASX: NDQ) is a fund that provides investors with low-cost access to some of the world's most revolutionary companies, including Google, Apple, Amazon and Netflix. All in a single ASX trade.

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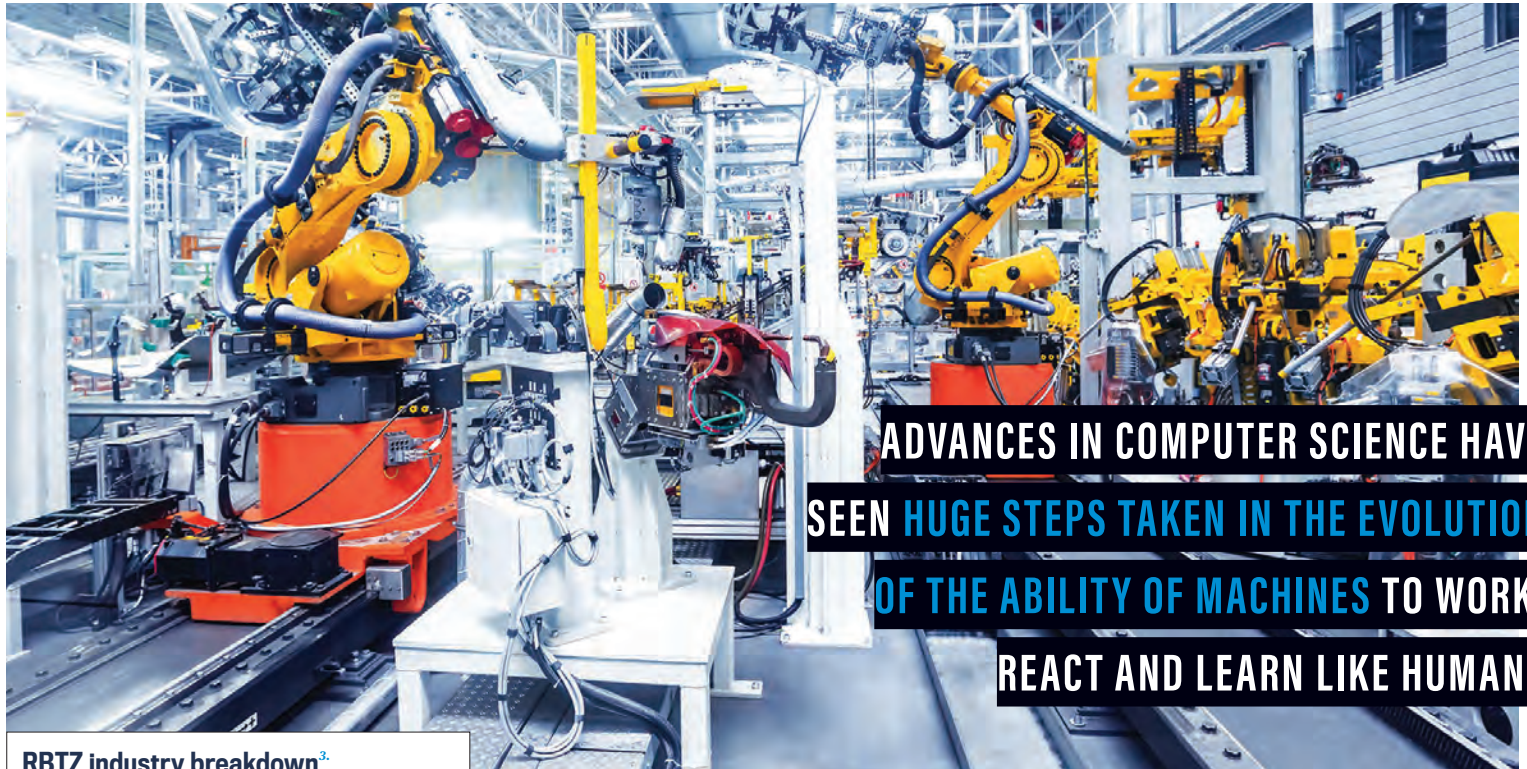
Currency Hedged Nasdaq 100 ETF now available (ASX: HNDQ)

Performance and Earnings Growth to 30 October 2020*

	NASDAQ 100 Index	Global Shares
1 YEAR RETURN	35.1%	2.4%
3 YEAR RETURNS (P.A.)	25.4%	9.1%
5 YEAR RETURNS (P.A.)	20.2%	8.5%
10 YEAR RETURNS (P.A.)	22.9%	12.3%
10 YEAR EARNINGS GROWTH (P.A.)	11.2%	0.5%

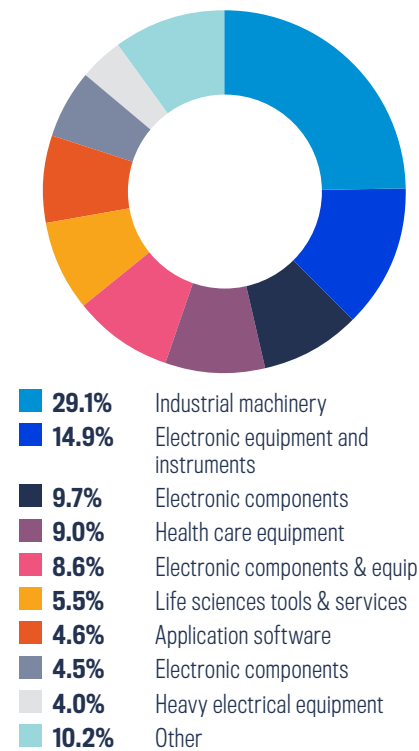
Past performance is not indicative of future returns of the index or ETF. Investing involves risk. The Nasdaq 100 Index's return volatility can be expected to be higher relative to global sharemarkets.

*Source: Bloomberg, MSCI. MSCI World Index represents 'Global Shares'. Performance does not take into account ETF fees and costs. BetaShares Capital Ltd (ABN 78 139 566 868 AFSL 341181) is the issuer. Investors should read the PDS at www.betashares.com.au and consider with their financial adviser whether the product is appropriate for their circumstances. The value of an investment can go down as well as up. Nasdaq-100 is a registered trademark of Nasdaq, Inc (Nasdaq). The Fund is not issued, endorsed, sold or promoted by Nasdaq and Nasdaq makes no warranties and bears no liability with respect to the Fund.



ADVANCES IN COMPUTER SCIENCE HAVE SEEN HUGE STEPS TAKEN IN THE EVOLUTION OF THE ABILITY OF MACHINES TO WORK, REACT AND LEARN LIKE HUMANS

RBTZ industry breakdown³



years ago. Advances in computer science have seen huge steps taken in the evolution of the ability of machines to work, react and learn like humans.

However, demographic trends also are amplifying the ability of robotics and AI to transform the world, as ageing populations and rising labour costs result in a shrinking and increasingly expensive workforce. These trends intersect, with the demand for a technological solution to the workforce problem likely to be a massive driver of growth in these industries.

The deployment of robotics and A.I. has been accelerated by the pandemic. Robots are being used to assist in the fields of retail and consumer products, healthcare and aged care facilities, while A.I. is playing a key role in the detection of outbreaks and development of a vaccine.

For clients interested in this thematic, BetaShares offers the Global Robotics and Artificial Intelligence ETF (ASX code: RBTZ), which aims to track the Indxx Global Robotics & Artificial Intelligence Thematic Index (before fees and expenses).

RBTZ currently holds just under 40 companies that potentially stand to benefit from increased adoption and utilisation of robotics and AI, including those involved with industrial robotics and automation, non-industrial robots, and autonomous vehicles.

THEME #3

Global new economy companies

The NASDAQ-100 is heavily weighted towards companies at the forefront of the new economy. These are large-cap technology companies and innovators in the consumer marketplace, including companies that continue to revolutionise our daily lives, such as Apple, Amazon, Facebook and Google.

Many of the NASDAQ-100's leading companies retain disruptive business models that are taking market share from companies in more traditional sectors such as retailing and media, and benefiting from the ongoing trend towards digitisation. These companies have exposure to an increasingly global revenue stream and leverage to upside in the global economic cycle, offering true global diversification benefits.

The BetaShares NASDAQ 100 ETF (ASX code: NDQ) is the only ETF in Australia to track the NASDAQ-100 index.

The fund was only launched in 2015, but as of 30 September, held just over \$1.19 billion in AUM. Over the 12-month period until 30 September 2020, NDQ returned 39.12% after fees and expenses. From inception to 30 September 2020, NDQ returned 21.42% p.a. after all fees.³

i For more information on these ETFs, and other funds offering thematic exposure, please visit the BetaShares website at www.betashares.com.au. For information on risks and other features of the ETFs, please refer to the relevant Product Disclosure Statement.

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by Ben Moore
Managing Director – Australia Client Group,
AllianceBernstein

Innovation:

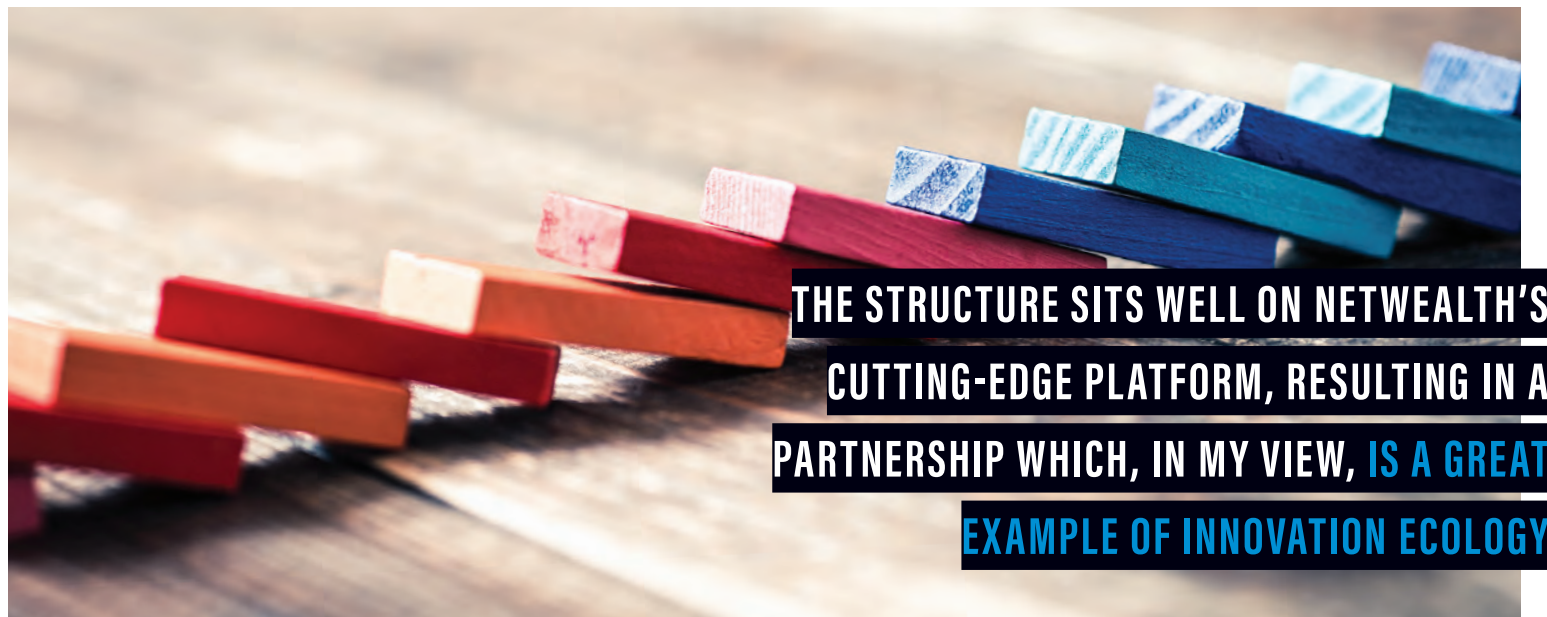
ARE YOU SEEING THE BIGGER PICTURE?

Changes you introduce in your business could have knock-on effects elsewhere. These, in turn, could affect your business. Taking this into account may help you to innovate more effectively.





ALLIANCEBERNSTEIN®



THE STRUCTURE SITS WELL ON NETWEALTH'S
CUTTING-EDGE PLATFORM, RESULTING IN A
PARTNERSHIP WHICH, IN MY VIEW, IS A GREAT
EXAMPLE OF INNOVATION ECOLOGY

WHEN MARK ZUCKERBERG invented Facebook, did he see the bigger picture? Could he have foreseen not only the success of his own idea, but all the other ideas and possibilities that it would create not just for his own business, but for other businesses too?

Could he have predicted, for example, that a global asset manager would use Facebook and data science to track the posts of known short sellers, using the insights gained to test its own conviction in various stocks, and to determine how much of those stocks to hold?

(Full disclosure: AllianceBernstein is that asset manager. Thanks Mark.)

The point is, innovation doesn't happen in a vacuum. The invention of the wheel eventually gave rise to roads, which in turn helped lead to the development of the internal combustion engine. This might seem obvious but it's a point that, in our view, often doesn't receive enough attention. And this could be important for a business (such as your financial advice firm, perhaps?) which is planning to innovate. You know what changes you must make to stay competitive and grow, but are you seeing the bigger picture?

Are you allowing for the ways in which your plans to innovate could affect not just your business and your clients, but other companies you work with – for example, dealer groups, brokers, asset managers and even office suppliers?

Just as importantly, are you aware of how innovations in their businesses could affect yours? Will they help it or hinder it?

It's a concept I like to think of as "the ecology of innovation". A change at one company could lead to changes in other companies and may even lead to a new wave of industry-wide innovation that no-one could have foreseen. Another term for it might be "the compounding effect of disruption".

Think, for example, of how financial-technology innovations introduced by Netwealth may have encouraged you (drove you?) to make further innovations to your business.

At AllianceBernstein, we're continually working with clients and technology suppliers to create solutions across a range of areas, including research and portfolio construction, to find attractive opportunities and avoid unintended risks.

The results have variously benefited all our investment strategies, including the AB Concentrated Global Growth Managed Portfolio, which joined Netwealth's platform in September last year.

It's quite innovative in Australian-market terms, being a global investment strategy structured as a separately managed account. The structure sits well on Netwealth's cutting-edge platform, resulting in a partnership which, in my view, is a great example of innovation ecology.

Thanks to Mark and his hi-tech peers, AllianceBernstein is also using natural language processing to gauge the sentiment of new car reviews, analysing mobile phone location data to measure foot traffic to bricks-and-mortar stores and assessing the "tone" of regulatory filings to determine whether companies are using more "negative" words.

These are innovative applications of new technology that benefit our investors.

So, if you're innovating, don't do it in a vacuum. Watch what your competitors, suppliers and others are doing, too, and factor their plans into yours. The results could surprise you. ■

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ALLIANCEBERNSTEIN®



The hunting ground for innovation

Innovative companies that can translate their success into sustainable growth drive above-market returns over the long term. Where should investors search for innovation? Sometimes you need to look at the companies closest to home from a different perspective, or question the long-term trends affecting our world further. First Sentier Investors' Australian equities growth team reflects on some home-grown success stories, while its listed infrastructure team highlights some global challenges innovative companies are solving.

Innovative Australian companies

Many Australian companies have the potential to compete with global giants. From stalwart mining companies through to complex businesses emerging in the information technology industry, our Australian equities growth team favours companies that can reinvest strong cash flows back into their business to fuel further growth.

Innovation is an important ingredient to growing earnings over the medium to long-term. That is why the team invests with an open mind and remains continuously inquisitive. They are looking for companies that can become industry leaders through market-leading products and services. However, they apply the additional discipline that investments in innovation must also demonstrate attractive returns on invested capital.

A2 Milk is a great example of a company that continues to develop an innovative product range and has taken its success with consumers global.

The company disrupted an industry staple in Australia and New Zealand with its innovative A1-protein-free milk products. It has extended this success into the A\$25 billion infant formula market in China, which is 20 times the size of the market in Australia. Infant formula now represents over 80 per cent of company sales.

A2 Milk has the highest compound annual revenue growth rate across the majority of ASX-listed companies, with significant exposure to China between 2015 and 2019.

Last financial year, A2 Milk's success in China also helped to drive an impressive return on equity of 43%. The company continues to extend its product range, with an eye for further growth through the US market.

It's not just the small, nimble companies that can generate growth for investors. Even though it has taken its place among the larger, more mature companies of the ASX, CSL is one of Australia's most successful innovators.

A great portion of CSL's innovation - and more than two thirds of its revenue - are based on technologies developed over the last 15 years. Its in-house-developed plasma products are state of the art and have consistently taken market share from its less innovative competitors, enabling CSL to consistently grow sales and expand profit margins.

The company's return on equity has exceeded 40% every year for the last 6 years. CSL spends more on research and development than any other ASX-listed company, resulting in market leading products such as Idelvion, a treatment for Haemophilia B, and Flucelvax, an influenza vaccine, which is distributed in markets globally.



25

PER CENT PLUS

The per annum return on First Sentier Investors wind and solar energy generating assets

\$1,000 invested at the IPO would be worth \$483,951 if you held it until CSL's 25th anniversary in September 2019.

Innovative listed infrastructure companies

Although renowned for their stability and predictability, listed infrastructure companies are also innovating to provide solutions to key issues such as urban congestion, renewable energy and digital connectivity.

Our listed infrastructure investment team takes a global perspective to analyse these developments around the world. Research coverage is organised by sector, to help identify global best practice.

The last decade has seen carbon-free renewables, with the help of low-cost natural gas, start to displace coal and oil from the developed world's electricity supply. The International Energy Agency predicts that, between 2019 and 2024, the world will add enough renewable generation capacity to power the entire United States. The continued build-out of renewables, and the need to upgrade and expand energy transmission networks, is expected to underpin stable earnings growth across the utilities sector.

A great example of a company positioned to benefit from this shift is NextEra Energy, a large cap US utility whose assets include regulated utility businesses and clean energy leader NextEra Energy Resources.

The company is a large holding in the team's global listed infrastructure strategy.

Some of its recent innovative projects combine wind and solar energy generating assets within the same facility, alongside battery storage. This increases the hours of the day that the facility can be utilised.

The benefit to consumers and the environment is clean, affordable energy. Investors have benefited too, with the shares delivering an annualised return of over 25% per annum since the strategy initiated a position in the stock in 2015.

In the communications infrastructure space, mobile towers have enabled - and profited from - strong growth in mobile data over recent years. Towers are designed to house equipment that can transmit telephone and mobile data signals. Their main customers are mobile phone companies, who lease space on the towers and then mount equipment to run their mobile networks.

Relentless growth in demand for mobile data has given the tower sector's earnings a defensive profile, protected from the ebbs and flows of the broader global economy. Planning restrictions in most markets make it difficult to build new tower sites, and represent effective barriers to entry. Long-term contracts help to minimise technology risk.

The forthcoming rollout of 5G technology is expected to transform many areas of the economy (HD video streaming and live streaming; Internet of Things; healthcare

monitoring; and autonomous vehicles). The increased connectivity that 5G networks offer will provide the next leg of growth in demand for data. Tower stocks such as Crown Castle and SBA Communications are uniquely positioned to benefit from this theme.

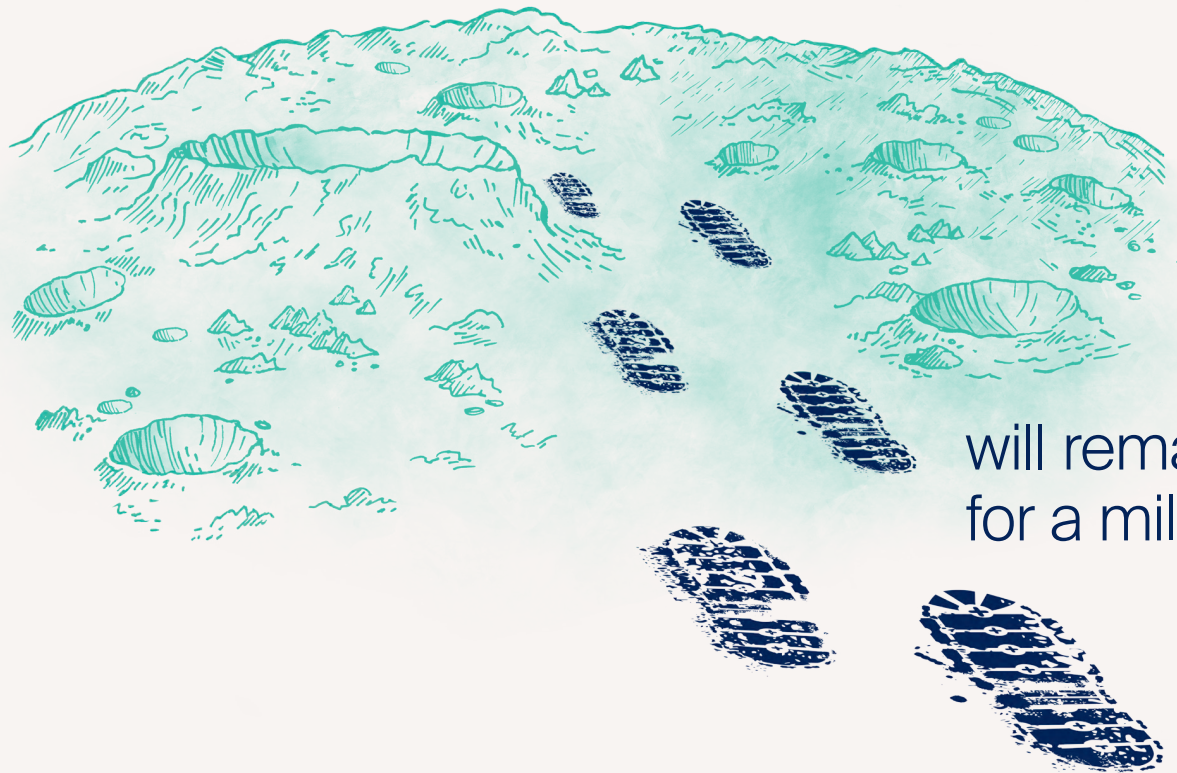
Innovative infrastructure companies are also helping to relieve urban congestion around the world.

ASX-listed toll road company Transurban operates portfolios of toll roads in Australia and North America, including the 95 Express Lanes in Washington DC. These give commuters a guaranteed speed of at least 90km/h, facilitated by innovative dynamic pricing. Vehicles carrying three or more passengers, buses and motorcyclists travel for free.

Transurban has transformed from a 'construction' company to a company where 40% of employees work in technology. They use military-grade video-capture technology to reduce accidents and congestion on their roads. Transurban is also preparing for the advent of electric and autonomous vehicles over the next decade and the changing patterns of road use they will bring.

Our investment team looks at over a dozen toll road businesses globally, and has found that Transurban's management and operations are world best practice. Recognising its potential for growth, our listed infrastructure team initiated a position in 2011. The company's shares have since realised annual average returns of more than 19%. ■

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on the moon...



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At First Sentier Investors – the new name for Colonial First State Global Asset Management (CFSGAM) – curiosity is at the heart of all we do. It's what shapes our investment philosophy and drives our active approach to investment management.

It also helps us tread carefully. We have always considered the long-term impact of our decisions on our clients and the communities in which we invest. As First Sentier Investors, nothing has changed.

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Investors



“WITH RETURNS ON CASH SO LOW, BOTH NOW AND FOR THE FORESEEABLE FUTURE, IT’S INCREASINGLY IMPORTANT TO CONSIDER ALTERNATIVES TO CASH - AND TO DO IT SOONER, RATHER THAN LATER”

Allocations in client portfolios

MAKING THE MOST OF CASH

With cash rates set to stay even lower for even longer, retirees urgently need higher-earning alternatives for the defensive portion of their portfolios. Actively managed fixed income investments can provide the answer – and the time to act is now.

A YEAR AGO in our paper ‘Optimising cash allocations in retirement portfolios’, we suggested that the RBA could take the cash rate to as low as 0% by the middle of this year. We had no idea that COVID-19 would be the trigger to get us there – but sometimes it’s nice to be right, even for the wrong reasons!

We also thought that even if cash rates weren’t cut further (from 0.75% at the time of writing), they would likely stay low for a long time. Our reasons for thinking the cash rate would remain lower for longer were that:

- structural trends in demographics, globalisation and technology were dampening growth and pushing inflation lower
- debt loads were high, and
- central banks were likely to continue to use their limited toolkits to pursue their narrowly framed (consumer) inflation targets for some time to come.

All of these reasons are still valid. We’ve also had the big cyclical shock of COVID-19, which has seen the RBA cut rates to 0.25% (effectively zero).

Could rates go negative?

Ideally the RBA’s cash rate would be lower still. Our modelling suggests that, based on the unemployment rate, inflation, and consumer and business sentiment, the cash rate should be about 3% lower than it currently is.

However, the RBA is unlikely to take rates negative, mainly because it thinks the side-effects could outweigh the benefits. Instead, the Bank is committing to buying enough bonds to keep the 3-year government bond yield at 0.25% – which is effectively a commitment that the cash rate will stay at least as low as 0.25% for three years. It may still take the cash rate slightly lower, to say 0.1%.

ee years. It may still take the cash rate slightly lower, to say 0.1%. ears. It may still

Schroders

What does it mean for investors?

These yields obviously offer very little return for the cash investor. And indeed, the return on cash is negative after inflation, and potentially likely to become more so as the RBA holds the cash rate at its current level or lower for years.

With returns on cash so low, both now and for the foreseeable future, it's increasingly important to consider alternatives to cash - and to do so sooner, rather than later. For retirees and other defensive investors whose primary objective is to preserve capital, every week or month invested in cash risks achieving precisely the opposite result, eroding the after-inflation value of their investment.

In our earlier paper we suggested that retirees should invest part of their existing cash allocation in defensively-oriented fixed income strategies - aimed at generating higher incomes while still largely preserving the key features of cash: certainty and liquidity. Given our even-lower-for-longer outlook for cash rates, we think the argument for substituting some fixed income for cash is even stronger now, and we make the same suggestion today.

Shouldn't I stay in cash until fixed income yields are higher?

While it's true that fixed income yields are materially lower than last year, anyone waiting on the sidelines for them to recover could be waiting a long time. Fixed income yields have fallen for similar reasons to cash returns - a falling cash rate and consequently lower government bond yields. As a result, they are unlikely to go much higher over the next few years, for the same reason that the cash rate won't.

However, there is also good news. After the initial shock of the pandemic, credit spreads (the difference in yield between government bonds and other fixed income investments) have returned to around their historical averages, so that investors can once again earn a liquidity or credit risk premium, depending on the investments they select. As a result, the prospective return on a well-constructed, diversified fixed income portfolio is likely to be several times higher than cash over the next few years.

on cash is negative after inflation, and potentially likely to become more so as the RBA holds the cash rate at its current level or lower for years.

Wouldn't I be better off in equities, where possible returns are higher? Wouldn't I be better off in equities, where possible returns are higher?

The answer is yes, if an investor's timeframe is long. But for the cash portion of a portfolio, where the timeframe is short and investors typically value certainty, the answer is no.

The - stable returns and known cashflows from fixed income provide much greater certainty than variable dividends and the uncertain return of capital from equities. So, to keep the risk profile of your client's cash bucket low, your client would be much better to be in fixed income than in equities. reasons to cash returns - a falling cash rate and consequently lower government bond yields. As a result, they are unlikely to go much higher over the next few years, for the same reason that the cash rate won't.

What should investors do right now?

We believe retirees can meaningfully increase returns with little additional risk by allocating part of their cash portfolios to high quality fixed income strategies. To best achieve this aim, those strategies should be actively managed, liquid and diversified. Risk management is crucial to manage and control a portfolios aggregated exposure to a variety of risks. In particular, we seek to limit correlation to equity markets and to minimise volatility and manage downside risks.

In adopting an absolute return approach, the most critical element of the investment process is to identify which assets to own, how much to own and when to own them. Active management is important because it helps investors take advantage of the emerging opportunities in fixed income while avoiding possible risks (such as the heightened risk of default in some corporate bonds). This is then complemented by extensive research and expertise in the fixed income asset class. The targeted result is a well-diversified portfolio with exposures across global credit, rates and currency markets with the potential to deliver consistent returns, with high liquidity but with much lower risk than the equity market.



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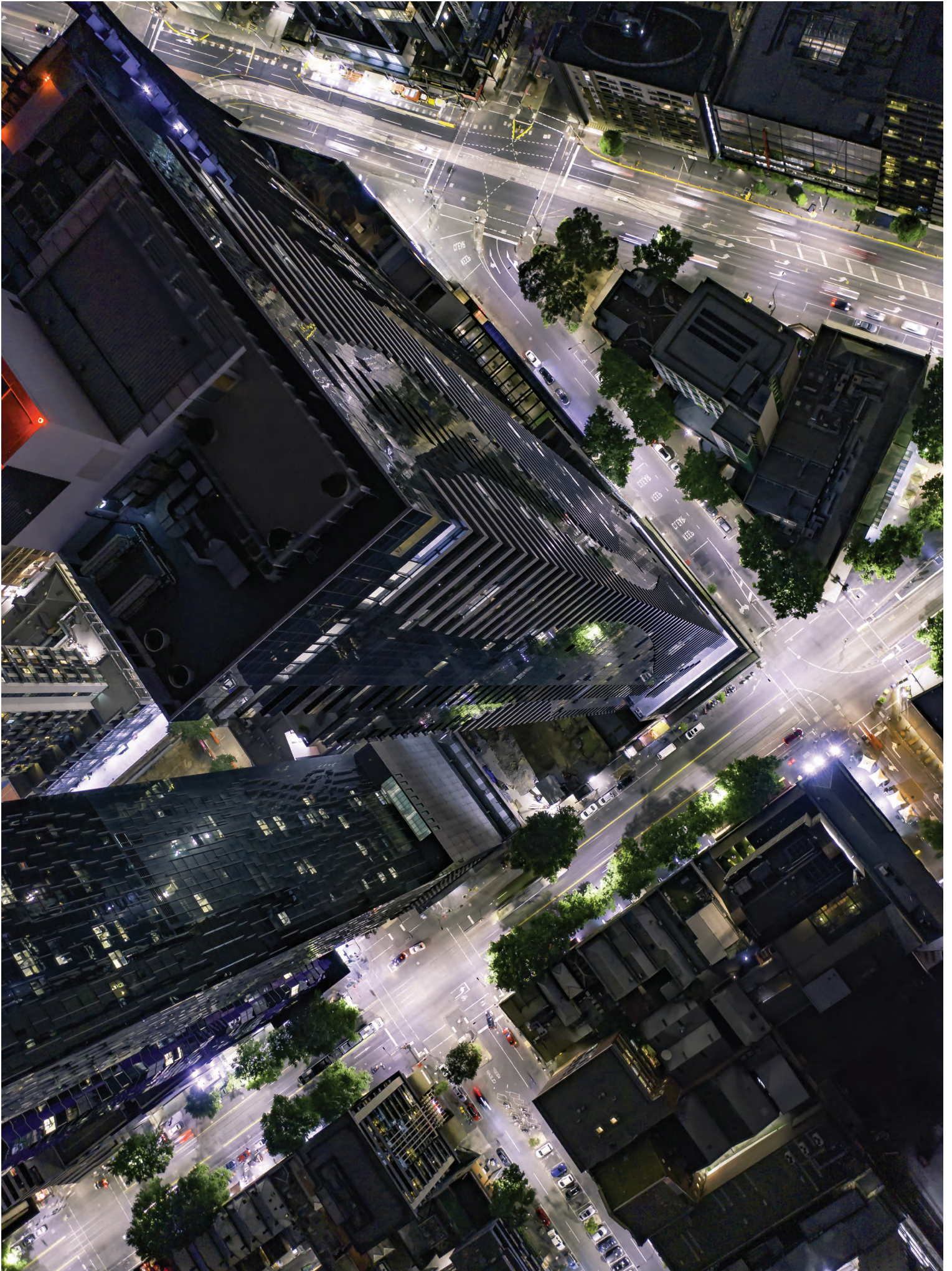


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by MLC Asset Management

Source¹ Baruch Lev, *Harvard Business Review*, Book Reviews/388, Volume 92, Issue 2, Summer 2018, pp. 388-389² Prof Jonathan Haskel, *The rise of the intangible economy: how capitalism without capital is fostering inequality*. Imperial College Business School.

The rise of asset-light capitalism

Asset-light companies, in industries ranging from technology to consumer products and pharmaceuticals, now dominate economies. Their way of creating value is so different that entire legal, financial and regulatory eco-systems are struggling to keep pace.

AROUND THE middle of the 1990s, something of historic significance occurred, but went largely unremarked at the time. Physical-asset-light, intangible-asset-dominant companies assumed market capitalisation leadership in the S&P 500 index from their physical-asset-heavy counterparts.

Think of it as the property, plant and equipment (PP&E) world being overtaken by the information, ideas and images (I3) world.

Advanced economies that, less than a century earlier, measured wealth and power through the value of rail, oil, ships, power plants and infrastructure now saw more value derived from intangible assets – assets that are not possible to touch.

Recent estimates suggest that the US private sector's annual investment in intangibles surpasses US\$2 trillion, or roughly double the annual investment in tangible capital.¹

In the realm of economics and markets, intangible assets, like all other assets, are sources of future value. But, unlike PP&E, they lack physical embodiment.

Intangibles include patents and trademarks, software and information systems, brands

and original designs, artistic products, and organisational capital – that is, companies' systems, processes and incentives that enable them to create value, like Amazon's and Netflix's customer recommendation algorithms.¹

Intangible assets create most of the profits and value for business enterprises these days. Tangible (physical) assets are mostly commodities – available to all competitors – and thus unable to create substantial value.¹

Just in case anyone thinks that intangibles are largely the domain of technology companies, they are in fact ubiquitous in every sector and industry: Coca Cola's major asset, its brand, is an intangible asset.

An upshot is that a veritable earnings growth chasm has opened between capital intensive and capital-light businesses over the past decade.

Flipping economics on its head

A feature of intangible companies is their seeming defiance of the law of capitalism that outsize margins in any industry invite competitors eyeing a slice of the economic pie.

In this scenario, motivated competitors gnaw at giants, ultimately narrowing overall industry margins and reducing behemoths to a more mortal size. Sometimes, disruptors go so far as felling giants all together. Think of mighty Kodak's downfall as it failed to respond to the digital challenge.

But the opposite seems to be happening.

While the bigger companies – the likes of Google and Facebook – are getting bigger, smaller businesses are faltering because they struggle to get investment. Frontier companies are breaking away from the laggards and the data suggests these divisions will only widen.²

Capitalism is not supposed to function this way. Competitors should be emerging that erode and corrode. Instead, bigger companies are more likely to have resources to allow them to benefit from synergies between intangible assets.

In creating the iPod (remember them), Apple combined MP3 technology with licensing agreements, record labels and design expertise to produce a winning product. This ability to combine different technologies and then scale up helps these companies to dominate markets – and the gap widens.²



Source

- ³ Baruch Lev. *Intangibles*. Stern School of Business, New York University, July 2018.
- ⁴ Hendrik Bessembinder, *Do stocks outperform treasury bills?* Department of Finance, W.P. Carey School of Business, Arizona State University.

- ⁵ According to McKinsey, an American firm that was very profitable in 2003 (one with post-tax returns on capital of 15-25 percent, excluding goodwill), had an 83 percent chance of still being very profitable in 2013. In the previous decade, the odds were 50 percent.
- ⁶ The number of listed US corporations has fallen by approximately half in the last 20 years, according to Credit Suisse research.



Accounting standards need to change to be useful to investors

Intangibles are so profoundly different that entire legal, financial and regulatory ecosystems are struggling to keep pace.

For investors, being able to forecast future earnings and value companies with some degree of confidence is all-important. Current accounting standards are falling short as they relate to intangibles earnings and valuations.

In the US, practically all expenditures on internally-generated intangibles – R&D, information technology, brand creation and enhancement, business designs and processes, employee training and other human resources development costs, “big data” creation and exploitation, customer acquisition costs etc – are immediately expensed, whereas expenditures on similar but acquired intangibles (including in-process R&D) are capitalised³ as assets on balance sheets.

The antecedents of the sweeping intangibles’ expensing can be traced back to a 44-year Financial Accounting Standards Board (FASB) standard mandating the immediate expensing of R&D (SFAS No. 2, 1974, “Accounting for Research and Development Costs”), which was enacted prior to the emergence of economy-changing, intangibles intensive industries.³

It really is odd that the major value

creators of modern businesses are treated as salaries or interest expenses, whereas the “commoditised” tangible (fixed) assets – marginal value creators because they are available to all competitors – are capitalised.³

The need to change the accounting rules for intangibles would seem to be compelling.

Most of the strategic, value-creating resources of business enterprises, such as patents, IT or brands, are currently expensed and, therefore, not recognised as assets in financial reports, thereby understating the earnings and assets of intangibles-growing firms, and overstating the earnings and assets of intangibles light enterprises.³

Reported earnings are the single most widely-followed measure of firm performance. Therefore, it is logical that accounting earnings provide a basis for valuation.³

An intangibles-induced deterioration in the quality and relevance of reported earnings indicates a significant harm to investors and other financial report users. There simply aren’t readily available, uniformly measured and audited alternatives to reported earnings available to investors.³

The intangibles-induced relevance loss of reported earnings should be of concern not only to their intended users - investors - but also to corporate managers, whose performance is often evaluated by investors on reported earnings.³

Winners are concentrated

The current wave of businesses driven by information, ideas and images has changed the nature of competition and sources of competitive advantage.

That said, it would be unwise to simply invest on a thematic basis assuming that all intangible-dominant companies are equal.

Big winners drive overall returns to a generally underappreciated extent. A Hendrik Bessembinder study⁴ showed that just 4 per cent of companies accounted for 100 percent of US equity market wealth creation since 1926.

Seeking the select group of winners also makes intuitive sense, given the increasing winner-takes-all dynamics evidenced by profitability and returns on capital at top firms staying higher for longer,⁵ increased corporate concentration,⁶ and the ability of cash-rich incumbents to purchase upstart challengers.

It is unlikely that even the most long-term investors today are investing on a multi-decade time horizon.

Nevertheless, the historic record showing a few winners ultimately driving returns and challenges posed by behind-the-times accounting standards emphasises the importance of active investment discrimination. ■

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WHERE TO TURN FOR RETURNS AND STABILITY

Today's investor, faced with minimal fixed income returns, late-stage equity valuations, and the prospect of growing market volatility, may have somewhere to turn: convertible bonds.

“CONVERTS” (CORPORATE bonds issued with a call option that gives the holder the right to convert the bond to equity shares) bring together equity and fixed income properties in a unique combination. The call option can give fixed-income investors access to alternative sources of return in markets where returns of any sort are increasingly hard to come by.

For stock investors, the bond component is designed to act as a floor underneath equity risk as markets become more volatile.

For multi-asset investors, converts can extend a portfolio's efficient frontier, adding bond-like stability to an equity tilt and stock-like potential to a fixed income tilt. And because of the idiosyncratic nature of the convertible universe, they can act as a diversifier across a range of portfolios.

Hoarding capital

Convertible bonds originated in the US railroad boom of the 19th century. Entrepreneurs, eager to preserve capital to invest in laying down track, issued the hybrid instruments as a way to save on interest expense and avoid depleting their balance sheets when principal repayment came due.

That fundamental objective, conserving liquidity, hasn't changed. Small- and mid-cap companies seeking to finance their expansions dominate convert issuance.

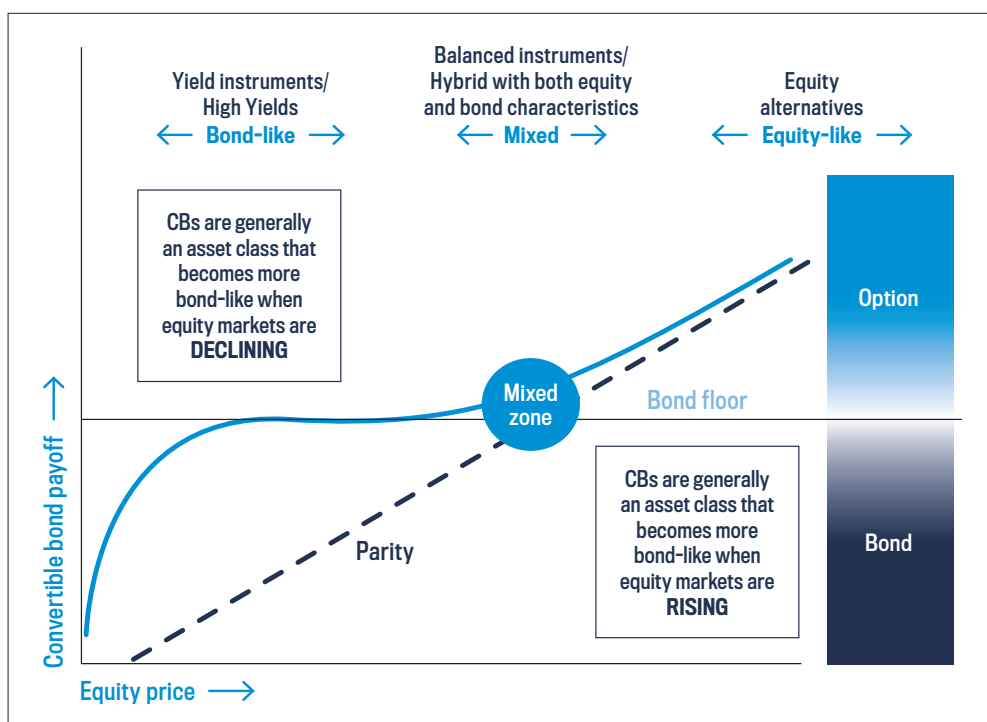
Unrated but not unworthy

The outsize proportion of small- and mid-cap issuance, untested in the credit markets, inevitably means much convert issuance doesn't meet the exacting standards of an investment grade rating. In fact, well over half the issuers forgo an agency rating altogether to save on the expense of obtaining one.

On the other hand, convert issuers typically do not carry any other form of unsecured debt on their books.

According to a November 2019 Bloomberg review, better than four out of five outstanding converts rank as senior unsecured debt, falling in right behind secured loans on the corporate capital stack. What's more, since many convert issuers refrain from issuing other forms of debt, they tend to have cleaner balance sheets than high-yield and even investment-grade issuers, as measured by risk ratios like free cash flow to debt and debt to earnings before interest, taxes, depreciation, and amortization.





Market Environment	CBs generally behave like a ...	Rational
RISING EQUITY MARKETS	STOCK	When the price of the underlying equity increases, the price of a CB tends to rise, capturing a portion of the upside
FALLING EQUITY MARKETS	BOND	The price of CB tends to fall less than the price of the underlying equity, seeking to mitigate downside risk

For illustrative purposes only. The above chart is designed to illustrate the equity and bond characteristics inherent in convertible bond products including both potential equity exposure during market upturns and resistance via a bond floor during market downturns. The above illustration does not attempt to portray market volatility or movements, which may have significant effect on convertibles bond prices.

An asymmetric advantage

In sum, and as distinguished from every other investment, the structure of convertible bonds favours investors, in our view.

Converts are, in their primary incarnation, bonds. Investors have contracted to get their principal back when the bonds mature. The bond-like contract places a floor underneath the convertible comparable to the principal value of a corresponding “plain vanilla” bond—the same bond, in other words, without the embedded call option. At this bond floor, the convert runs the same risks as any corporate bond: liquidity in distressed circumstances and issuer insolvency at the extreme.

Unlike a conventional bond, however, the convert has upside potential built in, in the form of the call option. If the issuer’s equity makes out well, convert holders can realize a greater return on their principal than they would have received in coupon payments alone.

The combination of the bond floor and the equity option can create an asymmetric return pattern. The potential for gain exceeds the potential risk of loss because of a differentiated payoff when the bond’s return profile falls in what we call the “mixed zone.”

The graph of the convertible’s return (above) illustrates this asymmetry. The line of the bond’s payoff balloons out and assumes its characteristic and uniquely convex shape as the price of the equity rises. The value of the convert flattens out at the lower bound of the equity price, the bond floor, and it should respond like a conventional bond. As the price of the underlying equity rises, taking the price of the option along with it, the value of the convertible itself rises.

When the value of the shares embedded in the option catches up to the par value of the bond, the convertible has reached breakeven, or parity. Above and beyond parity generally lies profit; the convertible grows steadily more equity-like as it approaches the option’s strike price.

The more convex the shape of a convertible’s curve—the faster it climbs off the bond floor toward parity and beyond—the more it resembles an equity investment (see image).

The mixed zone, where a convertible manifests its dual qualities, defines its sweet spot. Below the mixed zone, along the bond floor, the call option has little value. Above the zone, the bond becomes less convex and riskier as the compensating protection afforded by the bond floor loses its value.

A convert’s delta tracks the rate of change in its price relative to the price of the associated equity. As a general rule, the area between a delta of 20%, where the price appreciates at one-fifth the rate of the stock price, and a delta of 65% marks out what we define as the convertible mixed zone. Below 20%, the convert behaves like a conventional bond; above 65%, more like the underlying stock. The most favourable position for the convertible investor lies in the 20% to 65% mixed zone, where the bond floor is near and convexity is highest.

Finding value in volatility

The properties of convertibles make them one of the few investments capable of thriving in volatile markets. The dual nature of the investment gives them an advantage over conventional investments. They typically have short durations compared to other fixed income asset classes, which makes them relatively less sensitive to changing interest rates—issuers, as a rule, seek to cap their call exposure by issuing converts with short maturities. Rising rates, which undermine bond markets, usually accompany rising equity markets, which tend to lift the value of call options. So, the short duration supports the bond floor, while the call option affords an opportunity to participate in the upside. And just as greater convexity may generate more gain on the way up, it can deliver bond floor protection more swiftly on the way down.

Convertibles’ ability to withstand and even to profit from volatility has historically served long-term investors well. From the global financial crisis through the long subsequent recovery in US stocks, the convertible index held up better through the crash and kept pace in the rally. Convertibles’ resiliency enabled them to realize equity-like returns over the long run with fewer and shallower potholes along the way.

Their diversifying qualities and the presence of upside equity potential with a fixed income cushion make converts a prudent allocation in a strategic portfolio. For those investors concerned that geopolitical uncertainties are mounting and the global economy may be slowing, now would seem to be an especially opportune moment for converts, in our view.

We believe the prospect of volatility’s imminent return to the market creates a problem ripe for the convertible solution. At the same time, we believe convertibles are an asset class that demand active management to realize converts’ full investment potential. ■



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by **Jeremy Anagnos CFA**
Principal, Chief Investment Officer, Infrastructure, CBRE Clarion

Don't tell me this is not infrastructure

THE RISE OF DATA CENTRES

As investors' interest in infrastructure continues to rise, so does the debate over the types of assets considered core infrastructure. Data centre companies are at the nexus of this debate, as the sector is not universally considered core infrastructure in the listed space but increasingly sought after by private infrastructure investors. While not all data centre companies qualify as core infrastructure, the select group that does qualify provides investors attractive growth potential driven by long-term secular demand trends tied to the rise of the global digital economy.

Defining core infrastructure with a private market perspective

Our definition of core infrastructure is guided by a private market perspective that identifies core infrastructure as the marriage of a physical asset providing society an essential service with resilient long-term cash flows.

Our analysis of companies for inclusion in our core infrastructure investment universe is forward-looking and unconstrained by index definitions.

The benefit of our relatively unconstrained approach is the flexibility to keep pace with evolving market trends and actively construct a listed infrastructure portfolio inclusive of core assets with investment characteristics consistent with those owned by private market investors. For investors seeking exposure to infrastructure in the listed markets, we believe our approach provides the most accurate universe of core infrastructure assets.

Data centres are essential assets critical to the digital infrastructure ecosystem

Data centres are essential assets that provide society with the digital.



Mobile Towers

- Facilitate wireless communications in a cellular network
- Use radio frequency technology to send and receive signals to and from wireless devices.



Data Centres

- Central locations where computing and networking equipment are concentrated
- Collect, store, process and distribute large amounts of data.

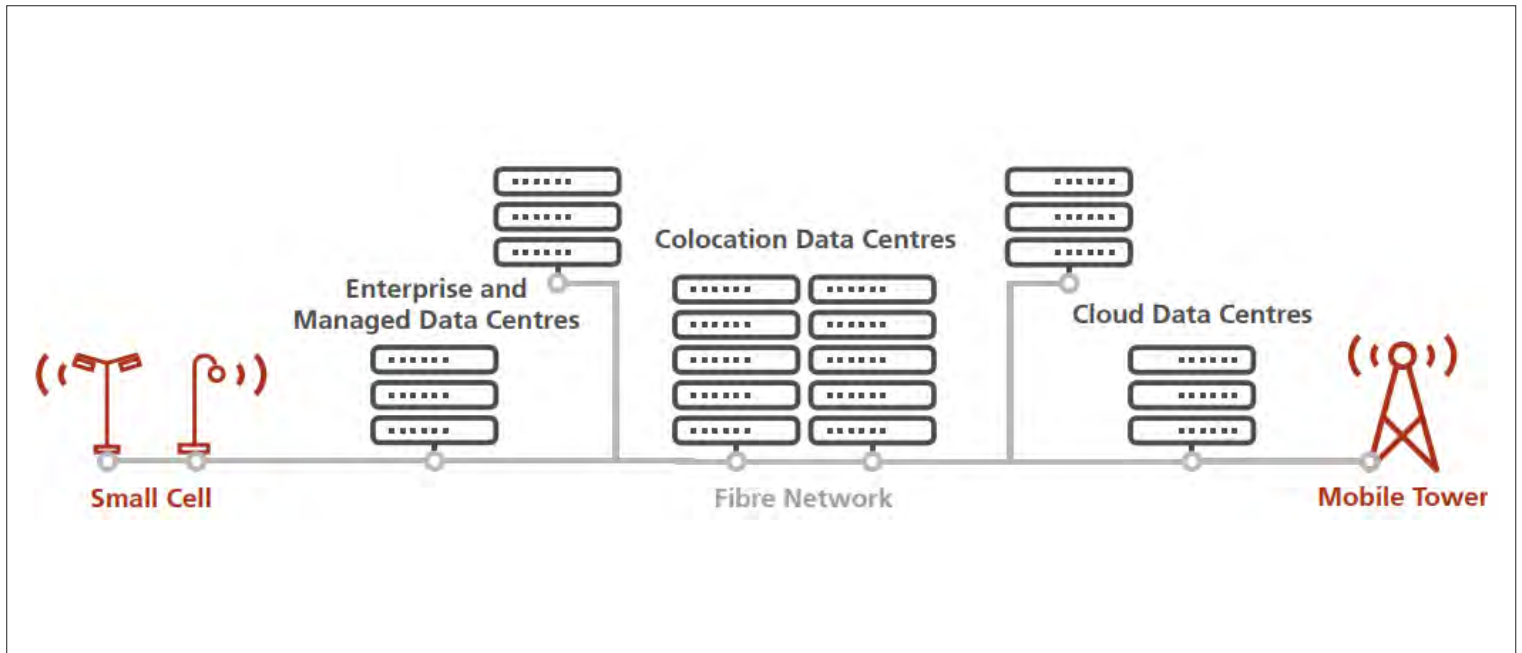


Fiber Networks

- Used for long-distance, high-performance data networking and telecommunications
- Use glass or plastic threads to transmit data over long distances.



Source
CBRE Clarion and Equinix Q2 2020 Earnings Presentation



Not all data centres are core infrastructure

Our view is that not all data centre assets qualify, and only a select group of companies can be considered core infrastructure.

Data centres as a core infrastructure investment have high barriers to entry stemming from premium platforms and premiere assets integral to the flow of data. Such assets are well-located and well-connected which drives sustainably high levels of demand from top tier tenants across the globe. Data centres that are infrastructure have more operational control of the assets versus the real estate approach which focuses more on the ownership of the land and building.

Companies focused more exclusively on the services side of the data centre business are neither core infrastructure nor real estate.

Case study: EQUINIX

Equinix is an example of a data centre infrastructure company included in our

investment universe, which we don't believe is widely included by our peers and is not included in industry benchmarks. Using our private market perspective as our guide, our analysis of Equinix draws a clear alignment with core infrastructure's key investment characteristics.

Essential Assets:

Equinix is the largest data centre company with a global platform built for retail collocation and network interconnection. Their premiere data centre assets provide critical connection points that help power the digital economy and are essential in supporting social and economic activity for the benefit of their investors.

Resilient Cash Flows:

The company has historically generated consistent cash flow, delivering 70 quarters of sequential revenue growth. Revenues tied to contractual cash flows with creditworthy customers, including mobile carriers, "blue chip" technology companies, and other industry-leading businesses. The average

contract length is greater than 18 years, including extensions.

High Barriers to Entry:

Asset and service quality and high switching costs result in high customer retention. Equinix continues to enhance value proposition by densifying its asset base, enhancing service offerings, and looking to provide a globally interconnected set of low latency data centre assets.

Predictable Growth:

Growth driven by the accelerating digital economy trends - continued network proliferation and interconnection, the rise of cloud-based architectures, and secular growth in data from long-tailed trends including AI, 5G & IoT.

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by Invesco Australia

The shape of things to come:

Smart cities

Large cities around the world are beginning to experience the same problems. London, New York and Tokyo, for example, are all running out of physical space – fast. To combat these issues and improve the quality of life in these densely populated areas, cities are turning to new technologies that make it feasible to monitor and connect everything – from buildings to street lights to self-driving cars – potentially enabling governments to provide city services more efficiently.

Predicting urban evolution

Institutional real-estate investors are mining smart-city data to understand the opportunities created by new patterns of movement, improved energy efficiency and future climate change, such as the following:

- **Smart buildings will be key to tackling global warming**
- **Data are reshaping the real estate investment industry**
- **Today's most advanced smart cities started modestly, adding new capabilities gradually rather than trying to build from the ground up**

“Investing in real estate used to be a really simple thing,” says Tim Bellman, head of global research at Invesco Real Estate. “You looked at supply and demand.”

Now, he adds, it's much more sophisticated. Data-driven buildings allow investors to make better-informed decisions and monitor their properties more closely, while potentially creating new data-related revenue streams.

In addition, highly-efficient buildings reduce expenses and address environmental challenges, an important consideration for investors guided by environmental, social and governance (ESG) issues such as climate change and human rights.

Smart and sustainable

According to Mr Bellman, the green shoots of smart-city real estate are already visible.

“If you just look at the number of people walking around cities with smartphones, those effectively smart individuals are interacting with smart buildings,” he says, by connecting with those buildings' Wi-Fi networks or having their

presence detected by sensors in a building's walls and floors. Once they are in, buildings can use those data to adjust services, such as heating and air conditioning.

“When you walk into a building, your movements are measured,” Mr Bellman explains, “and in some of our buildings, systems measure the number of people coming in and out and automatically adjust and regulate temperatures.”

This, of course, lowers costs by improving energy consumption.

Cities are triumphs of real estate – the most efficient use of land on the planet. But large buildings are big consumers of power, needed primarily to light, heat and cool large internal areas that are disconnected from the outside world. Making them more energy-efficient, says Darin Turner, managing director and portfolio manager for Invesco Real Estate and Mr Bellman's colleague in Dallas, Texas, is a key part of smart-city planning.

As an example, he points to Prisma Tower, an Invesco-backed development in the La Défense business district of Paris, where heating, cooling and telecommunications are provided by an external facility shared with a number of buildings.

“That's a type of approach that has been around for generations,” he says, “but its use of modern technology makes it unusual. The building doesn't have to utilise space for those purposes. We buy in those services at a cost-effective rate, and that means the building is more efficient.”

It is also what makes real estate more sustainable in the long term.

“When you are trying to understand sustainability, you have to have some key design principles,” notes Mr Turner.

“Things like resilience, flexibility and safety. But the other element is the impact of climate change – understanding how you need to be thinking about not just expectations for today but expectations 15-25 years from now.”

Investing is changing, too

These principles are already influencing how institutional investors assess real-estate opportunities.

“Over the last decade or so,” says Mr Bellman, “environmental and social-governance principles have become a very important part of investing generally, and we have found that doing the right thing for the environment was also a smart commercial decision. It made our buildings more attractive to tenants and it cost us less to run them.”

City “smartness” has also increased the complexity of real-estate investing, he adds, turning it into a much more finely tuned data-driven search for higher potential returns.

“At a very high level, a real-estate investment strategy relies on two things: signs of growth or change,” he says, “and smart cities are leading to changes in the patterns of movement within

An aerial night view of a city skyline, featuring several prominent skyscrapers illuminated with blue and white lights. The buildings are densely packed, and the lights create a vibrant, glowing effect against the dark sky. The perspective is from a high angle, looking down on the city.

43

MEGACITIES
are expected by year
2030 according to the
United Nations. The
term 'Megacity' is given
to a city with more than
10 million inhabitants.



Source

¹ Belt and Road refers to a large-scale infrastructure and investment initiative by the Chinese government focused on countries in Europe, Asia and Africa. “Belt” is a reference to overland routes and “road” refers to the sea routes



cities and the intensity of use of individual buildings. So, this is an exciting area for us to try to identify new patterns of value that will show outperformance in the varied buildings we can invest in.”

Those patterns, he explains, can be found in the huge amount of data that smart cities now generate.

“It’s much more fine-grained,” Mr Bellman says. “We can go down to street blocks and corners. We can come down to the number of restaurant bookings in an area or the number of people who have been observed parking in a particular location. And we can use data mining to try to understand where value is being created.”

A key role for City Hall

Good-quality data depend on the presence of sensors - although, as Mr Bellman points out, smartphones are already generating a large amount of that information, and while individual smart buildings can play their part, much depends on the commitment of the city as a whole to building a digital infrastructure.

“The key to being able to make this transition to a smart city is having that ability for overall connectedness,” says Mr Turner, “mostly driven by your overall internet capability, but then also by your devices around that internet capability.

“So, areas that we have seen that are the most advanced [in becoming smart cities]

- places like Amsterdam, New York, Seoul, Singapore - very much have that initial layer of telecommunications infrastructure in place. It’s mostly places in Africa, India, Latin America that are very far behind in installing that base layer of sensors that are really needed to make a smart-city environment.”

However, he suggests, that lack of infrastructure could be to the advantage of developing countries.

“In the developed world, you are not only trying to plan for the future but also attacking what’s currently on the ground. You have to incorporate planning around what is existing, and that can slow you down.”

By contrast, developing countries get to build from scratch.

“They have the ability to really leap forward on technology,” he says.

A global phenomenon

That opportunity has not gone unnoticed, particularly by China, which is investing heavily in smart-city developments, including significant commercial and residential real-estate projects both within its borders and across its Belt and Road Initiative.¹

Internally, China has partnered with four of its biggest technology companies - Ping An, Alibaba, Tencent and Huawei - to create what it calls the PATH to Smart Cities initiative (the name is an acronym of the companies’ initial

letters), developing smart-city capabilities in 500 cities across the country. And it is involved in a number of overseas smart-city projects, including a partnership with the Philippines government to build from scratch a 407-hectare smart city, the City of Pearl, on reclaimed land in Manila Bay.

Other countries, including India, the United Arab Emirates and Saudi Arabia, are following China’s lead and are unveiling strategies to drive smart-city development. India is planning to upgrade 99 of its cities from 2022 onwards under the country’s Smart Cities Mission, and Saudi Arabia has plans for a brand-new smart city, Neom, which will cover 26,000 km² of what is currently desert land.

Turning smart dreams into smarter reality

Developments such as these are not short of ambition, but Abhi Gami, senior investment analyst at Invesco, advises caution.

“The huge projects that people have been dreaming up for years have mostly fizzled out because they require people to accommodate technology,” he says, “instead of technology organically accommodating how people live.”

He cites the example of Songdo in South Korea, a smart city which has been built from scratch and has many smart-city innovations, including a central pneumatic waste-disposal system, which has failed to attract residents. It is currently home to about 70,000 people, far short of the 300,000 it has been designed to accommodate.

“The cities that are most advanced share the fact that they started modestly and slowly added new capabilities”, notes Mr Gami.

Early phases of the City of Pearl are expected to open in 2024 but, according to Nicholas Ho of Hong-Kong-based Ho & Partners Architects, the project’s lead designers, the development will probably take “two decades” to complete.

By then we will need many more smart cities to house and service the world’s growing population, nearly 70% of whom will be living in cities by 2050, according to UN estimates.

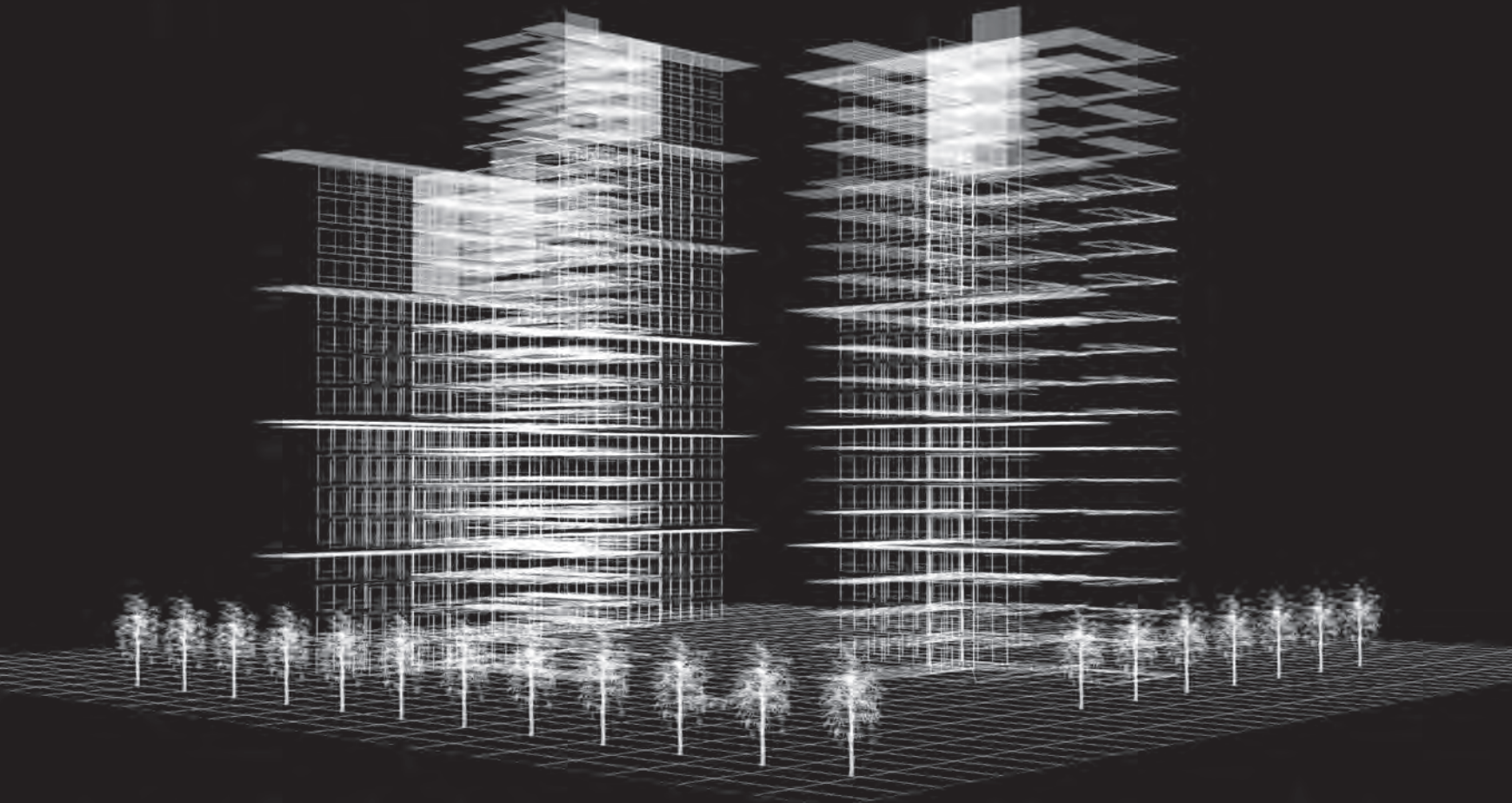
And that is exciting the conventional world of real-estate investment.

“We are talking about investing in areas that are new,” says Mr Turner. “Just from understanding the potential impact [of smart cities] and what that means for our quality of life, it’s an exciting time to be a real-estate investor.”

Mr Bellman agrees. “That interconnection of smart buildings with smart cities,” he notes, “creates the potential for us to generate additional value from our investments.” ■

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\$3.1

BILLION

The amount in real estate investments APN manages, as at 31 December 2019.

The value in not failing fast but

succeeding slowly

Sometimes the simplest inventions can be the most life-changing. The wheel, nails, soap, matches, push-up tube lipstick and frozen dinners spring to mind. Innovation at APN doesn't resemble that of game-changing inventors – as a fund manager, we follow a disciplined, proven set of investing rules. Skill is involved of course but, if innovation means departing from those principles, we want no part of it. However, there's another way to look at our approach to property investing which we like to think is innovative, based on sheer simplicity and an intensity of focus.

INNOVATION, ACCORDING to the dictionary, is “the introduction of new things, ideas or ways of doing something.” I'd add a condition to that. Shoe umbrellas and goldfish walkers are innovative but useless.

The introduction of new things, ideas or ways of doing something must also be valuable. APN may not be a Cochlear, Apple or Tesla, but the non-radical concepts that launched the business, and which we've relied on for over 23 years, were innovative and added value for our clients. Let's take a look at our non-radical ways of innovating.

NUMBER 1.

Saying 'no' to new ideas is just as important as saying 'yes'

At APN, we use the phrase 'Property for Income' a lot. It's fundamental to the way we manage our investments, based on four principles that ensure we remain tightly focused on security and stability of income at lower-than-market volatility:

- 1. We recognise that leases and the rents they generate are a fundamental characteristic of commercial real estate**
- 2. We avoid property investments that are more equity-like in nature, typically where significant proportions of revenue originate from things like property development and funds management than pure rents**
- 3. We seek out investments with longer-than-average leases, and**
- 4. We select investments that have long term utility, reducing the potential impact of lease reversion, where the rent received from a future tenant is less than that received by the current tenant.**

By sticking to these principles, we provide investment products that can closely replicate the risk and return of traditional income assets, making our investments in commercial property truly **Property for Income**.

Any innovation we consider must first fit within these principles. If it doesn't, it is

rejected. These principles help us to separate the good ideas from the bad.

The lease contract is especially important. The profitability of a tenant can fluctuate wildly, but the rent it pays does not.

To deliver predictable, stable income, we focus on high-quality commercial property with tenants of good standing.

The lease also entails regular rent reviews. Australian commercial rents usually rise, no matter the circumstances of the tenant. As long as they remain solvent, the rent must be paid. And if it is not, the landlord is usually towards the top of the debtor queue.

These factors reduce investment risk, making commercial property more an income than a growth asset.

Sticking to these fundamentals and maintaining the discipline to say “no” to innovating for the sake of it is how we deliver on our promise of regular, reliable and predictable income. For us, saying “no” is a critical part of the innovation process.

Source

¹ Not including cash or term deposits. The usual distribution timetable was quarterly or half-yearly for other property securities funds

² As at 31 December 2019. Returns net of fees and expenses and assumes distributions are reinvested, Investors' tax rates are not taken into account when calculating returns. Past performance is not an indicator of future performance



“INSTEAD OF FAILING FAST, WE TOOK IT SLOWLY, REMAINING TRUE TO OUR CORE PURPOSE. FAILING FAST MIGHT BE THE RIGHT APPROACH FOR TECH STOCKS; WE’D PREFER TO NOT FAIL AT ALL”

NUMBER 2.

Small ideas can be just as innovative as BIG ones

Monthly income. It's a small idea that delivers a big impact for our investors. For retirees who rely on cash flow for their living expenses, receiving a stable, monthly cash payment provides comfort and certainty.

In 1998, when we launched our first property securities fund, no other property fund paid monthly distributions.¹

This innovation recognised that retirees, our primary investor base, would appreciate more frequent payments than the usual half-yearly or quarterly distributions, which often fluctuated wildly. Consistent monthly income was a small but innovative idea that has proved its worth over 23 years.

Good big ideas don't come along very often; small ones regularly do. And they can make a big difference.

NUMBER 3.

Succeed slowly rather than fail fast

Start-up entrepreneurs and tech innovators love the “fail fast” philosophy. We prefer the “succeed slowly” approach.

As an example, we've taken our flagship AREIT Fund's income-focused, lower-risk philosophy and extended it to different geographies. Launched in 2011, our Asian REIT Fund has delivered 15% since inception.²

But we've only actively taken it to market in the last few years. And after many years of research and market testing, we are launching the APN Global REIT Income Fund in September 2020.

In both cases, this slow and steady approach has delivered the right team, processes and structure to give each fund the greatest chance of delivering on its promise to clients.

We've applied the same approach to new types of commercial property investments like petrol stations, storage facilities, technology parks and large format retail.

Instead of failing fast, we took it slowly, remaining true to our core purpose. Failing fast might be the right approach for tech stocks; we'd prefer to not fail at all. To do that, we take it slow.

NUMBER 4.

“That's enough about me. Now, what do you think of me?”

Innovation often starts with something that annoys you enough to want to change it.

We wanted to change the way we communicated with our investors. Like many in the financial services sector, we wrote articles and thought papers full of jargon and acronyms but without much personality. It bugged us, and it probably meant our clients didn't bother reading a lot of what we wrote.

Every professional tends to write for their peers rather than their clients. It's just the way things are. We might live and breathe all things property but our clients, from super funds and wholesale investors to financial advisers and mum-and-dad investors, generally don't.

As organisations succeed and grow, they face the risk of becoming ever more internally-focused. Nowhere is this more in evidence in finance than in what we ask our clients to read. The opportunity was to communicate intelligently, by explaining often complex concepts in an understandable, interesting way; not “dumbing down” but “smarting it up” with accessible language and a humble, explanatory tone.

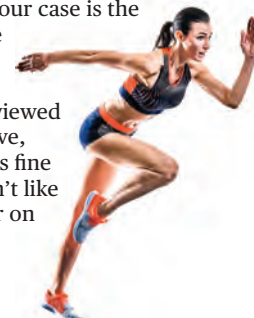
We made our content about them, speaking in their language rather than ours. The result has been higher levels of engagement, more time spent reading on our site and a wider audience that better understands what we're about.

You don't need to be an inventor to be innovative

There's a tendency to believe innovation is all about the moment when inspiration strikes. We believe it can also be expressed through the gradual accumulation of small ideas rather than radical big ones, and of being willing to succeed slowly rather than failing fast.

But, most of all, it's about remaining focused on the one big idea that got the business going in the first place, which in our case is the delivery of regular, reliable and predictable income to our clients.

And if that means we're viewed as a traditional, conservative, boring fund manager, that's fine by us. After all, if we weren't like that could we really deliver on our promise? ■



APN | Property Group

Property for income

The simplest ideas can often be the most valuable

At APN we take a slow and steady approach to real estate investment. We remain focused on delivering regular, reliable and predictable income - a simple idea that has proved its worth over 23 years.

apngroup.com.au





Five reasons to be positive

about emerging markets

Investors are weighing up what 2020 may bring for emerging market (EM) equities.

RECENT CONCERNS about the Covid-19 coronavirus have negatively affected Asian and emerging markets equity markets. The shock to Q1 global growth has the potential to be significant, given disruption to activity in China itself, combined with the impact on global supply chains, trade and tourism, as well as overall uncertainty.

However, we believe that coronavirus should have a short-term, transitory impact on regional and global markets. If the situation deteriorates, the turnaround time might be delayed by a quarter, based on our view that any outbreak takes time to contain.

So, while there will be negative sentiment in the markets over the first half of 2020, the structural drivers of long-term growth in the region remain unchanged.

A glance in the rear-view mirror in emerging markets

Like the years that went before, 2019 was not short of headlines: Argentina's lurch to the left spooked markets in the summer, the Turkish incursion of Syria raised the risks of sanctions and the US-China trade war whipsawed markets, as the mood oscillated between risk-on and risk-off.

Hopes that the decision of the US Federal Reserve (Fed) to cut rates would alleviate dollar strength were met with some disappointment as yield and safe-haven status appealed to nervous investors. And, while EM delivered positive absolute returns in US dollar terms, marked underperformance versus developed market (DM) equities did not go unnoticed.

So, where do we go from here?

EM is a volatile asset class suited to investors willing to take a long-term view. Certain issues run particularly deep and can flare up without warning - the novel coronavirus is a prime example of this. However, when we look at the developing world through a different lens, there are reasons to feel encouraged as we head into a new decade.

Five reasons to be positive about EM equities over the long term:

1. *Accommodative monetary policy*
2. *Pivotal government reforms*
3. *Light investor positioning, with scope for increase*
4. *A high valuation discount to DM and a promising earnings outlook*
5. *Slower growth does not destroy structural growth*

NUMBER 1.

Don't underestimate the importance of monetary policy

The year 2019 was characterised by easing monetary policy, with central banks simultaneously slashing rates. With limited firepower, developed market peers made small reductions while policy makers across EM cut rates aggressively in a relatively short time frame, supported by high real rates. From here, further cuts may follow in 2020, particularly in China, where the government is likely to lower rates to stimulate the economy.

While this should not be perceived as the panacea, lower rates can potentially stimulate activity and boost demand: cheaper borrowing can reduce the burden of servicing debt and, in turn, help companies finance capital investment, hopefully leading to higher future profits. Lower interest rates can also draw investment into the stock market from other areas of the financial system.

In 2019, 18 out of 26 EM countries loosened monetary policy.¹

NUMBER 2.

Change is afoot, but Rome wasn't built in a day

A busy election cycle across emerging markets in 2018 and 2019 has started to provide investors with insights into the future path of government policy.

This is not to say that all governments will pursue a pro-business agenda, but there are signs that some leaders are willing to take bold and decisive actions to shore up their finances and set their country on the path to more sustainable growth.



Source

- ¹ EM rate cuts: Based on MSCI EM Index constituent countries. Trading Economics, 18 December 2019
- ² Industry AUM: JP Morgan, EPFR Global, MSCI, Datastream, 18 December 2019
- ³ November flows: JP Morgan, 2 December 2019
- ⁴ Valuation data: Bloomberg. MSCI World versus MSCI EM Index. 15 years to December 2019, monthly data

Here, there is a need for patience, as we know markets tend to penalise the stock market or celebrate success in haste, whereas real progress takes time. As 2020 evolves, more green shoots may emerge.

Geopolitical ructions have dealt a blow to sentiment, with EM having borne the brunt of bad news as relations between countries deteriorated. The trade war - or tech war, as it's been labelled by many - runs deep, and should not be dismissed as an irrelevance. However, elsewhere in the emerging world, we have seen evidence that long-running disputes can be addressed - the spat between the US and Mexico comes to mind.

During 2018 and 2019, countries including India, Mexico, Brazil, South Africa and Indonesia hosted elections.

As the US and China take baby steps towards some form of resolution (such as the 'Phase One' trade deal), there remains an opportunity for EM equities to play catch-up following a period of pronounced relative underperformance.

NUMBER 3.

Moving from one extreme to another?

The year 2019 commenced with a big bang: In the first quarter, cumulative industry inflows reached +US\$22.8 billion. However, tensions between the US and China re-escalated and investors headed for the doors. A wave of de-risking saw cumulative outflows reach -US\$28.4 billion by the end of the third quarter.

EM share of global mutual funds' assets under management is 7.1% vs 9.1% historical average.²

If we examine the resultant industry-wide positioning, investor exposure to EM looks incredibly light relative to history. However, the inflows we witnessed in the latter part of 2019 could provide a glimmer of hope. In November, investors embraced more risk, committing US\$7.6 billion to the asset class.³

NUMBER 4.

Mind the gap

The valuation gap between EM and DM is trading at its widest in 15 years: -35% on a price-to-book basis.

The EM P/B multiple is trading at a 35% discount to DM vs a 15-year historical average of 13%.⁴



When we consider this alongside the outlook for earnings, there's good reason to think EM will lure long-term investors. For active fund managers such as Fidelity, market corrections can create the opportunity to buy attractive business at relatively reasonable valuations.

All holdings in the Fidelity Global Emerging Markets Fund are high quality and long-term names, characterised by a solid foundation of a robust corporate governance profile and balance sheet structure to weather more difficult economic environments. We don't see recent events as permanently impacting our investment theses.

NUMBER 5.

2020 - time to be structurally positive

EM has not and will not escape the slowdown in growth, with some of the largest economies, such as India and China, offering us proof that growth rates have long since peaked and rolled over. We have long argued that, despite the headlines, EM offers an abundance of structural growth opportunities, which lend support to a positive view on the asset class.

There are pockets of long-duration growth which underpin the argument for being structurally positive, with companies operating in significantly underpenetrated categories. These are attractive characteristics for the discerning investor, as these areas of the market can offer sustainable growth.

About Anthony Doyle

Anthony Doyle has over 16 years' experience in global financial markets, working for some of the largest investment management firms in Australia, Europe, and the United Kingdom.

In his current role, Anthony helps to position Fidelity's broad investment capabilities, strategy, market views and performance to clients.

Prior to joining Fidelity International, Anthony worked at M&G Investments in London as Head of Investment Specialists. He has also worked at Pioneer Investments and Macquarie Bank as an economist.

Anthony holds a Master of Business Administration from the University of London, a Master of Economic Studies from the University of New England, and a Bachelor of Commerce from Macquarie University. ■

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Found

Dr Robert Ballard found the wreck of Titanic in 1985 after a meticulous search of the ocean floor using an unmanned camera rig. His ingenious idea which led to the discovery, was to first locate the debris trail and then trace it back to the hull.

As an active fund manager, we also use **a meticulous approach** to find what we're looking for - well-run companies in emerging markets with a track record of robust corporate governance.

It's this meticulous approach, rewarding investors with strong long-term returns which has seen the Fidelity Global Emerging Markets Fund **win the 2020 Money magazine Best of the Best award for International Equities Emerging Markets.**

Learn more at [fidelity.com.au](https://www.fidelity.com.au)
Fidelity Global Emerging Markets Fund (Managed Fund)
(ASX: FEMX) now trading on the ASX.





Super low interest rates come with side effects

Ultra-loose monetary policy could even be counterproductive for economies.

SITTING ON THE DESK of Reserve Bank of Australia Governor Philip Lowe most days when he arrives at work are letters from the public. Many are from retirees who have one complaint in this world of low interest rates. “It’s not uncommon for people to say to me they’ve worked hard all their lives, they’ve saved, they’re frugal, they don’t spend very much, they rely on interest income and they’re having to cut back their spending,” Lowe told a parliamentary committee last year.

The RBA governor earlier that session said that for every dollar the household sector received in interest income, it paid more than two dollars in interest payments. So overall, lower interest rates help the economy because they enable more consumer spending. To extend such conventional analysis, lower interest rates promote business investment, reduce borrowing costs for governments, which frees up more spending, help exports by lowering a currency and create a ‘wealth effect’ that encourages household spending by boosting asset prices.

Such thinking has motivated central banks to reduce interest rates to rev economies such that low rates have been a mainstay since the global financial crisis of 2008. An obvious problem with interest rates as a macro tool is they lose their stimulus fizz when they are close to zero or even mildly negative.

UK economist John Maynard Keynes in 1936 spoke of the ‘liquidity trap’ when describing the limits of low interest rates as an effective policy tool. He described situations when uncertainty is so great that even low interest rates would fail to generate enough demand to ensure full employment.

But Keynes was indicating that low interest rates could be ineffective as a macro tool. The worry after 12 years of low and negative rates is that these settings produce side effects that make them counterproductive. Ten side effects stand out.



A core concern is that Keynes's liquidity-trap concept seems to underestimate the dampening effect of emergency measures. Low rates seem to dent consumer spending and business investment because they signal that authorities are gloomy, even panicked. A second side effect is that low interest rates have encouraged so much borrowing that consumer, corporate and government debt have reached an unprecedented level of GDP in many countries. This could prove a systemic risk. Even without such mishaps, future repayments are likely to reduce consumption and investment.

Another side effect is that low and negative rates can lift asset prices. Lower interest rates push investors into riskier assets and argue for higher prices on property and shares, asset gains that tend to boost inequality. More tellingly, negative policy rates helped push bond prices so high that yields went negative - and widely so. The concern is that, if low and negative rates help the economy as intended, interest rates will move higher and puncture asset prices.

A fourth problem is that low and negative rates trouble the business models of insurers and pension funds that typically use the safety and positive returns of government bonds to help meet long-term liabilities. A fifth spillover is that low and negative rates squeeze bank margins, perhaps to the point of threatening financial stability. Any crimping in bank margins brings a sixth problem; that at some

level, low rates could backfire by forcing banks to restrict lending - a level known as the 'reversal rate'.

A seventh handicap is that central banks have faced political pressure for hurting savers and rescuing reckless borrowers. An eighth side effect is low and (especially) negative rates can, perversely again, force people to save more to attain a targeted level of savings.

A ninth drawback is that low rates can encourage unproductive investment. A tenth criticism is that low rates help embed economies in the 'debt trap'. This term describes how indebted economies need more debt to overcome the problems left by past debt. But at some indeterminate point this strategy must miscarry.

These risks might explain why low rates have often failed to spark sustainable economic growth. The question arises as to whether such risks are worth taking to fight mild deflation which, in economic effects, is not much different from negligible, or zero, inflation. No matter these doubts, low and negative interest rates appear entrenched for the foreseeable future. In such a world, policymakers will need to rely less on monetary stimulus and be mindful of, and perhaps take steps to mitigate, the side effects they are creating.

It must be noted that real interest rates are more critical economically than nominal ones. Low nominal rates have essentially failed to charge economies because they haven't approached the negative real rates that

stimulated economies over much of the 1940s to the 1970s. That said, low nominal rates have helped stoke some economic growth. For all their side effects, low interest rates are yet to trigger an upheaval - a jump in inflation would undermine bond prices whatever level they were at. But even with these qualifications, central bankers appear concerned about the side effects that low and negative rates are provoking. They are among the most vocal in calling for instruments other than monetary policy to lead the world back to prosperity.

Downside protection matters

Will your investors be safeguarded in an adverse market?

ARSN:126 366 961

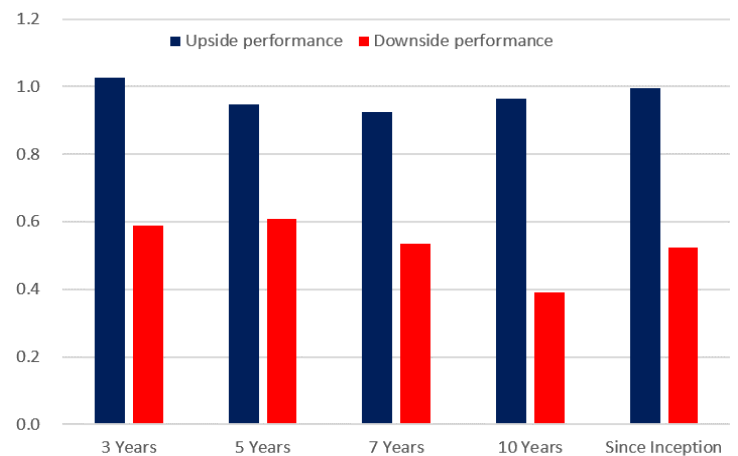
Magellan Global Fund

We invest in the world's best global equity companies, with the objective of generating attractive returns for our clients whilst reducing the risk of a permanent capital loss.

Performance chart growth of AUD \$10,000*



Downside protection#



Since inception the strategy has captured approx. 100% of up markets and 50% of down markets.

Fund Performance*	Fund (%)	Index (%)**	Excess (%)
1 Year	7.4	3.9	3.5
3 Years (% p.a.)	16.0	11.0	5.0
5 Years (% p.a.)	11.8	10.0	1.8
10 Years (%p.a.)	16.4	12.7	3.7
Since Inception (% p.a.)	12.0	6.5	5.5

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* Calculations are based on exit price with distributions reinvested, after ongoing fees and expenses but excluding individual tax, member fees and entry fees (if applicable). Fund Inception 1 July 2007. Returns denoted in AUD

Source: Bloomberg, Magellan Asset Management Limited. The market capture information above is based on the Magellan Global Fund. Calculations are based on exit price with distributions reinvested, after ongoing fees and expenses but excluding individual tax, member fees and entry fees (if applicable) in USD relative to the MSCI World Net TR Index using rolling 3 month returns. Inception date 1 July 2007. Downside capture shows if a fund has outperformed a benchmark during periods of market weakness, and if so, by how much. Upside capture shows if a fund has outperformed a benchmark during periods of market strength, and if so, by how much.

** MSCI World Net Total Return Index (AUD)

Important Information: All performance data is as at 30 September 2020. Units in the fund(s) referred to herein are issued by Magellan Asset Management Limited ABN 31 120 593 946, AFS Licence No. 304 301 ('Magellan'). This material has been delivered to you by Magellan and has been prepared for general information purposes only and must not be construed as investment advice or as an investment recommendation. This material does not take into account your investment objectives, financial situation or particular needs. This material does not constitute an offer or inducement to engage in an investment activity nor does it form part of any offer documentation, offer or invitation to purchase, sell or subscribe for interests in any type of investment product or service. You should read and consider any relevant offer documentation applicable to any investment product or service and consider obtaining professional investment advice tailored to your specific circumstances before making any investment decision. A copy of the relevant PDS relating to a Magellan financial product or service may be obtained by calling +61 2 9235 4888 or by visiting www.magellangroup.com.au. This material may include data, research and other information from third party sources. Magellan makes no guarantee that such information is accurate, complete or timely and does not provide any warranties regarding results obtained from its use. Statements contained in this material that are not historical facts are based on current expectations, estimates, projections, opinions and beliefs of Magellan. Such statements involve known and unknown risks, uncertainties and other factors, and undue reliance should not be placed thereon. Any trademarks, logos, and service marks contained herein may be the registered and unregistered trademarks of their respective owners. This material and the information contained within it may not be reproduced, or disclosed, in whole or in part, without the prior written consent of Magellan. MC215

Lessons from 5 decades of investing

ONE OF CLAUDIA HUNTINGTON'S most successful investment decisions hinged on a single question. She was meeting with Lotus Development Corp., a pioneer of spreadsheet software, while the company was struggling through a challenging product cycle. The beleaguered CEO was facing heavy criticism and less than thrilled about meeting with her.

"My initial meeting was hard to get, but I was finally granted 15 minutes," Huntington recalls. "When I entered the room I could see he was tense, bracing for the inevitable questions about the coming quarter."

But that wasn't her question. "I told him, 'Let's not talk about the next few quarters. Can you talk about your vision for where you plan to take this company over the next five years?'" The executive's body language immediately relaxed, and the conversation ended up running two hours. "He opened up about the risks and opportunities the company faced, his long-term strategy and how he planned to execute on that strategy," says Huntington, who liked what she heard and decided to invest.

That proved to be a good decision because the company turned around and the stock outpaced Wall Street expectations.

Of course not all her investments have worked out as well as Lotus, but Huntington believes her focus on long-term results, a trait she shares with her Capital Group colleagues, offers a clear advantage when evaluating companies and their leaders. "Quarterly results are important too, but taking a longer view can lead to rich dialogue with company leaders," she says. "Our best investment decisions are made when we are on the same wavelength as the CEO. We gain a deeper understanding of their talents and the

likelihood that they can successfully navigate risks and execute their strategy."

Huntington, who began her investing career in 1973 – a period of rapidly rising inflation and volatile markets – has decided to retire in 2020. The portfolio manager recently sat down to share insights and lessons learned over nearly half a century as a professional investor.

What are the most important

I've learned that this business is more art than science. Early in my career I thought it was primarily about math and perfecting my model. Sure, you need math, but the more you invest, the more you realize it's about making judgments – about people and about the future. There are no facts about the future, so you have to try to look around corners.

Perhaps the most important lesson I've learned is that a company's management is essential to its ultimate success or failure. If you have a great company run by a poor CEO, the odds of that company turning into a good investment are low. On the other hand, if you have a mediocre company in a mediocre industry with a superb CEO, then it is much more likely that company will turn out to be a good investment. So, being able to calibrate CEOs and management teams is an important skill to develop.

Can you share some examples of CEOs you've encountered who were difference makers?

A recent example is Satya Nadella, Microsoft's chief executive.

He was not an obvious choice to run the company when he succeeded Steve Ballmer in 2014, but he has excelled for a number of reasons. One thing Satya does at the end of every meeting, regardless of whom he is meeting with, is ask, "What do you think?" The fact that he wants to encourage participation, to hear other voices, is such a demonstrable, cultural advantage.

One of the most effective CEOs I've ever encountered was Mark Donegan of Precision Castparts, a maker of specialty metals for the aerospace and defense industries. Donegan is a detail-oriented leader with a laser focus on productivity and a great allocator of capital. But what is most special about Donegan is the culture he has fostered at his company. He created a real sense among his employees of working together to do the right thing.

I often ask executives to describe the culture of their company. Some have great answers; others look at you like you came from the moon. The best companies are often the ones with a very strong culture.

Identifying a strong CEO is no guarantee of long-term investment success. Years ago, I invested in a company called Silicon Graphics largely because I believed the CEO was first-rate, and I had faith in his strategy for the company – a maker of specialized computer systems for graphic applications. We identified the opportunity early, and the company experienced strong growth. The investment was a good one – until it wasn't.

The CEO eventually got interested in politics and essentially assigned running the company to a subordinate who made a series of bad decisions.



I had established such trust and faith in the CEO that I didn't look more closely when changes were made. That was an important lesson for me.

How has culture shaped you as a portfolio manager?

At Capital, we are encouraged to focus on long-term results. In fact, under The Capital SystemSM, compensation paid to our investment professionals is heavily influenced by results over one-, three-, five- and eight-year periods. Increasing weight is placed on each successive measurement period to encourage a long-term investment approach. Our culture is also designed to encourage what I call the lonely idea. By definition, good investments are not something everyone knows about. It takes a great deal of courage to identify an opportunity early on that has the potential to be a great investment.

Precision Castparts, the company I mentioned earlier, is an example of a 'lonely idea'. On paper this company was not that interesting. It was in the industrials space, with a concentrated number of clients and limited supply sources, so there were risks. When I traveled to Portland to meet with CEO Mark Donegan, I found the headquarters on the third floor of a small unmarked industrial building next to a gravel parking lot down a dirt road. Clearly this was a cost-conscious company. I found it to be well-managed and operationally focused.

When I presented this unlikely investment idea to our investment group, I was challenged by my colleagues. They were polite and respectful, but skeptical. "Why would you want to invest in a specialty metals company in this stage of the cycle?" But the beauty of The Capital System, is that I could act on my conviction to invest, and by doing so I convinced some colleagues to invest with me. Our system allows that bright spark of the lonely idea to shine through – rather than being dimmed by consensus.

You began your career in a tumultuous time for markets and have seen your share of downturns. What advice do you give younger colleagues?

I started my investing career near the beginning of one of the worst bear markets since World War II. My first job was at another asset manager that had three rounds of layoffs in my first six months. Capital ended up acquiring the firm's assets, which is how I came here. This early experience taught me that this is a very volatile business. Capital ended up acquiring the firm's assets, which is how I came here.

This early experience taught me that this is a very volatile business. I also quickly recognized a stark difference between the way Capital and my former employer managed uncertainty. Capital has learned to manage through volatile periods and views down markets as opportunities.

We try to reassure associates during periods of uncertainty and encourage them to focus on long-term opportunities that may arise. With the COVID-19 pandemic leading to a recession and bouts of volatility earlier this year, I shared with younger colleagues a list of 10 tips for weathering market downturns to provide some perspective from my own experiences. Among them are "don't dwell on what the market did yesterday," "pay attention to balance sheets," and "keep talking to companies." The easiest thing to do in a downturn is to just freeze, so many of my suggestions try to help colleagues manage emotions and take action.

For a primarily U.S.-focused investor, you have spent much of your time traveling abroad. Why is that important?

First and foremost, traveling gives me fresh perspective on the companies that I follow. So many companies today have global operations and customer bases. I can travel to India, for example, and visit a pharmaceutical business. That's going to give me perspective on all pharmaceuticals, wherever they are.

I travel to get some notion of the competitive environment, but also a sense of where challenges could come from or new opportunities. To truly understand a company – or a market or an industry, for that matter – you really have to go see it with your own eyes. You can't do this job from a Bloomberg terminal.

As an investment analyst in 1982, you predicted the coming of the mobile phone. How do you think the world will be different in 10 years?

I have witnessed remarkable change in my career, not only in terms of investing. When I started, there were no cell phones, no internet, not even desktop computers. I am certain there will be comparably huge leaps in the coming years. Many will be in technology, but there will be leaps in other areas.

With respect to energy, I expect there will be some. That's going to have a tremendous impact on the kind of transportation people use. There will be major changes in agriculture, in the way farms operate.

I think one of the most exciting areas is medicine, where I believe there will be great leaps not only in drug discovery, but also in virtual medicine. People will be monitored, diagnosed and treated remotely.

What drew you to a career in investing?

I would describe myself as someone who has always been interested in learning about the way things work. That's what drew me to study economics in college and then to a career in investing.

What's more, Capital has a culture that encourages lifelong learning, which really has been a perfect fit for me. In fact, as we speak I am working on a project with several Capital analysts to quantify the role that management plays in a company's stock returns. I can't wait to see the results of this study, and I'll be working on it until my last day in the office!

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Automation for the people

Fintech in the real world.

Technology is already playing an outsized role in the evolution of traditional financial services, as enterprises attempt to adapt to evolving consumer expectations, reduce costs, prevent competitive losses from nimbler startups and find novel ways to grow revenues in the digital age.

OVERALL INVESTMENT in fintech leapt ahead in 2018, reaching US\$55 billion worldwide, or roughly double the year before.⁴

We've seen that trend continue as demographic and technological trends converge and the value proposition differential between winning, technology-enabled companies (versus those who've been left behind) becomes evident.

In this article, we explore the areas we see for the biggest disruption over the long term and summarise the impacts we are seeing across a variety of financial services companies.

From business to consumer: The democratisation of fintech

The Global Financial Crisis (GFC) and subsequent "Great Recession" influenced the younger generation of millennials – those born between 1982 and 2004 – almost as much as the Great Depression changed their great-grandparents' financial habits. The GFC highlighted the failures and shortcomings of some of the world's largest and most venerated banks and financial institutions. And they haven't gained ground since then.

According to various surveys, banks and insurance companies have generally retained their negative connotation with millennials since the global stock market crashed more than a decade ago, a generational perception that is likely to last a lifetime.

That lingering scepticism has fed into other considerations that have helped millennial sensibilities drive the development of fintech and will continue to help shape the financial services landscape of the future. Fintech companies are aiming to provide them with a clear alternative to the old-line, business-as-usual institutions. As those imperatives intensify, we believe the future of finance will be shaped by three main megatrends.

Digital transformation

Legacy financial infrastructure requires significant investment in people, physical locations, aging technology systems and even older paper-based processes. This dated foundation places incumbents at a disadvantage in terms of both cost structure and user experience.

In contrast, new companies have a clean slate and can begin with a state-of-the-art template from the outset. This dynamic is playing out in virtually every vertical integration within financial services, including banking, capital markets, real estate, insurance, payments, asset management and wealth management.

Artificial intelligence (AI)

The ability to deduce actionable insights from data is driving the financial industry to an inflection point in terms of its ability to create frictionless and personalised consumer experiences that are predictive, personally

relevant and useful. Taking a page from the playbooks of Amazon and Netflix, incumbent financial firms are seeking to move from a "search-and-browse" to "curate-and-deliver" model, where they anticipate client needs utilising data and machine learning.

Emerging fintech companies are making a genuine impact in areas that consumers care about, such as access to small business loans and home mortgages, "intelligent" automated savings plans based on a customer's profile, investing more wisely for college and retirement, or obtaining better value from their health, home and vehicle insurance coverage.

Distributed ledger technology (DLT)

Within financial services, DLT holds promise because it offers tamperproof, transparent tracking of transactions. Operational processes can be streamlined and settlement times can be shortened. Not only does this help to reduce costs for financial services firms, but it also frees up capital, which is increasingly important given the decline in returns, the competitive tightening of fee structures and increased regulatory burden since the financial crisis.

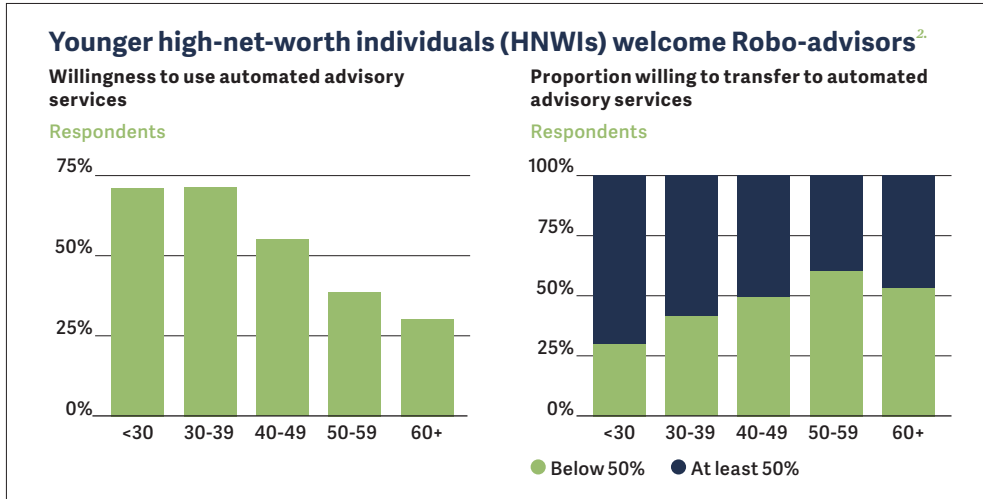
Distributed ledgers can be used to tokenise assets, which opens up new possibilities for financial products. DLT-driven "smart contracts" can also help automate many aspects of financial services.



Source

- ¹ Accenture
- ² Capgemini, Evolution of the Automated Advisor, 2016
- ³ CFA Institute: Algorithmic Trading and High-Frequency Trading, 2019

- ⁴ Tabb Group estimate
- ⁵ Willis Towers Watson Quarterly InsurTech Briefing Q4 2018, February 2019



Our research tells us that, with deeper, data-driven insights, financial institutions should be able to better identify what customers need and want in their financial engagements, prioritise investments into customer experience enhancements, redesign outdated processes and create innovative, intuitive digital experiences.

Right here, right now: automation is spreading through financial services

Fintech's influence is already apparent throughout the sector by the following examples.

Investing

- Last year, human brokers conducted just 25% of US stock-market trading; the rest was driven by automated systems, such as computerised high-speed trading programs. Humans wrote the code and sometimes oversee the trades, but machines are increasingly taking on even those roles.³
- Regulators estimate that computers are now generating 50% to 70% of trading in equity markets and 60% of the trading of financial futures contracts, with AI and machine learning being applied to huge amounts of data to produce investment advice.⁴
- Robo-advisory services are on the rise. These accounts are designed to rebalance allocations among asset classes when pre-set thresholds are hit. They have yet to be tested by a full boom-and-bust market cycle, but recent market volatility has revealed their efficacy in client service models.

Payment systems

- Today, new digital payment systems stand poised to eliminate the use of credit and debit cards and change the nature of online banking. And, there is a whole generation of young people who are quite comfortable with the idea of never having to carry cash or even a credit card for their daily needs.

- Fintech startups are becoming important connection points in the financial services ecosystem. They are partnering with banks to support the massive shift of consumers using their bank accounts for an ever-increasing number of electronic payments. As the financial services sector's data-sharing infrastructure continues to gather strength, it will be easier for startups to launch new products, which could weaken the data moat that has protected banks until now.
- We see the growing prevalence of digital payment apps in emerging markets extending the consumer universe to include individuals that don't currently have bank accounts. That's a huge potential source of clients – and client data.

Lending

- Low interest rates have encouraged more small businesses to seek affordable credit and more consumers to borrow or refinance high-interest debt. Online-lending upstarts have a competitive advantage over banks saddled with legacy technology. However, these companies lack access to the stable, low-cost funding sources that regulated banks enjoy. Rather than build the technology and process from scratch, banks may increasingly choose to partner with online-lending platforms.
- Over the past year, we saw a wave of alternative lending startups seeking to raise

funding. Alternative lending encompasses bank independent loan provision for businesses and individuals. Platforms put would-be lenders (often private or institutional investors) in touch with potential borrowers. A new generation of alternative lending startups is attempting to use machine learning to improve underwriting and trying to innovate around point-of-sale financing to provide alternatives to traditional credit cards.

Insurance

- The insurance sector is ripe for disruption. Funding to insurtech companies—those applying new technologies, behavioural finance and data analytics—reached record levels in 2018, driven by large investments. Funding across all stages totalled US\$4.15 billion in 2018, up 87% from the previous year, according to a Willis Towers Watson analysis.⁵
- The new companies are focusing on keeping costs and premium rates low by processing most everything via mobile applications.

Democratisation of alternative investing

- Access to alternative investments such as venture capital, commercial real estate and hedge funds has historically been restricted to institutional investors and high-net worth individuals. We are seeing a confluence of factors breaking down the demographic barriers to retail investors and expect access to become much easier.
- On the technology side, we are seeing fintech platforms being built to facilitate investing in alternative assets such as property, private companies, collectible cars and fine art. Several fintechs are also exploring ways to utilise blockchain tokenisation techniques to make investing in alternative assets more liquid, which we believe has a lot of potential.

Conclusion

Fintech encompasses many verticals and segments, such as AI, machine learning, data sciences, digital wealth management, personal finance, robo-advisory, portfolio and risk analytics, blockchain, financial research and others. Technology disruption can be both a challenge and an opportunity, so it's important to have the agility and speed to make thoughtful tech investments, while navigating highly regulated industries. ■

The future of finance will be automated, intelligent and real-time			
	AUTOMATED	INTELLIGENT	REAL-TIME
Megatrends	Digital transformation	Artificial Intelligence (AI) / Machine Learning (ML)	Block chain / Distributed Ledger Technology (DLT)
Impact	Cheaper	Better	Faster
Timeframe	Near term	Medium term	Long term



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IMPROVING THE CLAIMS EXPERIENCE THROUGH INNOVATION

Whether it's a serious illness, or an accident with disastrous consequences, submitting and handling a claim is a logical and linear process. However, how clients respond mentally and emotionally can be anything but. AIA Australia is changing the future of claims through innovative programs which better support clients holistically.

As a financial adviser, part of your role is to work with and support your clients during perhaps some of the most devastating and challenging times of their lives.

How your clients deal with these types of events is not a logical or linear process. While it is a normal, natural response to a loss or changes of circumstances, it can affect every part of your clients' lives, including their thoughts, behaviours, feelings, health and relationships.

As an insurer that protects the lives of more than 3.5 million Australians, we understand the impacts that illness can have on clients and their loved ones. Taking an innovative approach and moving away from a traditional,

transactional claims process, AIA Australia (AIAA) is providing a more personalised experience to support clients and advisers. We're changing the future of claims through innovative programs and making the claims experience as smooth as possible. We want to focus on more than just the payment.

Claims Companion

AIAA's innovative Claims Companion program leads the way. Designed to help clients regain some control during their illness, while also enabling AIA to assist them at the commencement and through the claims experience.

A free-of-charge service for AIA claimants, AIAA Claims Companion provides support to clients in the face of significant health events. No matter where your clients are located, we'll find a way to support them in the most convenient way. This includes tele-claims and video conferencing options nationally, and a face-to-face service currently operating within Victoria.

Clients are given their own personal Claims Companion to assist at the beginning of the claims process. Their Claims Companion can talk them through the forms, and help them answer the questions. The Claims Companion is also a valuable resource to support you as their adviser on the claims journey.



HEALTHIER, LONGER,
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**WORKING IN PARTNERSHIP WITH CLIENTS, THE
AIAA REHABILITATION TEAM PROVIDES AN EXTRA
LEVEL OF SERVICE AND CARE TO ASSIST YOU GET
CLIENTS BACK TO WELLNESS AND WORK**

The Claims Companion can discuss what information they might need from their medical practitioner to support their claim and to help them understand what AIAA requires from them. This all serves to make the claims process as fast and simple for your clients as possible. In addition, the Claims Companion offers resources to ensure clients and their families have a strong support network in place during their journey.

Advisers can get AIAA clients who are starting a claim involved by contacting the AIAA claims team directly to discuss their client's needs. Alternatively, the client can contact AIAA's claims team directly.

Rehabilitation service

Innovation around the claims experience also means supporting clients once their claim has been paid. This is where the AIAA rehabilitation service comes in. The health benefits of being engaged in the workforce are numerous. Offering a valuable service your client can call

on to help look after their well-being is part of AIAA's promise to help people lead healthier, longer, better lives.

When clients have suffered an injury, disability or health condition, the AIAA rehabilitation service assists in arranging work related rehabilitation services to assist clients return to work, or to gain new employment should they be unable to perform their previous role.

Working in partnership with clients, the AIAA rehabilitation team provides an extra level of service and care to assist you get clients back to wellness and work.

Assisting clients with tailored solutions, the team includes highly experienced rehabilitation counsellors, occupational therapists, an exercise physiologist, a physiotherapist, registered nurse and chiropractors.

Returning to work can be one of the best forms of treatment and AIAA can assist with specialised rehabilitation services at the right time in the recovery journey. Whether graded

exercise programs, business coaching, modification of work environments, career advice and redirection or re-skilling/ retraining, the service is customised.

Every client experience is unique

It's important to remember that the claims and health journey for clients is not linear, nor is it on a time frame. Every client experience is unique. Hopefully, taking this innovative holistic approach to the claims experience and considering individuals' situation will help you to better support your client as they work through their health journey, in their own way, at their own time. ■

i For more details about these services and getting your clients involved, contact your AIAA Client Development Manager or a member of the team on 1800 033 490, or email au.adviserservices@aia.com.



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Three light-bulb strategies for super

Recent years have seen advisers forced to focus on the myriad of complex changes to superannuation that have come into play since 2017. We spoke with Keat Chew, Netwealth's head of technical services, who identifies three key strategies that may add value to existing client relationships.

NUMBER 1.

FHSSS – a strategy for all age groups

According to Keat Chew, the government's first home super saver scheme (FHSSS) is an often-overlooked tool.

"I think [the FHSSS] has a new lease of life with the new scheme now within superannuation," Keat says. "You just put in additional [voluntary] contributions, which can be withdrawn later [for the purposes for buying or building the first home] with the added tax benefit. Obviously, you need to know the framework, and you certainly need to know what the criteria are."

A key strategy is that re-cycling existing non-super savings through the FHSSS, (up to the maximum thresholds) and claiming a tax deduction for the super contribution on the way through, results in a positive tax arbitrage benefit.

This could increase the final amount available to withdraw, even where it was done over a very short timeframe.

The interesting part of this arbitrage strategy is that it is also applicable to parents (and grandparents) who want to help working adult children in purchasing their first home – a gift of cash to the adult child allowing them to make an FHSSS concessional super

contribution, thereby also giving them the advantage of the tax arbitrage strategy.

Keat explains that even the youngest children could benefit under the FHSSS scheme, as there is no lower age limit on super contributions. In these cases, cash gifted to the minor child could be contributed (by the guardian) as a non-concessional contribution. While there was no initial tax arbitrage benefit, from age 18 onwards (when it could be withdrawn), the contributions plus the associated earnings (having compounded over many years) could make up a substantial first home deposit!

"If you have a couple, they're assessed individually," says Keat.

"Therefore, if one of them had bought a property before, then that person cannot access the scheme, whereas the other person could still access it. It is based on individual assessment."

In terms of accessing the money, Keat explains that it's easy in the sense that it's not advisers who make the application; it's the client that applies to ATO. The ATO then calculates the maximum withdrawal amount and advises the client.

Timing is important, and he points out that it's critical that the ATO releases the payment before a contract is signed. Once the funds have been released to the client, they have 12 months to purchase or build their first home.

He also explains that, if the client's plans change after the amount is released, there is an "escape clause". Either make a non-concessional contribution equal to the released amount (less PAYG) to super, or keep it and be subject to the 20% FHSSS tax.

This strategy may also provide advisers with the perfect opening to widen discussions with clients to include other family parties (such as children, parents and grandparents), where such strategies may be relevant, depending who your client is.

"It really can be a strategy for everyone," says Keat.

NUMBER 2.

Selling a small business – minimise the CGT and get the maximum amount into super

The next strategy explored is how the proceeds from the sale of a small business can be used to contribute to super, emphasising the importance of the financial adviser being involved before the sale is finalised.

"We need to think about other caps that we could use, and that's the small business \$1.48 million capital gains tax (CGT) cap that we should be looking at," says Keat.

"It's only available to small business owners on the sale of eligible assets, which is primarily



the sale the business, but it could include a property or building that they use in their business as well.”

Keat suggests there are four small business CGT (SBCGT) concessions available to reduce or eliminate the tax payable on the sale of the business, once the client meets certain criteria. The four concessions are the 15-year exemption, the 50% active asset exemption, the small business retirement exemption, and rollover relief.

But he emphasised that only two of these - the 15-year exemption and the retirement exemption (\$500,000 lifetime cap) - can be used together or individually, up to the lifetime \$1.48m cap, to direct money into super. Therefore, these are the two that deserve advisers’ extra attention.

“The small business concessions are not counted against the contribution caps, but do form part of the total super balance, so timing of the contributions can be critical in maximising the total amount into super,” Keat says.

“Utilising the small business SBCGT concessions to make a contribution to super, prior to making any non-concessional contribution, could put you above the total super balance of \$1.6 million. While that is not a problem in itself, it will preclude any further non-concessional contributions.

“Alternatively, make your non-concessional contributions first, even up to the total super balance of \$1.6 million, and still make the contribution under the SBCGT concessions, as these are exempt from the total super balance test. In this way, we can maximise the amount in tax concessional super. That’s what we should be aiming to achieve.”

Keat emphasises that the SBCGT eligibility rules are very complex and would normally be the responsibility of the accountant, particularly where more complex corporate and trust structures are involved.

NUMBER 3.

“Untaxed element” - the hidden death tax

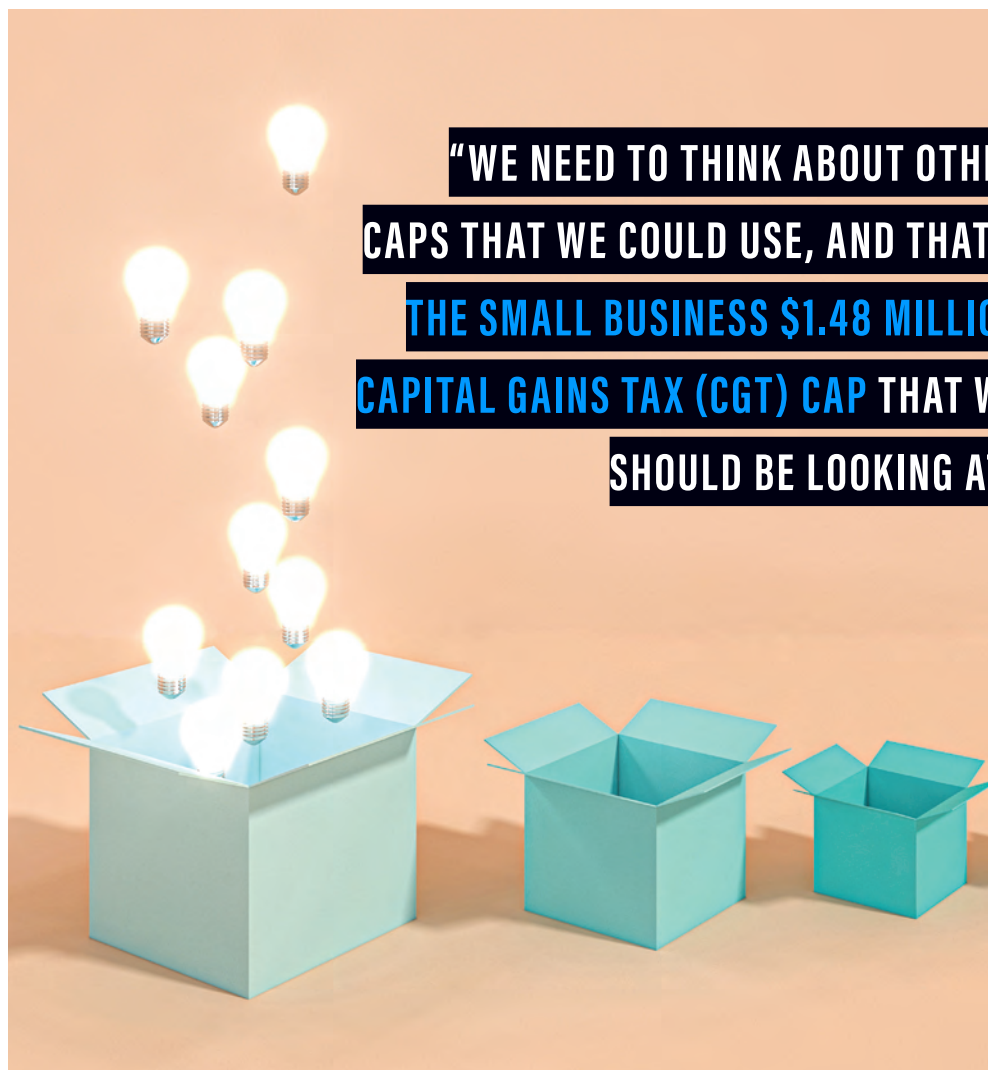
The third strategy is how, in certain situations, an “untaxed element” can be created on death and result in additional tax being payable by non-tax dependants.

“When we talk about death benefits, we talk about death lump sum payments, we talk about pensions, but we seldom talk about the untaxed element,” Keat says.

“You don’t normally get it arising in a taxed fund in a normal lifetime; it’s only on death where a death lump sum payment is made, which includes an insurance payout.

“Where there is a death lump sum, and there are life insurance proceeds, the untaxed element will arise.”

If the dependant keeps it in the same fund and takes a pension, or exits super taking



“WE NEED TO THINK ABOUT OTHER CAPS THAT WE COULD USE, AND THAT’S THE SMALL BUSINESS \$1.48 MILLION CAPITAL GAINS TAX (CGT) CAP THAT WE SHOULD BE LOOKING AT”

it as a death benefit lump sum, it doesn’t arise because there is no tax payable on these benefits received by a tax-dependant death beneficiary.

“Where I have concern is because from 1 July 2017, a death lump sum can now be rolled over (by a tax-dependant death beneficiary to begin an income stream),” Keat says. “For example, if you have someone who has died in another fund, and you see you’re going to go to a better fund and you roll over with this, there’s a problem because it’s a death lump sum, it’s got insurance, and if it’s rolled over to us, then there’s a 15% tax on it - the untaxed element.”

Keat outlines three tactics for advisers to think about when trying to reduce the untaxed element.

The first is to increase the service period.

“Pre-1983, we used to roll over a dollar or so, and it still happens. You can still roll over some money and inherit a longer service period. If you can do that - if you have one of those legacy old funds - then that would

be good to roll over into the fund with death insurance cover.”

The second is “to maintain the insurance cover in another fund. If you maintain it separately, then at least it will not impact the accumulated balance, but that other fund (with insurance cover only) still has a problem. That’s when you need to think, maybe if you have non-dependants, then insurance cover should perhaps be outside super.”

The third tactic is to avoid making non-concessional contributions to a fund where an untaxed element is expected, as the tax-free component reduces the taxed element which results in an increase to the untaxed element.

Keat also notes that advisers need to be aware of this trap at two levels. The first is to consider the above strategies before death, to minimise the untaxed element. The second, and far less visible trap, is when dealing with death benefits for beneficiaries, as rolling over to a better fund could crystallise an untaxed element and cost the client significant tax. ■



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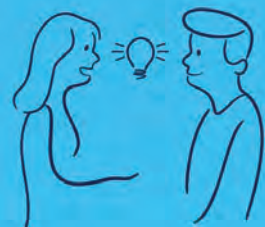


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