

# the **INVESTORSvoice**

Magazine of the Australian Investors Association - *Investors helping Investors*

**March 2018**



**YOU'LL BE SAFER  
IF YOU SWIM  
BETWEEN THE FLAGS**



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**MARKET PERFORMANCE  
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# DISRUPTION, technological change and the internet of things

## Australian Investors Association National Investment Summit 2018

**We are just at the beginning of the beginning of all kinds of changes...Is your portfolio ready?**

Building on the early IT revolution of the 1990's and the mobile and smart phone revolution of the 2000's, we are now entering a new inflection point. The combined forces of the acceleration of computing power, data storage, communication networks and digital platforms has all come together in a new force we now know as the 'Internet of Things'.

The world will see more technological acceleration and development in the next five years than we have seen in the last 20.

What does this mean for Australian investors?

# SYDNEY 23rd March 2018

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## President's Message

By Graeme Bottrill



As I write this in late February 2018, Christmas and New Year seem like just a dim memory. We have had a break and we are back into the investing game. Then we are suddenly shaken from our post-holiday mode by the gyrations of the stock market.

We packed up for Christmas with the ASX200 at 6070 and then during January we had some minor ups and downs and on the 2nd February we were at 6121. Ok with that! Then we were shaken by two days of falls and ultimately we reached 5820 on the 12th February – a fall of 4.9%. And it seems that it was all caused by the USA data being better than expected, leading to an expectation of interest rate increases maybe higher and faster than they thought. But now it's back to business as usual – or is it?

I look back at a passage that I wrote in my message for the December 2017 IV - *We probably should not expect to see our market above its all-time high for some time. In fact, we have not had a correction for some time and some commentators are starting to hint that a correction may be due. I make no predictions but I have difficulty seeing any major factors to support any significant across-the-board increase from here.*

I have skimmed through the articles in this edition of IV, and the mood seems to be rather watchful. Roger Montgomery very succinctly explains both sides of the debate, but there is a sense of 'be careful' coming through. Peter Switzer is optimistic and he is probably the only one; Jody Elliss comments that the market appears to be gearing for some sort of correction in March; and Alan Hull's outlook for 2018 is 'not a rosy one'.

So we make up our own minds. At this point I remind myself that the market is comprised of people (and some computers programmed and operated by people) and people are mainly impacted by hope and fear and the fear element seems to be growing. People sometimes become fearful for no good reason. They just get spooked by something. Is the recent volatility a sign of things to come? I have no idea, so like the rest of us, I wait and see.

If we turn to the property market for a moment, there have been some reports of a market cooling in some areas. It is likely that speculative apartment developments funded by Asian money will not be as sought after as they were previously. The queue of willing purchasers seems to have dissipated as banks have been told to cease interest only lending and the Asian buyers may also have retreated somewhat. I have heard from those residing in the north shore suburbs of Sydney, that property prices are still rising in that area.

And now to AIA matters. We have our Sydney Investment Summit on Friday 23rd March on the subject of **Disruption**. (See the promo on the left). It promises to be a cracker of a seminar with a great line-up of knowledgeable speakers. Some will give their tips for investment in these sectors. Bookings are very good, but we still have space for more and I encourage those who are able to seriously consider attending.

We are finalising planning for our Annual Conference, to be held from 29th July to 1st August. The title is 'Synchronicity' and the theme is [Identifying opportunities in a world growing in sync ....](#)

For the first time since 2007 all 45 countries tracked by the OEDC are on track to grow in 2018. We will be exploring what a world that is structurally awash in capital will look like—and what that will mean for investors. Full details will be available shortly and then bookings will open.

Enjoy the journey!

Graeme Bottrill



# THIS YEAR, YOU'LL BE SAFER IF YOU SWIM BETWEEN THE FLAGS

THIS YEAR, YOU'LL BE SAFER IF YOU SWIM BETWEEN THE FLAGS *continued...*

ROGER MONTGOMERY

Only time will tell if a bull or bear market awaits investors in 2018. There's plenty of ammunition for both scenarios. But I think it will pay investors to look closely at the boundaries marked by the bull and bear cases, and treat them like the flags between which they must swim.

## The bull case

Let's look first at the bull case.

To begin with, the economic backdrop is supportive. The global economy is described as displaying "strong", "synchronised" growth, and 'Goldilocks' is the adjective attached to the economy. The US is growing at an annualised 3-4 per cent, China is growing at over 6.7 per cent, and the EU is set to beat expectations with robust growth of 2.3 per cent this year.

In keeping with this growth theme, many point to high and double-digit rates of earnings growth for US corporates. Many argue that valuations are not stretched with the PE ratio for the S&P500 at an "undemanding" 21 times.

Furthermore, with wage growth virtually non-existent for many years, commentators are suggesting inflation is dead. Some even go so far as to suggest that advances in technology have simply made inflation "obsolete". As more jobs are replaced by technology that never sleeps, takes holidays or requests superannuation, salary costs fall and wages decline, thus increasing the profits for companies.

The combination of economic growth, rising profits and modest, if barely existent, inflation is of course a perfect picture for equities, hence the 'Goldilocks' moniker.

Most surprisingly perhaps is the view that stocks remain cheap in aggregate, especially when compared to bonds. In the United States, for example, US 10-year Treasury Bonds can be purchased on a yield of 2.40 per cent. This is equivalent to paying 42 times earnings with no growth in those earnings. Clearly, if an investor can purchase a stock on a Price-to-Earnings ratio of less than 42 times, with the benefit of earnings growth, stocks are 'relatively' more attractive than bonds.

Indeed, that equation, along with low inflation - suggesting rates aren't going to rise anytime soon - is the force driving more than a little of the enthusiasm for stocks today.

Another source of optimism is what investors refer to as the "Central bank 'put'". Record-low volatility suggests that there is confidence, on the part of market participants, that any setback in financial markets will be met by central bank buying of assets until stability returns. The idea that the Fed 'has your back' has many adherents in today's market.

Bulls also argue that government-backed programs that encourage wealth creation, and a self-supported retirement - such as superannuation in Australia - eventually find their way into financial markets. Population growth and increases in life expectancy are also proffered as reasons to expect demand for goods and services to expand, fuelling profit growth decades hence.

With so many bullish arguments, and of course many global indices surging, the optimists make an excellent case. The issue facing investors however is that these arguments represent just one of the flags between which they should swim.

## The bear case

At the other end of the beach are the negative arguments, and no fair examination of the prospects and risks for 2018 would be complete without a hearing given to the bears.

Let's begin with the bullish enthusiasm. By itself this is not a worry for investors; indeed it can be an essential ingredient to monetising an investment strategy. Enthusiasm becomes a concern only when it morphs into unbridled exuberance, when the fundamentals of the asset are thrown out in favour of the prospect of an early gain.

There are signs of exuberance. When the CEO of American Airlines, Doug Parker, announced on an earnings call with analysts, "I don't think we're ever going to lose money again", I wondered whether bullish enthusiasm had crossed over to irrational exuberance. When WeWork's CEO Adam Neumann told Forbes.com in October, "No one is investing in a co-working company worth \$20 billion. That doesn't exist... Our valuation and size today are much more based on our energy and spirituality than it is on a multiple of revenue", I couldn't help but think, 'here we go again'.

With commentators calling "Loss the New black", citing the market capitalisations of Uber, Snapchat, WeWork and Amazon as evidence of a "new world order", and articles with titles such as 'Buy Everything', 'RIP Bears' and 'Congratulations Capitalism' increasingly common, it is worth asking whether sound reasoning has been usurped by unbridled optimism.

Investors have surprisingly short memories and there is no doubt that the fear of missing out - as reflected in the pursuit of companies with zero profit such as Tesla - is replacing the fear of loss. When that happens it is worth being cautious.

Recently, in *American Consequences*, Dan Ferris wrote, "Investors have pushed [that] reality aside and fallen in love with companies that have a great story and a soaring share price... regardless of profitability. What they don't realize is that equity only has value if a company earns a profit. That means there's a much higher probability than investors currently acknowledge that unprofitable highfliers might be worth... zero."

In the last twelve months some of the best performing stocks have been those representing companies that have generated more than a billion dollars of losses. That's right - not profits, but losses. Meanwhile, forty-five companies listed on the Nasdaq 100 are now trading on P/E ratios of more than 200 times. The combined market capitalisation of Tesla, Uber and Twitter is circa US\$130 billion and their combined profit is...zero.

Many have pointed to the extreme level of the CAPE Shiller Ratio (CAPE), a ratio created by Nobel Laureate Prof. Robert J. Shiller which compares the S&P500 index price, adjusted for inflation, to the ten year average earnings. This month, the CAPE ratio hit 32.24. That is a high ratio. Indeed, between the year 1881 and today, the average CAPE ratio has stood at just 16.8. Moreover, it has exceeded 30 only twice before: in 1929 and in 1997-2002. Higher CAPE ratios imply low future returns and the model has done a very good job of predicting future returns.

There is little doubt that the US stock market is characterised by a combination of very high market valuations, but it is also characterised by strong earnings growth, and very low volatility.

History however suggests that the combination of high CAPE, high earnings growth and low volatility existed before most significant corrections.

Indeed, Shiller recently identified there have been 13 bear markets in the US since 1871. A bear market is defined as a 20 per cent correction from a high within a 12-month period. The 'peak months' before the bear markets occurred in 1892, 1895, 1902, 1906, 1916, 1929, 1934, 1937, 1946, 1961, 1987, 2000, and 2007. There were a couple of notorious stock-market collapses - in 1968-70 and in 1973-74 - but Shiller did not include them in his recent study because they were more protracted and gradual.

His first observation is that the average CAPE ratio was higher than average, at 22.1 in the peak months, suggesting that the CAPE does tend to rise before a bear market. For investors today, with the CAPE ratio well above average, it is valuable to note that prior to 10 of the bear markets since 1871 were preceded by an above average CAPE ratio.

Peak months before past bear markets also tended to show high real earnings growth: 13.3 per cent per year, on average, for all 13 episodes. And "the market peak just before the biggest ever stock-market drop, in 1929-32, [recorded] 12-month real earnings growth [of] 18.3 per cent."

Those who point to near record-low levels of volatility as protection against a bear market, should heed Shiller's observation that "stock-price volatility was lower than average in the year leading up to the peak month preceding the 13 previous US bear markets". He adds, at "the peak month for the stock market before the 1929 crash, volatility was only 2.8 per cent."

The supply side argument put forward about technological innovation rendering companies more profitable fails to acknowledge the demand side of the equation: that fewer jobs and lower wages mean less customers for the products companies sell. Henry Ford broke with tradition at the turn of the last century and gave all his employees a pay rise because he realised they were the customers for his T-model car. Generational unemployment and "capping inflation for our lifetimes", whether due to economic mismanagement or technological innovation, could produce deflation, which of course is an outcome that is as bearish for equities as rampant inflation.

Before getting too excited about the current Goldilocks economic conditions, it may pay to know that there is absolutely no correlation, in any geography, between economic growth and stock market returns. Perhaps surprisingly if the economy is expanding at above average rates, there's a 50 per cent chance the stock market will do better than average and a 50 per cent chance that it will do worse.

With respect to the Central Bank 'Put', it is true that in recent history central banks have intervened following any signs of instability in markets, through measures such as Quantitative Easing. And while it is likely that central banks will be slow and measured, they can't control 'animal instincts', which combined with record levels of margin debt against the S&P500 will force many investors to sell even more shares as prices decline.

## So, who is right?

There are of course many other arguments put forward to suggest you should be fully invested. We agree that in the long run, being fully invested is preferred. But it is also true that the higher the price you pay the lower your return, and holding long term just means locking in a low return on a long-duration asset. Prices today are factoring in all of the bullish arguments with little room for setbacks, hiccups or speed bumps.

Those who are patient will be well rewarded for investing when there is blood in the streets. Remember, be fearful when others are greedy and greedy when others are fearful, no matter whether you are bullish or bearish in 2018.

**Roger Montgomery**  
**Chief Investment Officer, Montgomery Investment Management**

*The Montgomery Global Funds own shares in Amazon*

“Enthusiasm becomes a concern only when it morphs into unbridled exuberance”

# ANOTHER HIDDEN FACT POINTING TO A STRONG OZ ECONOMY IN 2018

PETER SWITZER

One of my key drivers for writing each morning is to pick up on big stories relevant for the economy or the stock market that are either ignored by my mates in the media or at least treated with little respect. I do this because what makes a journalist's day might not necessarily be important for anyone who wants to make money out of investing, building a business or becoming a top notch employee bound for promotion.

The stuff I dig up daily also has relevance for Prime Ministers, who might want to get loved and elected next year because as Bill Clinton once advised: "It's the economy, stupid."

It's about competitive advantage and most people who fall into the winner's class have a competitive advantage and really understand where the economy and markets are heading.

One absolute beauty was the recent Westpac-Melbourne Institute Leading Index, which puts together a whole lot of indicators on the economy to try and predict where the Oz economy is heading. Yep, that's why it's called a leading index. And this has special significance for me as I have been out of kilter with the majority of economists in tipping our economy will do better than the consensus guesses out there by Australia's best economists.

Luckily, there's one pretty decent economic body on my side called the Reserve Bank of Australia and the pointy-headed economists and bankers there would be happy to see the most recent reading of this index.

I reckon Malcolm Turnbull and Scott Morrison also would've liked what you're about to see.

So, this leading index showed a six month annualised growth rate reading of +1.41% in December. Now you might be asking "so what?" The number seems meaningless but you need to know the previous reading was only +0.66% in November. That's a big jump of 113%!

Remember, the index indicates the likely pace of economic activity — growth of production of goods and services, job creation, business profits, etc. — relative to trend three to nine months into the future.

A good mate and economist, Bill Evans, who heads up the Westpac economics team has been constructing and watching this index for decades and his reaction is worth noting.

"This is a very strong above trend reading and, following the solid results in October and November, points to solid above trend

growth in the early part of 2018."

This is economist speak for: "This is a ripper number and I'm really excited about the prospects for the Oz economy!"

What's good about this number is that it vindicates my optimism on the economy. It makes the Australian Industry Group survey that predicted over 400,000 new jobs this year believable. And it makes it very possible that this better-than-expected growth of the economy translates into better company profits and higher stocks prices.

We're now in "confession season", where companies admit if they've got unexpected bad or good news coming when reporting season happens. Happily for optimists like me, Macquarie's Martin Lakos told me on my radio program that the negative confessions have been small, while the positive ones have been bigger in number.

This leading news came as we learnt that the Internet Vacancy Index rose by 0.2% to 83.6 in December in trend terms, after increasing by a revised 0.5% in November (previously reported +0.3%). The index has now risen for 14 consecutive months — the longest period of growth since March 2011 and has increased by 8.1% over the year to 5½-year highs!

Against that we learnt that our labour productivity for the financial year grew by 1.1% on an hours worked basis and 0.5% on a quality-adjusted worked basis in 2016-17 - the lowest annual growth in five years.

However, this is a relatively old figure going back to the 12 months ending 30 June 2017. Over that year, business investment, which raises productivity, was low and had not taken off as it has now. I expect productivity to rise this year.

One final thing is that we know we created 403,000 jobs last year and it started in the second half of 2016-17. And as you add more workers to jobs without bumping up the technology from business investment, productivity initially falls. This is a negative story that turns positive this year and gets even better in 2019.

If you don't believe me as an economist, then believe me as a journalist!

**Peter Switzer is the founder and publisher of the Switzer Report. AIA members are entitled to a free three-month subscription to the Switzer Report. Visit [www.switzer.com.au/aia](http://www.switzer.com.au/aia) for your free subscription today**

# MARKET PERFORMANCE MEASURED BY \$AUD - \$USD

JODY ELLISS

“Our market appears to be gearing for some sort of correction”

Why is the Australian Market the Worst Performing Market in the World? The Australian market -represented by the Top 200 (XJO) is the only major market in the world that is yet to recover from the Global Financial Crisis (GFC).

In 2007, powered by the commodity boom, low interest rates, and growing Asian markets, the world markets went to new highs. Our market -represented by the ASX 200 (XJO) went to a new high of 6850 on 1st November 2007 before it started to decline with the Global Financial Crisis.

Our Index (XJO) is the only major Index in the world that has NOT moved over its GFC high.

Our Index, unlike most other world Indexes, is composed of more than 30% commodity stocks (XJO). The only other major Index that carries this weighting of Commodities is the Toronto Stock Exchange (TSX) in Canada.

If we look at where our market experiences growth and decline, we find a strong commonality with overseas investment in our market, which we can measure with the \$AUD-\$USD. This is caused partially because our commodities are bought and sold in \$USD internationally.

From 2003 to 2007 the \$AUD spent most of its time below \$0.75 USD. During this time, we saw accelerated growth in our market aided by demand in commodities. By mid-2007 — our \$AUD had breached the \$0.80 level. This was the first time in recent history since the 1987 crash. There is a strong correlation between a rising \$AUD in the last 30 years and a falling Australian market.

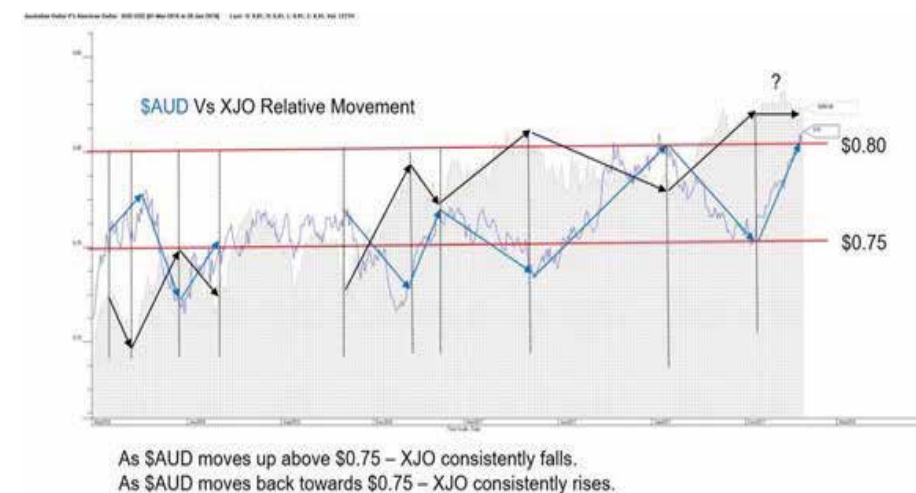
If we have a look at the XJO growth vs \$AUD in the last 4 years (See Chart) we can see the strong growth occurs in our market below \$0.75. We also see strong growth occurring with a falling \$AUD and a reversal of our market occurring with a rising \$AUD.

We have seen a massive growth in our market from below 5000 (XJO) in 2015 to crossing 6000 at the end of 2017 which has corresponded to strong commodities growth. The ups and downs have a strong inverse correlation with the \$AUD.

Now in the beginning of 2018, with our market holding just above 6000, we see the \$AUD rising aggressively to breach \$0.80. If the last 30 years have anything to say, this will place a strong downward pressure on our market once again. In a time when we should be experiencing a strong push up to finally breach our GFC high — the aggressive rise in our \$AUD will certainly insure this will not occur in 2018.

Our market appears to be gearing for some sort of correction in March. Our Institutions use Share Price Index futures (SPI) to insure large portfolios and we can see the current differential between XJO and the SPI is more than 50 pts. This is estimated to represent more than 80% institutional insurance as we move into February. This is indicative of limited upward growth from this point.

Despite the world market growing aggressively, we must consider defensive strategies on Australian stock investments while we carry a high \$AUD. We can in fact use \$AUD to insure our portfolio by buying the \$AUD. If we see the \$AUD falling back towards \$0.75, we can once again look to buy stocks and expect strong growth for the next wave up in our market.



**Jody Elliss has been trading and investing the stock market for the last 35 years. He is a licensed stock broker and financial planner but does not have any retail clients as he actively invests in the market and provides institutional services.**





# 2018...A CHARTIST'S PERSPECTIVE

# 2018...A CHARTIST'S PERSPECTIVE *continued...*

ALAN HULL

For some time I have been saying that global equity markets are all being led higher by the U.S. Stockmarkets, namely the NASDAQ. So if the U.S. sneezes, the rest of the world catches a cold.

Furthermore, ever since the U.S. Stockmarkets both accelerated upwards from August 2017 they have departed even further from sound fundamentals. Therefore analysing them from a technical or a chartist's perspective is key.

So let's take a look at the lead up to what appears to be a market top in the U.S. at the end of January and then contemplate the future of these markets in 2018. The first sign of instability occurred in August 2017 when the U.S. markets broke out of their long term trading channels. I will use the NASDAQ index to illustrate my points here, but know that very similar patterns have also occurred on the Dow Jones index. The Dow Jones being representative of the NYSE.

The NASDAQ was already rising in what we call a speed/resistance fan (diverging trendlines), which is considered unstable, and at the point of breaking out its average price to earnings (P/E) ratio was about 30. For Stockmarkets a P/E ratio range of 10 to 15 is normal and 25 plus is considered to be bubble territory. So to break out from this pattern was both fundamentally and technically pushing it.

But then in January we saw the U.S. Stockmarkets go even one better and break out from the break out. This meant we had to zoom in and start monitoring these index charts on a daily basis. It also meant selling down our growth portfolio in anticipation of a major market reversal. You can see the steeper and narrower trend (blue lines) developing on the daily chart of the NASDAQ.



We were now in an exponential trend and any sign of a wobble would be good reason to get out of the way. A wobble being either a sharp drop in the index and/or a rapid increase in volatility. As trends get steeper and steeper, they get narrower and narrower. So a key warning sign is an increase in volatility. And as things played out, we got a good dose of both in the first week of February, as the NASDAQ index collapses down through both its earlier trends.

“a key warning sign is an increase in volatility”

We were now toying with a major reversal and I recommended getting out on the day our market rallied after the U.S. markets retested their medium term trends (the lower red line in the daily chart of the NASDAQ). This test failed as the indexes didn't manage to re-enter their trading channels. It was time to go...

So far this narrative brings us to the start of February (the time of writing)...where we are all cashed up and wondering where markets are headed for the rest of 2018. Now we need to go back to the bigger picture to get our bearings. So we return once again to a monthly chart of the NASDAQ which shows the next major support level at 6,600 points (the upper blue line).



This will most likely be the level at which the NASDAQ rebounds and it may retrace up to 50% of the previous decline. Often referred to as a dead cat bounce. Then I suspect the NASDAQ is likely to fall down through this level, signaling the start of a major down cycle. So on the back of the dead cat bounce, I will start to short sell. The following chart, where I speculated on the future path of the NASDAQ, was originally published in July 2017. I was obviously overly ambitious with a peak at 8,500 points...

My outlook for 2018 is not a rosy one. I believe global equity markets led by the U.S., are in the process of reversing. The down cycle we are about to embark upon will be significant and it is not one that I am willing to ride out with my growth portfolio. On the other hand I will continue to hold my income stocks and look forward to adding to them. When the time is right.

Alan Hull, Author & Stock Market Expert

# INVESTING IN ‘LOW TO MID’ CAPITAL GROWTH

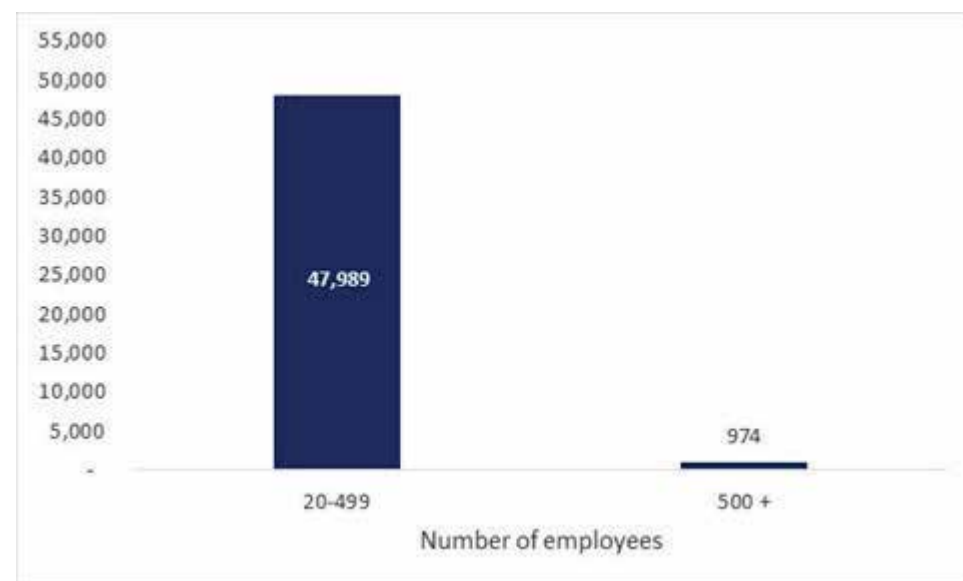
VAUGHAN HENRY

Growth capital is a form of private equity that involves investing in established, profitable businesses that are seeking a partner to provide capital and strategic guidance to maximise their growth. The number of opportunities in ‘low to mid’ growth capital is large. There are approximately 48,000 investable private companies that have between 20 to 499 employees based in Australia or New Zealand. In addition to a large opportunity set, there are also favourable market tailwinds in terms of business owners wanting to exit their businesses. The Institute of Public Accountants provided analysis in 2016 that of the two million Australian private businesses, over 70% of these businesses are owned by baby boomers and most baby boomers plan to exit their business in the next ten years.

(Source: “The Baby Boomer Business Exit Tsunami” – November 2016;

<http://www.smh.com.au/small-business/trends/can-the-boomers-sell-their-businesses-20150312-1428k0.html>).

Number of private companies within Australia & New Zealand (Source: Orbis)



Valuation multiples in the Australian growth equity market are attractive with our average entry multiple for investments from 2013-2017 at 6.4x EBITDA, relative to the Australian LBO average of 8.2x EBITDA. And, on average, low-mid growth equity businesses are acquired at significant multiple discounts to larger businesses which creates an attractive entry and exit dynamic for investors. The scale of the market also enables there to be a high proportion of proprietary and exclusive deals; for our team this was around 50% by number over last 12 months.

Despite the attractive attributes of the low-mid growth equity market, there are less than 20 active growth capital funds operating in this market. This is in comparison to the 12 larger private equity funds that typically target companies with greater than 500 employees whilst having a market opportunity set of approximately 1,000 companies.

“Investing in smaller companies provides significant scope for operational improvement”

Investing in smaller companies provides significant scope for operational improvement, particularly through supporting and developing the management teams. Many private equity firms have built separate operational teams and deal teams, so that the operational team can focus solely on the development of investee companies. However, we have always had a strong focus on operations and go into every deal with a clear strategy of how we are going to support management teams to build the business through to an exit process. Whether it is managed through the deal team or a separate team, a critical part of growth capital investment is to ensure that the team managing the investment is actively involved from beginning to end.

Investors need to be aware that you usually need to qualify as a ‘sophisticated investor’ in order to access growth capital investment opportunities from Blue Sky and other investment managers that offer these types of investments. To qualify as a sophisticated investor you, or entities you control, must have aggregated gross income of at least AU\$250,000 in each of the previous two years or net assets of at least AU\$2.5 million. If you do not qualify as a sophisticated investor you can still access private markets investment opportunities as a retail investor through listed investment companies, such as our Alternatives Fund (ASX:BAF) that gives investors access to a diversified range of private markets investments across private equity (including our ‘low to mid’ growth capital investments), private real estate and real assets.

Led by Nick Dignam, the Blue Sky Growth Capital team continues to build momentum. They have a strong sector bias and favour investments in sectors we call the ‘essentials’ – 7 out of the last 11 investments were in three of our target sectors of food, healthcare and education. But perhaps the most important and unique feature of our Growth Capital team is a genuine partnership approach to investing, including the willingness to take minority positions.

Vaughan Henry,  
Blue Sky Alternative Investments

# WHY WE’RE THINKING ABOUT YIELD ALL WRONG

GREG MACLEAN

Sometimes it makes sense for individual investors to look to institutions for cues and clues to inform how they invest – or at least how they think about the world they invest in – and sometimes it doesn’t.

No doubt about it, institutions will have an edge over the ‘average Joe’ or ‘weekend warrior’ when it comes to information and investment insights; financial institutions employ the best and brightest and draw on research garnered from all over the world using tools out of the reach of most of us individually.

But there are times when it makes sense for individual investors to play to their strengths rather than follow the lead of institutions, and the behaviour I’m seeing around the so called ‘yield trade’ is a perfect example of where this is happening.

## Global phenomenon

Indeed, the yield trade is, in my view, a defining characteristic of global financial markets in the last decade, ever since central banks started dropping interest rates in the wake of the global financial crisis.

Most superannuants today were brought up at a time when you could get strong yields out of fixed income, and for many self-directed superannuants, particularly those with their own funds in the rundown phase, having a cheque on a regular basis coming in without thinking about it is very nice.

As we know, times have changed. The trap investors are falling into as I see it is they’re not changing with the times.

Back in the day, when investment grade bonds were yielding north of, say, 5 per cent, and when equity markets were up bond yields were down (and vice versa), the simple arbitrage provided good and consistent returns throughout the cycle.

In financial circles, the bond/equities arbitrage is almost a religion. It started with Harry Markowitz who published the hypothesis for modern portfolio theory in 1952. Markowitz, who got a Nobel Prize for his work, was a pretty humble guy because he says he was only putting down on paper what any decent asset allocator and funds manager knows: when the risk-free rate goes up, equities come down and bonds go up, so if you have a mixture in your portfolio things tend to balance out you can reduce the volatility.

This simple concept forms the basis of much of current institutional regulation. However, with yields now around 2-3 per cent, there is hardly any ability to arbitrage.

Institutional investors are commonly mandated to hold minimum requirements for bond type investments in their portfolios, and this has in turn led to the yield trade, where these investors are paying big premiums for bond proxy investments.

## Total return mindset shift

If you believe that low bond and fixed interest yields will persist into the future, then you need to start rethinking the traditional approach to asset allocation and income in retirement. My own view is that I’ll be planted in the ground for 50 years before risk free yields will come back to where they were pre 2008.

There are three options for superannuants as I see it:

1. Cut back expenditure. People will say “I have to have yield and I want to preserve my capital”, but I seriously wonder whether that makes any sense if a reduction in living standards starts to impact your enjoyment of life.
2. You could be tempted to go to a riskier type of bond product along the lines of a junk bond or a hybrid, but, if you’re going to take more risks to get back to the income you once were earning, you should really be rethinking your strategy, especially if you are in the rundown phase when security should be a priority.
3. Or you could change your investment focus from yield to total return. Properly managed this will allow you to preserve your overall risk exposure, while liquidating assets as required to preserve your living standards. This makes by far the most sense to me if your achievable portfolio total returns comfortably exceed that of a traditional bond/equity portfolio.

In many cases, this total return-style strategy will allow you to enjoy both an appropriate living standard while still permitting overall capital growth.

The strategy of managed asset liquidation requires that your portfolio has a minimum requirement for liquidity. This can be achieved through an appropriate blend of equities and real assets.

Free of restrictive regulation, individual investors have a marked advantage over institutions and can be far more flexible in asset allocation.

Thinking about yield without considering capital growth and liquidity could lead investors to impinging on their lifestyles. If this is the case perhaps it’s time for people to shift their focus to total returns.

**Greg Maclean is the Global Head of Infrastructure at AMP Capital, responsible for developing and managing AMP Capital’s infrastructure research capabilities. [www.ampcapital.com.au/smsf-suite/register](http://www.ampcapital.com.au/smsf-suite/register)**



# CURRENCY DISRUPTION: FROM FIAT TO CRYPTO, AND GREATER PERSONAL FREEDOM



## When you think about 'change', or disruption, how does it make you feel?

Is it a good thing, or a bad thing? From the Industrial Revolution, through the 20th century, and into the tentatively dubbed 'Information Age', we've witnessed some of the most significant and disruptive changes ever conceived in human society. The pace never seems to slow. In fact, as demonstrated since the inception of cryptocurrency, the pace of change is capable of exponential rates of acceleration.

Fortunately, change and disruption have come to be recognised for the improvements they bring to society, although they are not always viewed positively from the perspective of established institutions. Change is often perceived as a proposition of risk by those most comfortably situated, but what about internet, email, and mobile phones? These are but a few examples of disruptive technologies that were viewed with suspicion at the outset, but grew to demonstrate significant value and social advantage.

So, what about cryptocurrency? We see the same kind of resistance against this new and burgeoning sector, and in large part that can be attributed to a lack of education about the prospective advantages it makes available; it's nothing short of revolutionary. We need to communicate that story, especially in terms of the way it will allow ordinary people to hold a greater level of banking power, and take back something they almost certainly never had – personal financial sovereignty.

## Speed of transactions

What kinds of benefits does cryptocurrency offer? The most obvious to a new adopter is the speed of transactions. At present an international currency transfer takes three days. At each stage of the process there will be a fee for handling the funds, and until now the customer has been powerless but to pay, and wait. However, people are pleasantly surprised at the speed with which their first cryptocurrency transaction moves from one part of the world to another – in minutes, rather than days. If you're overseas and need to send money to a family member, you can be secure in the knowledge that your funds will arrive quickly and safely.

On top of that, neither national government nor banks can apply fees or charges until the currency is exchanged for fiat: the customer gains true financial sovereignty. But that example only scratches the surface of disruptive possibilities for the near future.

**BEN HAGEMANN**

## The Internet of Things

Some of us have heard a new phrase bandied about lately – The Internet of Things, or IoT for short. It's a simple name for a revolutionary concept, describes the way machines talk to each other using wireless connectivity. IoT can exist in a domestic setting, such as your home fridge connecting to the internet to automatically order more bread and milk to be delivered, or a retail setting shop's display fridge ordering more cans from a soft drink supplier as it begins to run out of stock.

Although that kind of technology is not widely used here in Australia, mainstream application is not far away, and together with a digitally engineered Blockchain payment known as a 'smart contract', IoT won't only streamline logistical processes; it will streamline the attached systems for payment and accounting as well.

Cryptocurrencies function on the basis of mathematical security regulations. These algorithms, when combined with the institutional trust and statutory legislation that we conventionally understand, create a system of currency that is more trustworthy than anything previously known. There's no need for transaction clearances or lines of credit: the accounting is done automatically and in real-time, which saves human time and resources.

## A real example from the blue-chip world

At present, the Australian iron ore-mining industry is undergoing its own revolution, using IoT connectivity to enable driverless haul trucks to transport freshly excavated iron ore to driverless trains, which transport the ore to port – it's happening right now! Wear and tear on those haul trucks can be recorded electronically, scheduled automatically, and the maintenance is performed by human employees. But what would happen if cryptocurrency was used to *automatically and instantly* settle expenses and payroll?

“Cryptocurrencies function on the basis of mathematical security regulations”

CURRENCY DISRUPTION *continued...*

Picture this: Somewhere in the dusty-red Pilbara Desert, deep in an open-cut pit, a 50-foot-tall mining excavator picks up and automatically weighs a few tonnes of unprocessed ore, and generates a value for it. An empty haul truck drives over and creates a machine-to-machine (M2M) smart contract with the loader, to pay for the ore in real-time as it is loaded into the tipper tray.

This digital 'smart contract' incrementally pays the excavator, bucket by bucket, so the accounts are never out of balance. The excavator also incorporates profit margin to be spent when scheduled maintenance rolls around, as well as cover the expense of its capital investment.

Once full, the truck drives to the crusher to dump its load, and another M2M smart contract is generated. This time the crusher pays the truck. After so-many loads, the truck heads back to the workshop for scheduled maintenance, where it directly pays the diesel fitter who carries out the work, and the store for parts and consumables like tyres and oil. There's no need for PAYG accounting each week, and the store's stocktake is done in real time.

Meanwhile, these chains of smart contracts are overseen by a small accounting team acting as the secondary caretaker of accounts, rather than a massive team of accountants required for primary-level generation and collation of costings data. Now, the efficiency improvements become clear.

Another benefit for the maintenance employee is that the Australian government will no longer have to hold his tax to a PAYG ransom each week, leaving the employee free to invest that capital in whatever way he wants, only paying for tax owed at EOFY, with no need to wait for a return. In turn, there will be less pressure on the Australian Tax Office. If you scale the employee's situation up to the level of the mining company, it's easy to see that a democratic, free market such as this is will lead to greater financial sovereignty. If you apply that to your own SMSF in the future, it may be possible to reduce bank fees, and save more funds for enjoying your retirement.

The cryptocurrency genie is out of the bottle, and its myriad opportunities for streamlining business and investment operations are only now being acknowledged and explored at the highest levels of corporate governance. The social implications for this disruptive change include an ability to free up more of our most precious resource, human energy, and direct it to problems more challenging than simply balancing financial accounts. It's an amazing near future to look forward to, one in which our children and grandchildren will enjoy new opportunities that we're only beginning to imagine.

**Ben Hagemann, Bitcoin Trader**

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# WHERE'S YOUR SUPERANNUATION INVESTED?

WHERE'S YOUR SUPERANNUATION INVESTED? *continued...*

ISHAN DAN

It's an interesting question. Some of you will know, most of you won't and that's quite a concern. Besides your house, your superannuation fund is your second biggest investment that will carry you through retirement and give you the lifestyle you desire. Most tradesman will say their super is invested with one of the big industry funds but be completely unaware of the underlying assets in the fund. For something that affects every single Australian in such a huge way, it pays to know where your hard-earned money is really going.

Speaking with a friend over the weekend, I asked him where his super was invested. Seems like a straight forward question but all he could tell me was that it was in 'some type of managed super fund'. After a bit of digging, we managed to find out his superannuation fund was invested in a stock standard AMP Flexible Lifetime Super fund using a balanced investment option. Great... so where exactly was the money going? How much risk is your super fund taking to achieve these returns and what are the underlying assets?

As I soon found out, it's not an easy question to answer especially when investing in an industry, retail, corporate or public-sector fund. A Self-Managed Super Fund is the only type of super fund where a superannuant is fully aware of its underlying assets. Whilst one can find out the price of any ASX listed at the click of a mouse, good luck trying to find out what specific investments your fund manager is investing your money into. How do you know your fund manager isn't losing you money? Well here's some hard facts:

- 1 in 7 growth super funds have made nothing over the past ten years.
- 47 of 346 growth funds in operation since 2006, failed to beat the official inflation rate over that time (2.5%).
- ANZ runs 27 of these lemon funds.
- More than 150 funds have not earned more than 3.5% a year.
- 33 funds have only delivered an average investment return of 5% or more for the past 10 years.
- REST is the top earner with 6.7% a year.

- Top 5 performers 2016/17:
  - o HOSTPLUS – Balanced (12.4%),
  - o First State Super – Growth (12.3%)
  - o Sunsuper for Life – Balanced (12.2%)
  - o Russell iQ Super Employer – Russell Balanced portfolio (11.9%)
  - o Australian Super – Balanced (11.8%)
- Bottom 5 performers 2016/17:
  - o Betros Bros Super Fund No 2 (3.2%)
  - o ASGARD Independence Plan Division 2 (4.7%)
  - o LESF Super (5.4%)
  - o Pitcher Retirement Plan (5.9%)
  - o AMP Superannuation Savings Trust (5.9%)



One fund manager, ANZ's One Path, wrote to its members telling them that long-suffering account holders should leave if the super fund is unable to perform any better. What a disgrace. We suggest if your super is invested in any of these bottom performers, you should switch. You don't want to be one of those people that realise later in life that you've not enough to survive retirement and then start taking bigger and bigger risks to improve returns. In short, it spells disaster.

The question on your mind now is probably where to switch and what investment option within a super fund do I choose? So, first things first. Generally, your employer will contribute 9.5% of your pay towards your super fund every month. From here that pool of money is invested into shares, bonds, property and cash. Portfolios are weighted between growth and defensive assets. That means you have the choice of selecting a pre-made portfolio to meet your risk level and financial objectives. So, when you're selecting the investment option in a super fund, you're effectively selecting the assets you want your money to go into. But how risky should you go?

Above 80% of Australians have their super in a balanced option. That generally means 60%-80% of growth-style assets, such as shares (both international and Australian) and property, and 30% to 40% in more conservative investments, such as cash and fixed interest. Anything above 80% in growth-style investments is considered high risk growth.



“ it pays to know where your hard-earned money is really going ”

A recent AFR article highlighted the fact that many super funds were hiding the extremely high levels of risk by investing in assets that are difficult to classify. Unlisted property and infrastructure assets fall under this banner. By investing in these assets, some super funds can achieve much higher returns by hiding the level of risk they're taking and deliver time and time again. Balanced super funds have been investing in highly geared infrastructure projects such as airports, toll roads and tunnels because these assets are deemed 'defensive' or safe. But it's far from the truth. These balanced super funds are sometimes 90% invested in high risk options, deemed defensive. This sort of deceptive 'funny buggers' can lead to painful losses. In the event of a sharp correction, these balanced funds will be absolutely hammered due to the high-risk assets that are in the portfolio. And all it will take is a sudden rise in interest rates. Infrastructure and property assets will turn sour.

Here is a good example from Australian Super and their super portfolio mix.

Accumulation Options	High Growth %	Balanced %	Socially Aware %	Conservative Balanced %	Stable %	Indexed Diversified %
Australian Shares	35.0	27.2	27.5	19.4	11.2	36.1
International Shares	43.2	33.7	33.4	24.0	13.6	42.7
Private Equity	3.8	3.3	3.3	1.6	0.0	0.0
Direct Property	5.3	7.5	7.5	5.9	6.5	0.0
Infrastructure	6.7	11.2	11.4	6.8	7.4	0.0
Fixed Interest	0.0	2.9	2.9	19.7	27.0	9.7
Credit	3.2	5.2	5.2	3.9	4.2	0.0
Cash	2.8	9.1	8.8	18.7	29.9	11.5
Actual currency exposure as at 31 December 2017						
	28.4	21.7	21.5	14.2	8.5	41.9

A Balanced fund means 60% shares and 40% cash & bonds. Looking at the above table you'll notice a few extra assets that don't quite fit the shares or cash banner. They are Private Equity, Direct Property, Infrastructure, and Credit. According to the rules they're all deemed defensive. Let's see how 'defensive' they are with 27.20% in alternatives i.e. private equity, property, infrastructure and credit.

Delving a little deeper into the fund, we found out that the Australian Super fund invests in high risk transmission lines, airports, toll roads, seaports, water utilities, communications, wind farms, shopping malls and office buildings. There were some 200 property projects, 400 private equity projects and 1040 debt securities issued by companies such as \$356m in ENA S.A.U, which is a Spanish road toll operator. These assets should be deemed high risk growth assets. If that was the case, this balanced option would be 88.1% growth and 11.9% defensive. Wait a minute. That looks a lot like a high growth fund?

According to MLC Wealth Sentiment survey, 45% of women aged 18 to 29 and 27% of men the same age, have no idea what risk profile their super is invested in. That is – conservative, moderate, growth or high growth. Women aged 30-49, the figure is 27% and 14% with men. The risk profile is such an important aspect of your super fund, it simply can't be ignored. Your super fund should be a safe, low risk investment that is able to ride market downturns and still be reasonably safe. Don't fall victim to the balanced fund high risk rort. When the tide changes, you don't want to be caught out.

Ishan Dan, Wattle Partners

“ many super funds were hiding the extremely high levels of risk ”



# WHY ARE DECLINING BUSINESSES DIFFICULT INVESTMENTS?

Forget pizza, bruschetta, risotto and pasta. One of the best things about Italy is mortadella, a pork sausage flavoured with spices and pistachios. It may not be fancy but it is loaded with flavour, and great travelling memories.

What, then, to make of **Felsineo**, the leading mortadella manufacturer, offering a vegan option – of a pork sausage – sold under its traditional label?

The decision could be seen as either bold or stupid but Felsineo had little choice. As Italy's population ages, demand for meat is falling. Younger Italians, meanwhile, are increasingly choosing a meat-free life. **Eurispes** (the Institute of Political, Economic and Social Studies), estimates that 7.6% of the population is either vegetarian or vegan. And meat-eating Italians are buying higher quality cuts. Sales of cured meats like mortadella fell 5% in 2016.

Felsineo is desperately trying to fight a slump in sales, which is proving more structural than cyclical. It is a challenging task, although successfully investing in a shrinking business like Felsineo may be even harder.

## Different strategies

Overcoming structural change *is* possible. **Netflix**, which once sent out DVDs in cardboard envelopes and now streams its own content across the Internet, proves it. But it's a rarity. History shows that established firms struggle to reinvent themselves.

Changing what has worked for decades takes courage, especially if it causes sales to initially fall faster and costs to rise for years. Genuine innovation is more likely to come from newer and more agile firms with no preconceptions, no history.

An alternative path is to fight structural change through diversification. This, as in Felsineo's case, involves expanding the product range to 'adjacent' categories and markets. It seldom works though, as all challenged firms end up doing the same thing and competing fiercely with each other.

A third path is to acquire businesses in unrelated industries, much like **Fairfax** bought Stayz, an online accommodation portal. This is risky. Successful acquisitions are generally opportunistic and not motivated by need.

None of these options are attractive. So if a firm falls victim to structural change, why not just shrink?

For investors at least, this makes sense. The best managers are those that allocate capital most efficiently, not those that try to predict future trends. After reaching maturity, often sitting back and focusing on cashflow is the low risk option. In practice though, it rarely happens.

## Shrinking is preferable but hard

When sales are falling, fixed costs have a growing, adverse impact on profitability. And there is only so much that a firm can cut expenses. Again, Fairfax proves this point.

At the same time, directors and managers don't want to oversee a contracting business, often because their fees and salaries are dependent on growth. Owner-managers, meanwhile, tend to take pride in the longevity of their companies to the point of even denying their businesses are in trouble. Gerry Harvey, the founder of white goods retailer **Harvey Norman**, comes to mind.

STEVE JOHNSON

“History shows that established firms struggle to reinvent themselves”

Declining businesses tend to first resist structural change. Then, when it's too late, they try frantically to fix things up with ill-conceived new products or foolish, overpriced acquisitions. Either way, shareholder value is destroyed. This is why declining business make for such difficult investments.

When we invest in such businesses we don't expect them to turn around. We look for alternative sources of value unrelated to the core business that might be hidden within them.

One of the recent investments in the Forager International Shares Fund, into set-top-box manufacturer **Technicolor** is a good example. The stock is discussed in detail in the Forager December 2017 quarterly report. But if you can't find a reason like this to invest in a declining business, best steer clear.

**Steve Johnson, Forager Funds Management, [www.foragerfunds.com](http://www.foragerfunds.com)**

# E-COMMERCE'S RELENTLESS RISE IS RATTLING MANY TRADITIONAL RETAIL BUSINESSES

MICHAEL COLLINS

***But the 'Amazon effect' has been less disruptive at an economy-wide level.***

Type relentless.com into a browser and where will you end up? At amazon.com. When Jeff Bezos established Amazon as an online bookseller in 1995 he toyed with calling his venture to dominate retail 'Relentless'.

While that name would be apt, Amazon is better known as the 'Everything Store'. That label identifies that Bezos's genius was to see that selling books on the internet would enable him to gather data on people's spending habits so that he could sell them other things. And Bezos sure is doing that. Amazon.com has 373 million products listed for sale, a count that includes items on 'Amazon Marketplace' where third-party sellers display goods.

Amazon's ascent is part of e-commerce's broader emergence in recent decades. In a compliment to Bezos, the term 'the Amazon effect' symbolises the disruption e-commerce has inflicted on traditional retail.

The disruption attributed to e-commerce raises social, economic and political questions. The 'retail apocalypse' as these drawbacks are termed include jobs losses in traditional retail, job displacement that keeps wages low, and rising inequality linked to low wages growth and the loss of jobs. Another upshot is that e-commerce is judged among forces keeping inflation low.

How the tech-driven changes in retail unfold across the industry, society and the economy could offer a guide to the broader benefits and disadvantages of technological advances overall. The surprise might be that the macro-level upheavals associated with e-commerce have – so far – been more muted than many might expect.

It might be too early to judge the macro repercussions of e-commerce because sales over the internet are still to peak as a share of retail sales and could well reach a 'tipping point' at which disruption will accelerate. But so far at a macro level, the rise of e-commerce has come without the disadvantages – and, perhaps one advantage – that many associate with online shopping.

## A jobs 'apocalypse'?

Times are certainly dark for many traditional retailers. More than 20 big US retailers are shutting stores. About one in four of the country's 1,200 shopping malls is expected to close within the next five years. The social costs of this are real but hard to quantify.

The economic aspects are more measurable and they fall short of proving a 'retail apocalypse' is occurring. US research firm IHL estimates that US retailers will open 4,080 more stores than they will close in 2017 and that number of new stores expands to more than 10,000 if smaller shops are included.

Retail jobs aren't disappearing either. Retail employment in the US grew at an annual rate of 0.3% from 2006 to 2016 to 15.8 million workers, an increase of 467,000 jobs over the 10 years. Studies say these figures underplay the number of retail jobs added because they don't include storage and distribution e-commerce jobs.

The absence of a store-closing and job-shedding apocalypse makes it harder to blame e-commerce for the wages stagnation that economists lament is hobbling economic growth and leading to wider inequality. The more contentious macro effect of e-retailing is whether or not it is keeping inflation too low.

One side of the debate argues that online shopping increases the competitiveness of the US retail sector and restrains the ability of firms to raise prices. Others respond that the cost advantage of e-retailing is overstated, online prices are not noticeably lower, many e-retailers run on such low margins they can't afford to discount, and that the big falls in prices are coming from energy, food and rents, not goods sold online.

The evidence so far says that e-retail has a muted deflationary impact. This could change as the productivity boost linked to today's technological gains – including from e-commerce but especially, say, from artificial intelligence's ability to automate services – is expected to become increasingly deflationary.

Whatever the Amazon effect is, or will be, on prices, the public thinks that lower prices are found online. That will only help Bezos in his relentless quest to sell people everything.

**Michael Collins, Investment Specialist, Magellan Group**

**TChart: Average hourly earnings of all US retail workers**



Source: Federal Reserve Bank of St Louis. 'Average hourly earnings of all employees: retail trade.' CES4200000003. Updated October 2017. [fred.stlouisfed.org/series/CES4200000003](http://fred.stlouisfed.org/series/CES4200000003)



# MORTGAGES & FAMILY LOANS EXPLAINED SIMPLY!



With the price of housing in Australia, our children are finding it more and more difficult to come up with the ever rising deposit needed to purchase a home of their own, leading to many parents lending their children money to help them get started. The question is, are they doing this to their own detriment?

Let’s look at an example:  
Mr & Mrs Jones came to see me as they are going to lend money to their son for the purchase of a property. They wanted to know the best way to loan the money to protect them from loss.  
Good question and very wise to deal with it before they made the loan.

In simple terms people can lend money and not take security for the loan. That puts them in the same position as any other debtor that the borrower owes money to. They have no priority rating at law to have their loan repaid whereas, if they have formal loan and mortgage documents in place, they become “secured creditors”.

In most instances, secured creditors rate before unsecured creditors in law.  
Let me explain further:

## MORTGAGES

A mortgage is a legal document securing an interest in real property held by a lender as a security for a debt, usually for a money loan.

The word is a Law French term meaning "dead pledge." In the later Middle Ages the term was interpreted by folk etymology to mean that the pledge ends (dies) either when the obligation is fulfilled or the property is taken through foreclosure.

A mortgage itself is not a debt, it is the lender’s security for a debt.  
It creates an interest in land (or the equivalent) from the owner to the Lender, on the condition that this interest will be surrendered to the owner when the terms of the mortgage have been satisfied or performed.

In most jurisdictions mortgages are strongly associated with loans secured on real estate rather than on other property (such as ships) and in some jurisdictions only land may be mortgaged.

A mortgage is the standard method by which individuals and businesses can purchase real estate without the need to pay the full value immediately from their own resources.

Mr and Mrs Jones were concerned as they were lending \$20,000 and the bank was lending the rest. They should still have loan and mortgage documents in place in order to be secured creditors.

## SECOND MORTGAGES

### Registration

A mortgage is usually effective from the date of signing, not from the date of registration. Accordingly, you may choose not to register a second mortgage but you are not in as strong a position legally as you would be if registration is affected.

## SHANE ELLIS

For example, you will not be able to exercise your power of sale to transfer the property to a third party unless your mortgage is registered.

If you do not register your mortgage over the property, the title will not show that you have an interest in the property. Consequently, you may lose priority to a third party who does register a mortgage or lodges a caveat against the property to secure other loans or obligations.

You should also consider entering into a priority agreement with the first mortgagee. This will limit the possibility of the first mortgagee providing further advances that will take priority over the loan which the second mortgage secures. The down side with this is that the first mortgagee may seek that their costs be paid for the Deed being created, & may also insist on further Deeds of Priority if they make further advances.

In all instances, however, you should seek appropriate legal advice to cater to your specific circumstances.

Mr and Mrs Jones are starting to think it is all too difficult so let’s look at the flip side where there is no formal loan documents and a mortgage for security.

In simple terms, you can choose to lend the money to your son and not take security for the loan. That puts you in the same position as any other debtor that your son owes money to and you have no priority rating at law to have your loan repaid. Not a good position to be in.

If for example Mr and Mrs Jones came to see me after the money changed hands, they are still able to complete loan documents.

If you have lent money to a family member without any formal documentation in place, maybe it is time to rethink your strategy to protect your capital.

**Shane Ellis is the Managing Director of the Shane Ellis Legal Group & SMSF LawEquityProtect. He is a Senior Consulting Lawyer specialising in SMSF ESTATES & LAW, FAMILY ESTATE PLANNING, Asset Protection Structuring & Business Structures.**

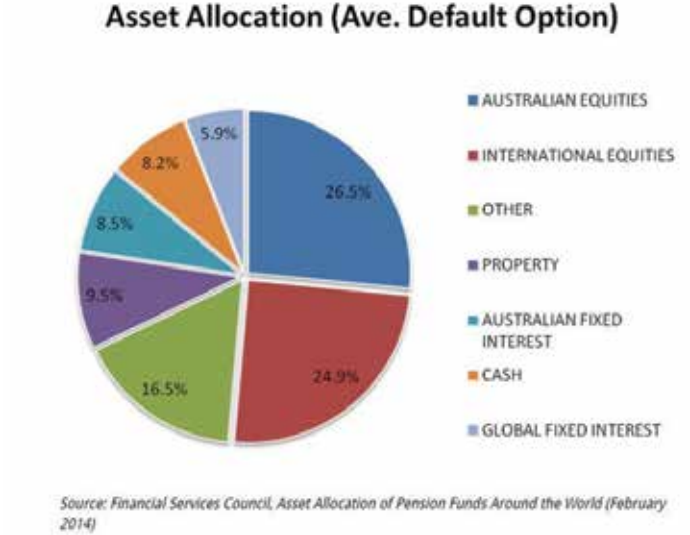
# IS THERE SOMETHING MISSING FROM YOUR ASSET ALLOCATION MODEL?

## CAMERON WINDOW

If you are acting as the trustee for your own SMSF, you will at some stage of your working life, had money invested in an industry or retail super fund.

At some point in time, for one reason or another, you’ve chosen to take control of your own future prosperity, and set up your SMSF. And why wouldn’t you? All the information required to make informed investment decisions is readily available, and you have the time and energy to do your own research. Managing it yourself gives you the ultimate flexibility to back your winners, to invest in areas you have knowledge in...plus of course you are not paying a fund manager or financial planner (or both – a planner who invests in funds)!!

Now, one thing fund managers and financial planners do well is allocate assets across a range of different markets. In fact the average default mix, as offered by Australian super funds, looks like this:



One could consolidate these pieces of pie in to these categories:

- Equities = 51.4%
- Fixed Interest = 14.4%
- Property = 9.5%
- Cash = 8.2%
- Other = 16.5% (likely hedge funds/private equity etc)

Upon setting up an SMSF, what we see is that people head out and buy their favourite shares, maybe a residential or commercial property, put a bit of cash in TDs/at-call, and maybe even put some equity in to a private firm. But what about that 14.4% fixed interest component?

What’s amazing is that so many people, even when it appears on their fund’s portfolio report, really have no idea what that ‘fixed interest’ piece of pie represents, and so often it is left out of an SMSF portfolio! In fact, across the entire \$1bn value of SMSFs in Australia, less than 3% is in fixed interest! This is the lowest percentage in the OECD...by some margin.

**What IS fixed interest (or fixed income) anyway?**  
A fixed income security is an investment that provides a return in

the form of periodic payments and the eventual return of principal at maturity. This is essentially bonds and hybrids. Companies and governments issue debt in these forms, as a way to raise capital. If a business wants money, they can issue shares, they can go to the bank, or they can issue a bond or hybrid. These are legal debt obligations, and any failure to repay principal or interest as part of the arrangement, constitutes a default. Because fixed income ranks above ordinary shares, in that unlikely default scenario, bond holders must be paid out before shareholders can see a penny.

**Why is fixed income in Australia so far behind the rest of the developed economies?**  
It’s really to do with access. Up until a decade ago, in Australia, bonds only traded in \$500,000 parcels. Overseas, (eg USA) bonds can be bought and sold in denominations as small as \$1000. So that large investment size here has made it impossible for the majority of private investors to access. That has since changed, and now these products can be bought and sold in \$50,000 parcels, or even smaller on the ASX.

That’s the other factor which has stunted the growth of fixed income in Australia – where and how do they trade? The overwhelming majority of fixed income products trade in an ‘over-the-counter’ (OTC) market, which is a negotiated market-place with multiple participants. This is not unlike currency, or real estate, in that there is no specific exchange. That being said, there are now a number of fixed income products trading on the ASX, and I expect this to continue to grow. There, you can buy and sell bonds and hybrids with as little as \$100 in your pocket! This expansion on to the listed market can only help bring exposure, and transparency to our asset class.

**What are the different types of fixed income products?**  
Fixed income covers all bonds and hybrids. That range is enormous – with the global bond market being four times the size of the global share market. Risk and return can be as low as a federal government bond @ 3%pa, or as high as a speculative corporate @ 18%pa! Interest payments can be set as a fixed rate, a floating rate over BBSW/LIBOR, or indexed with inflation. So if you have a particular view on rates and growth, you can assert that view on your fixed income investments. That is: Rising rates = Buy floaters. Falling rates = Lock in a fixed rate. Inflation fears = Buy index-linked.

With a combined annual income of 7.14%pa, and an overall yield to maturity of 8.00%pa, here are three fixed income investments that may add value to your current investment portfolio:

Issuer	Call/Maturity	\$ Spend	Yield	Running Yield
Members Equity Bank	28-Nov-22	\$52,179.00	7.13%	6.78%
Money Me Financial	16-Nov-20	\$51,897.81	12.40%	12.82%
Sydney Airport	20-Nov-30	\$68,195.29	5.25%	3.00%
Totals		\$172,272.10	8.00%	7.14%

**Cameron Window, Executive Manager – Fixed Income – MINT Partners Australia**  
**E – [cameron.window@mintpartners.com](mailto:cameron.window@mintpartners.com)**



# OFFICE MARKETS

## A BELLWETHER FOR THE ECONOMY

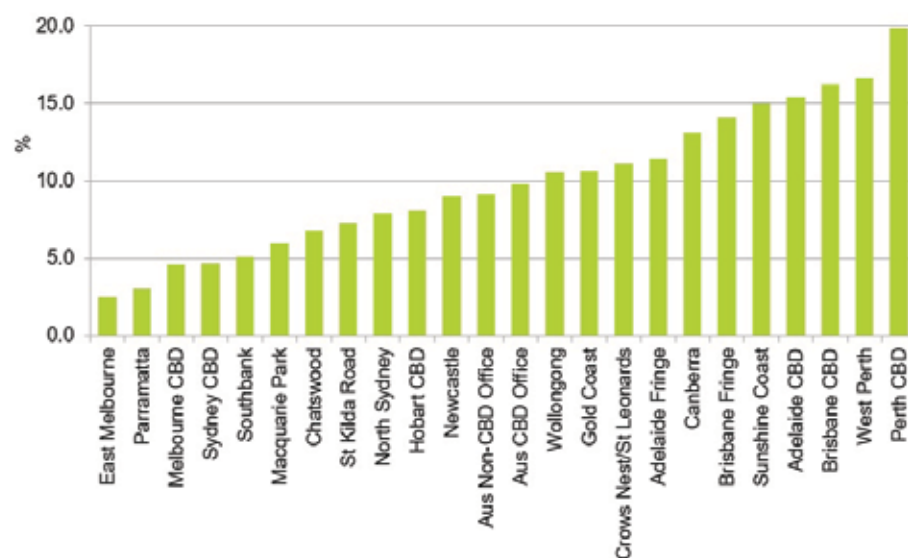


Our cities are the engines of economic growth. They provide the infrastructure to facilitate growth and their strength provides an important bellwether for the overall economic health of the nation.

Australia's 22 largest office markets comprise more than 25 million square metres of office space. Sydney (5.0 million square metres) and Melbourne CBD's (4.5 million square metres) are by far the two largest followed by Canberra (2.4 million square metres) and Brisbane CBD (2.3 million square metres).

Most of Australia's office markets are in good shape with the average vacancy rate sitting at 9.8% (Figure 1), although this is inflated by the high vacancy rates in Perth CBD (18.4%) and West Perth (16.7%) – both markets are still feeling the effects of the mining downturn.

Figure 1: CBD and Non-CBD Vacancy Rates: January 2018



Source: Property Council of Australia

### ADRIAN HARRINGTON

The uptick in the economy on the eastern seaboard is reflected in the very low vacancy rates across the Sydney and Melbourne markets. The two lowest vacancy rates across the country are Melbourne and Sydney respectively - East Melbourne (2.5%) and Parramatta (3.0%). Sydney and Melbourne CBDs are also in excellent shape. Both have around 4.6% of their stock currently vacant, recording their third lowest vacancy rates on record. In Sydney, you need to go back to 1990 for the lowest vacancy rate of 3.6%. This was just prior to the 1991/92 recession and the subsequent skyrocket in the vacancy rate to 22.5% in January 1993. In Melbourne CBD, the record low vacancy rate was 3.0% in 2008, just prior to the GFC.

Business sentiment is improving, employment is growing and this is being reflected across most office markets. The December 2017 NAB Business Confidence Index shows businesses are reasonably optimistic and this is being translated in increased investment and job creation. More than 400,000 jobs were created in the past year – the strongest year of job creation over a calendar year on record. Not all of these jobs require an office, but many do, including the fast growing IT and finance sectors.

As a result of the tight office markets in Sydney and Melbourne, rental growth has been strong. According to CBRE, in 2017 office rents in premium buildings in Sydney CBD increased by 14.2% and in secondary buildings by 20.5%. It was a similar story in Sydney suburban markets, with North Sydney prime rents increasing by 15.4%. In Melbourne CBD, rents in prime buildings increased by 15.9%, whilst rents in secondary buildings increased by 13.4%. Unfortunately, for the Brisbane and Perth CBD's it's a different story. Prime rents in Brisbane CBD were flat and in Perth they fell 11.1% over the year.

“Most of Australia's office markets are in good shape”

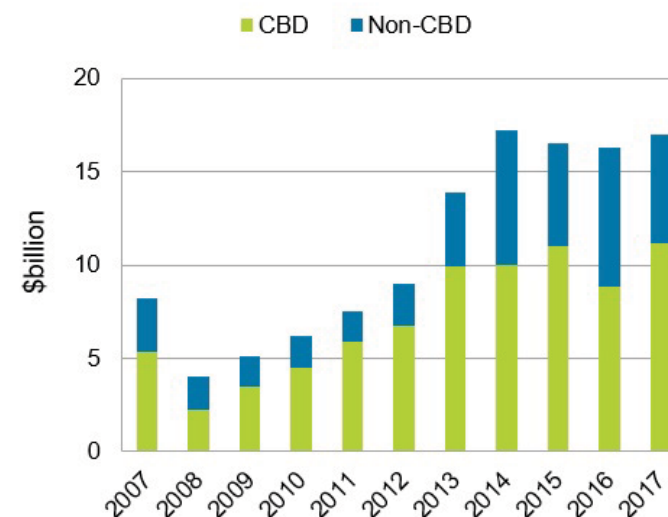
## OFFICE MARKETS

### A BELLWETHER FOR THE ECONOMY *continued...*

The combination of limited new supply in both Sydney CBD and suburban markets in the next few years as well as a reasonably strong economy, points to a positive outlook for Sydney. In Melbourne, although 450,000 square metres of new office space will hit the CBD market in the next three years, more than 50% of this space has been pre-committed and with little new space coming on line in Melbourne's suburban markets, the outlook for Melbourne is also positive.

It's not surprising that investors, both domestic and international, have been chasing office buildings. Across Australia, more than \$17.0 billion of office transactions occurred in 2017, up slightly on 2016 levels (Figure 2).

Figure 2: Australian Office Transactions: 2007 – 2017



Source: Knight Frank

The CBD markets accounted for \$11.26 billion and non-CBD markets \$5.84 billion of office sales in 2017. Sydney and Melbourne CBD office buildings were in hot demand, with \$4.98 billion and \$3.34 billion of transactions respectively. Sydney suburban office buildings were also in demand with just over \$3.0 billion of transactions being recorded. Yields on office buildings in these two markets have contracted to record lows. Prime yields in Sydney CBD are now just below 5.0% and in Melbourne they are hovering just above 5.0%.

Offshore investors accounted for 43% of all office sales in 2017 followed by unlisted funds/syndicates at 26% and A-REITs at 9%. If the highly influential ULI/PwC Emerging Trends in Real Estate Report is a gauge – offshore investor activity should continue this year. Based on a survey of more than 600 global institutional property investors, financiers and developers in late 2017, ULI/PwC identified Sydney and Melbourne as the two most attractive Asia-Pacific markets to invest in 2018 beating the regional powerhouses of Singapore, Shanghai and Hong Kong. Global investors now consider Sydney and Melbourne as gateway cities alongside New York, London, Paris, Singapore, and Hong Kong. This, combined with their market transparency, relatively

high yields (at least compared to other major global cities which are yielding between 3% and 4%) and the positive economic outlook are all key drawcards for global investors.

One of the most talked about issues in 2018 will be the landlord-tenant relationship. The chase for talent is on. You just have to look at the number of tech firms that have located in, and around, Martin Place (now referred to as Silicon Place) in Sydney – Apple, LinkedIn, Atlassian, Dropbox, Facebook and Tesla. People want to work in environments inside and outside the office where there is amenity. Today's tenants are using their office space as an employee attraction and retention tool.

At the same time, to take advantage of the growing number of start-ups and businesses wanting more flexible, “edgy”, collaborative space, we are seeing the rise of co-working spaces. Companies such as WeWork, HUB, Wotso and many others, are changing the game. These companies are leasing space from landlords and creating innovative workplace environments (Figure 3) that foster collaboration and networking, provide better amenity, and more flexible lease terms to occupiers. And, whilst it started out a few years ago as a place for start-ups and entrepreneurs to come together, share infrastructure and collaborate, large companies are also now using co-working places either as temporary project space, or places where they can send teams to innovate alongside start-ups.

Figure 3: WeWork Co-Working Space in Pyrmont, Sydney



Looking ahead, we expect the pace of office yield compression to slow and the focus to move to income generation as the primary driver of performance. In such an environment, asset specific factors will be critical including landlord tenant relationships, quality of tenants, lease expiry profile, location, and the active management of the building's facilities. With record high electricity prices, and electricity being one of the major costs of operating a building, efficient operating of the building will be crucial to optimising the bottom line.

**Adrian Harrington**  
Head of Funds Management, Folkestone



uncertain. Established positive trends in various market segments.

**SPECIAL OFFER**

# Refer a Friend

## AIA Membership Refer a friend \*3 months free

Regardless of your age or present level of wealth, the AIA can assist you with education and information to make better investment decisions. If a friend or relative joins as a result of your recommendation, both of you will receive an additional three months free membership.

Simply write your name and member number on the back of the referral card. This is our way of saying thank you for your recommendation. We also draw your attention to a new membership category, Student. Full time students under the age of 30 are welcome to join the association at the discounted rate of 50% off regular membership and no joining fee. ~ The AIA Board

## AN UNCONVENTIONAL INVESTMENT APPROACH

PORTFOLIOS ARE CONSTRUCTED FROM THE GROUND UP,  
DRIVEN BY INDIVIDUAL SITUATIONS  
AND NEEDS

# BESPOKE AND INDEPENDENT FINANCIAL ADVICE

# Calendar of Events

Please Note:  
As AIA events are confirmed,  
details are posted to the AIA website  
[www.investors.asn.au](http://www.investors.asn.au)  
Please note topic is subject to change.

DATE	DAY	TIME	EVENT	VENUE
NSW / ACT				
02-Mar-18	Friday	12.30pm	Hills District Discussion Group	Beecroft Presbyterian Church, Mary St Beecroft
07-Mar-18	Wednesday	7.00pm	Sydney Inner West Discussion Group	Birkenhead Hotel, 205 Lyons Rd Drummoyne
12-Mar-18	Monday	7.30pm	Canberra Discussion Group	Ginninderra Labor Club
14-Mar-18	Wednesday	7.30pm	North Shore Information Meeting	The Chatswood Club, 11 Help Street Chatswood
23-Mar-18	Friday	8.30am	AIA National Summit: Disruption...technological changes and the internet of things	SMC Conference and Function Centre, 66 Goulburn St Sydney
28-Mar-18	Friday	3.00pm	Northern Beaches Discussion Group	Dee Why Builders Club - 18 Fisher Rd Dee Why
04-Apr-18	Wednesday	7.00pm	Sydney Inner West Discussion Group	Birkenhead Hotel, 205 Lyons Rd Drummoyne
06-Apr-18	Friday	12.30pm	Hills District Discussion Group	Beecroft Presbyterian Church, Mary St Beecroft
09-Apr-18	Monday	7.30pm	Canberra Discussion Group	Ginninderra Labor Club
11-Apr-18	Wednesday	7.30pm	North Shore Information Meeting	The Chatswood Club, 11 Help Street Chatswood
27-Apr-18	Friday	3.00pm	Northern Beaches Discussion Group	Dee Why Builders Club - 18 Fisher Rd Dee Why
02-May-18	Wednesday	7.00pm	Sydney Inner West Discussion Group	Birkenhead Hotel, 205 Lyons Rd Drummoyne
04-May-18	Friday	12.30pm	Hills District Discussion Group	Beecroft Presbyterian Church, Mary St Beecroft
09-May-18	Wednesday	7.30pm	North Shore Information Meeting	The Chatswood Club, 11 Help Street Chatswood
14-May-18	Monday	7.30pm	Canberra Discussion Group	Ginninderra Labor Club
25-May-18	Friday	3.00pm	Northern Beaches Discussion Group	Dee Why Builders Club - 18 Fisher Rd Dee Why

## VIC

06-Mar-18	Tuesday	6.45pm	Geelong Discussion Group	St George Workers Club, Geelong West
07-Mar-18	Wednesday	1.00pm	Frankston Discussion Group	Private address; contact Bill Shirley for details: bill.shirley63@bigpond.com
27-Mar-18	Tuesday	7.00pm	Greensborough Discussion Group	Diamond Valley Library, Greensborough
28-Mar-18	Wednesday	7.00pm	Kew Discussion Group	Phyllis Hore Room, Kew Library
29-Mar-18	Thursday	4.00pm	Melbourne Bayside Discussion Group	Private address; contact Kevin Macdonald for details: km.macdonald@bigpond.com
04-Apr-18	Wednesday	7.30pm	Blackburn Discussion Group	Naturalist Club of Victoria, 1 Gardenia Street Blackburn
10-Apr-18	Tuesday	6.30pm	Melbourne Information Meeting	Telstra Conference Centre, Room 1, Level 1, 242 Exhibition Street Melbourne
24-Apr-18	Tuesday	7.00pm	Greensborough Discussion Group	Diamond Valley Library, Greensborough
01-May-18	Tuesday	6.45pm	Geelong Discussion Group	St George Workers Club, Geelong West
02-May-18	Wednesday	1.00pm	Frankston Discussion Group	Private address; contact Bill Shirley for details: bill.shirley63@bigpond.com
29-May-18	Tuesday	7.00pm	Greensborough Discussion Group	Diamond Valley Library, Greensborough
30-May-18	Wednesday	7.00pm	Kew Discussion Group	Phyllis Hore Room, Kew Library
31-May-18	Thursday	4.00pm	Melbourne Bayside Discussion Group	Private address; contact Kevin Macdonald for details: km.macdonald@bigpond.com

## QLD

07-Mar-18	Wednesday	1.30pm	Brisbane Information Meeting	Wesley House, 140 Ann Street Brisbane
13-Mar-18	Tuesday	7.00pm	Brisbane Managed Investments DG	Carindale Library, Carindale Shopping Centre
19-Mar-18	Monday	7.00pm	Chermside Equities Discussion Group	Chermside Library, Hamilton Road Chermside
21-Mar-18	Wednesday	7.00pm	Brisbane Equities Discussion Group	Carindale Library, Carindale Shopping Centre
21-Mar-18	Wednesday	6.30pm	Sunshine Coast Discussion Group	The Old Post Office, Buderim
04-Apr-18	Wednesday	1.30pm	Brisbane Information Meeting	Wesley House, 140 Ann Street Brisbane
10-Apr-18	Tuesday	7.00pm	Brisbane Managed Investments DG	Carindale Library, Carindale Shopping Centre
16-Apr-18	Monday	7.00pm	Chermside Equities Discussion Group	Chermside Library, Hamilton Road, Chermside
16-Apr-18	Monday	9.30am	Gold Coast Information Meeting	Helensvale Community, Centre 31 Discovery Dr Helensvale
18-Apr-18	Wednesday	7.00pm	Brisbane Equities Discussion Group	Carindale Library, Carindale Shopping Centre
18-Apr-18	Wednesday	6.30pm	Sunshine Coast Discussion Group	The Old Post Office, Buderim
02-May-18	Wednesday	1.30pm	Brisbane Information Meeting	Wesley House, 140 Ann Street Brisbane
08-May-18	Tuesday	7.00pm	Brisbane Managed Investments DG	Carindale Library, Carindale Shopping Centre
16-May-18	Wednesday	7.00pm	Brisbane Equities Discussion Group	Carindale Library, Carindale Shopping Centre
16-May-18	Wednesday	6.30pm	Sunshine Coast Discussion Group	The Old Post Office, Buderim

## SA

13-Mar-18	Tuesday	7.00pm	Adelaide Information Meeting	Fullarton Park Community Centre, 411 Fullarton Road Fullarton
17-Apr-18	Tuesday	7.00pm	Adelaide Information Meeting	Fullarton Park Community Centre, 411 Fullarton Road Fullarton
08-May-18	Tuesday	7.00pm	Adelaide Information Meeting	Fullarton Park Community Centre, 411 Fullarton Road Fullarton

## WA

06-Mar-18	Tuesday	7.30pm	Perth Information Meeting	Wembley Downs Tennis Club, cnr Morden & Ednah Streets Wembley Downs
20-Mar-18	Tuesday	7.30pm	Perth Discussion Group	Wembley Downs Tennis Club, cnr Morden & Ednah Streets Wembley Downs
03-Apr-18	Tuesday	7.30pm	Perth Information Meeting	Wembley Downs Tennis Club, cnr Morden & Ednah Streets Wembley Downs
17-Apr-18	Tuesday	7.30pm	Perth Discussion Group	Wembley Downs Tennis Club, cnr Morden & Ednah Streets Wembley Downs
01-May-18	Tuesday	7.30pm	Perth Information Meeting	Wembley Downs Tennis Club, cnr Morden & Ednah Streets Wembley Downs
15-May-18	Tuesday	7.30pm	Perth Discussion Group	Wembley Downs Tennis Club, cnr Morden & Ednah Streets Wembley Downs



# IP rich content and global brands verses bricks, digging holes and tech unicorns

With tech unicorns hitting saturation point across Venture Capital funds in Australia, exploratory mining companies continuing to try their luck underground, and the dangerous amount of property taking up portfolios, media as an asset class is arriving just in time. The rapid evolution of technology has caused a massive disruption on all aspects of the media industry. Thanks to technology we now have easy access to connectivity, interactivity, convenience, personalisation and portability of content. Investors can now invest in media via Venture Capital and Private Equity, and

benefit from media's potential to generate substantial capital growth and income.

Learn about the key content areas that dominate today's media including news, sports, education and entertainment and why there is underway a democratisation of content for all audiences across all media. When investing in media, the underlying asset must be innovative and focused on content creation, ownership and/or distribution businesses with the potential to reach a global audience.

Learn how we identify high-growth media assets and why it's crucial to invest throughout the business cycle from start-ups, to revenue generating growth stage and late-stage exits.

Learn what this exciting industry is developing, how global brands leverage their IP for profit, and peer inside the world of merchandise, gaming and online content consumption.

## Holly Grofski

Managing Director and CEO,  
Global Mercus Funds Management



**Holly Grofski** leads the success and growth of the funds management, strongholds of GMFM. Those who met Holly speak of her passion, drive, healthy scepticism and how she has been leading by example to modernise financial services within Australia's complex

compliance environment. Holly's focus is building a team of specialists to catapult the Global Mercus suite of modern investment products such as the GM Media Fund into the powerhouse of expertise, commercial capability, customer focus and innovation they have become known for.

## Sander Schwartz

Independent Executive Producer and Content Advisor



**Sander Schwartz** develops live-action and animated content for exhibitors and distribution platforms in the media landscape. He provides advisory services to TV and Film companies and respecting development, production, and distribution of programming for

traditional and new media. Sander joined Warner Bros. from Sony Pictures Family Entertainment (SPFE), where he served as the division's first President. As President of Warner Bros. Animation he was responsible for the production of theatrical, television and made-for-video animated programming.

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Dates to be announced, visit our website for specific dates in March.

[www.globalmercus.com.au/events](http://www.globalmercus.com.au/events)

For further event related enquiries or requests. Please contact:

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International Client Services Director

**+61 424 802 961**



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