UNCONVENTIONAL WISDOM | *Unique investor insights from Wattle Partners*

December 2021

The month that was…

- Despite the all too regular commentaries focused on fear, uncertainty and doubt, investment portfolios delivered another strong year of returns in 2021. Whether it was the spread of the Delta Variant, unexpected inflation, the Evergrande default or more recently the Omicron outbreak, investors had little choice but to accept risk in 2021. And in most cases, they were rewarded. A brief look at the performance of the major asset classes is evidence of this, with research house Morningstar's benchmark 'Balanced' portfolio returning around 11 per cent for the year. This remains well ahead of return objectives for this level of risk, which are typically 3 to 4 per cent above inflation. Once again, equity markets were the primary driver of returns, with the MSCI World Index returning 25 per cent, outperforming the ASX's return of 13 per cent.

- This last point is an important one to stress for readers, with many people still perceiving global investments as being higher risk than Australia. Whilst Australian equities delivered a strong return given the circumstances, they were somewhat held back by the old-fashioned composition of the index which despite being in traditional 'value' sectors like financials and materials, couldn't keep up with their global counterparts. A closer look at the sector returns for the year shows that it was indeed those more cyclical and, in many cases, lower quality, companies that drove returns, with telecommunications leading the pack surging 28 per cent, followed by property trusts, retailers and the financial sector all around 20 per cent. As many predicted, the winners of 2020, being strong, defensive and consistent, albeit expensive, companies were the losers of 2021 with the likes of CSL and Woolworths anchoring the consumer staples and healthcare sectors to below index returns. Surprisingly, the resurgent energy sector and booming technology were the only sectors to post negative returns for the year.

- This trend accelerated in the final month of the year, as news that global central banks would be withdrawing liquidity from the market saw traders pull capital from the more expensive technology name. The result was a more than 5 per cent sell-off domestically, as Afterpay, Zip and their many competitors were brought back down to earth. The full sector returns are shown in the table below.

Sector	December	Quarter	Year
A-REIT	3.8%	8.9%	21.6%
Communications	0.8%	4.9%	28.5%
Cons. Discretionary	1.0%	0.0%	21.3%
Cons. Staples	-2.4%	-0.5%	7.1%
Energy	2.3%	-8.8%	-2.0%
Financials	4.3%	-3.3%	20.2%
Healthcare	-2.4%	-0.1%	8.0%
Industrials	3.6%	1.1%	11.2%
IT	-5.4%	-6.1%	-2.8%
Materials	6.4%	12.4%	6.8%
Utilities	6.9%	10.0%	4.6%
Small Ords	1.1%	1.6%	14.2%

- As we touched on above, December marked the end of what has been close to 15 years of 'unconventional' monetary policy. Both the Federal Reserve and Reserve Bank of Australia made the somewhat expected decisions to begin tapering their bond purchases, or what many term money printing. This will occur over the coming months, to end by around the middle of next year, withdrawing hundreds of billions of liquidity from the market. Despite concerns that this event would lead to a 'taper tantrum' and market sell-off like what occurred in 2012 and 2016, markets rallied on the news, buoyed by the fact that it meant the economy may actually be improving. Tapering bond purchases is one thing, increasing interest rates is another entirely, and whilst expectations for 2022 rate hikes continue to grow, the yield curve suggests they are increasingly unlikely.

- This last point may well dominate the trajectory of markets in 2022 and beyond, with several central banks including the UK and New Zealand, offering real-time insight into whether the decision was the correct one. With the majority of inflation coming from just a few sectors and slowing of global growth expected once the pandemic benefits dissipate, they may well be putting a brake on an economy that is already beginning to slow, exacerbating the problem they were trying to avoid. From an investment perspective, it leaves retirees with a difficult choice. With volatility expected to increase and sharemarket valuations historically high, can you afford to move money back to traditional cash and fixed income investments even though they offer little in the way of returns?

- Expanding on this, it is worth highlighting that a significant portion of the equity market performances in 2021 was driven by earnings growth. There has been little in the way of multiple price-earnings ratio expansion, with many of the world's leading companies simply selling more product and doing so at higher prices than before. This has been a key driver behind the S&P500's 26 per cent return and the Nasdaq's 21 per cent result. You could not find a better example of this than Apple, which recently surpassed a US$3 trillion valuation, making it the most valuable company in history. It has done so despite a long list of experts saying they were ex-growth as much as a decade ago and through the dominance of both the services and hardware sectors of technology.

- Omicron became real over Christmas, with a pervading feeling, in the south at least, that political leaders were 'letting it rip'. After years of seeking 'donut' case numbers, to see these spike into the tens of thousands has likely uncomfortable for many, but particularly those planning travel or events. The impact of last year's lockdowns may well not be felt again, but the implications of isolation periods on supply chains and eventually retail spending is now an underappreciated risk to Australia's expected 2022 recovery. Only time will tell how difficult this gets, but it remains clear that the central bank is unlikely to raise rates in this environment.

- December saw the fall from grace to one of Australia's limited numbers of global success stories, as fund manager Magellan Group saw its share price sold off heavily. The negative sentiment remains focused around their relative underperformance against the booming global benchmark index, despite delivering near ten per cent returns for more than a decade. This expanded into the personal sphere in December, when the CEO quit, and it was confirmed that the CIO Hamish Douglass and his wife had separated. Whilst each of these events alone were of limited concern, news that their largest customer, St James Park of the UK, had pulled their mandate in favour of a low-cost provider sent the share price spiralling. Despite the negativity, this may well be the ultimate contrarian play at current prices.

- Finally, the year ended as it started, with a flurry of corporate activity and acquisitions. Pension funds acquisition of Sydney Airport was approved, whilst both CSL and Ramsay put their prospects firmly into the future announcing significant acquisitions of ancillary businesses.

  Surprisingly, property fund manager Charter Hall, announced the purchase of equity manager Paradice, just as Christmas neared.

  According to experts, this deal flow is set to persist as we move into 2022.

Model Portfolio Update

- Investment Committee -

Index	Index Points - November	Index Points - December	Performance	
			1 Month	1 Year
S&P/ASX 200	7239.8	7444.6	2.6%	13.0%
All Ordinaries	7562.5	7779.2	2.5%	13.6%
US Dow Jones	34483.7	36338.3	5.4%	18.7%
US S&P 500	4567.0	4766.2	4.4%	26.9%
Hang Seng (HK)	23475.3	23397.7	-0.3%	-14.1%
FTSE 100 (UK)	7059.5	7384.5	4.6%	14.3%
Nikkei 225	27821.7	28791.7	3.5%	4.9%

Top 5 Performers	1 Month	Bottom 5 Performers	1 Month
National Australia Bank	9.3%	Magellan Financial Grou	-36.0%
Origin Energy	9.2%	Woolworths Ltd	-6.9%
Commonwealth Bank of Australia	8.4%	CSL Ltd	-5.2%
Wesfarmers	8.1%	Cooper Asian Equities F	-2.1%
Magellan Infrastructure Fund	7.3%	Firetrail Absolute Return	-2.0%

Once again, every asset class delivered a positive return during the quarter with only one investment falling more than 5 per cent, being Magellan (-39 per cent). The result was another strong quarter for the Balanced Growth Model Portfolio, with outperformance against the primary benchmark continuing. It is worth highlighting that the returns achieved in 2020 and 2021 will be very difficult to replicate in future years and will likely require more active management.

Cash & Fixed Income

The fixed interest allocation was the weakest performer, as central bank policy around the world saw quantitative easing come to an end and highlighted the risk of rate hikes. The index suffered its worst monthly drop in history in October, down 3.5 per cent, but the more flexible and high-quality Franklin and Ardea funds easily outperformed their benchmark. Hybrids rallied after a strong reporting season gave comfort in their capital security. Despite low returns, the allocation remains key to meeting cash flow needs and having dry powder for opportunities.

Equities

The allocation to global equities remains the core driver of returns within the portfolio, despite underperforming the benchmark during the quarter. This has been due to the incredible recovery from the more cyclical sectors of the global economy, being mining, banking and energy and our preference for higher quality, growing companies for the global market exposure.

Sustainability, clean energy and more responsible investments delivered the strongest returns in the quarter following the COP26 conference, with Nanuk's New World Fund the standout. The tactical weighting to 'smaller' growing companies has also been a key source of returns,

The domestic equity allocation was able to overcome a highly disappointing quarter from Magellan and still outperform the benchmark. The portfolio carries a tactical tilt towards more cyclical and 'undervalued' businesses which were central to the strong performance as the technology sector dragged on the index. Macquarie Group remains the standout reaching a record high just 18 months on from the pandemic, announcing a capital raising to fund an aggressive acquisition strategy.

Origin Energy and BHP, being the core energy and materials exposures, were among the strongest as the reflation of the global economy supported commodity prices. Telstra reached a 52-week high as the year came to a close and NAB (8.0) is clearly closing the gap on the other majors in home loans.

Both the growth and defensive alternative allocations delivered positive returns that outperformed the index; this despite inflation hitting 3 per cent during the quarter. On the defensive side, gold bullion was the standout as investors sought hedges amidst a spike in inflation and expected volatility. The decision to increase exposure to institutional-grade property paid off, with funds seeing stronger valuations as the reopening of the economy spurred investors.

The Firetrail fund continued to underperform, which is somewhat expected given the role of the long-short strategy is to deliver positive returns when markets fall. Magellan's infrastructure strategy is nearing breakeven after a difficult few years gaining 8.4 per cent in the quarter with the fund benefitting from the global energy crisis and a pivot towards reopening beneficiaries.

Investment updates

National Australia Bank (ASX: NAB)

NAB managed to avoid the issues faced by both Westpac and ANZ, becoming a clear second in home lending in the quarter behind CBA, with loans growing above system growth rates. The result was a 77 per cent increase in cash profit to $6.56 billion for the 12 months and a doubling of the dividend to 67 cents.

This strength came despite another fall in the net interest margin, triggered by cuts to the RBA's lending program, but likely offset by out of cycle rate increases by the bank and more success on their cost-cutting program. NAB announced they would be exiting lending to oil and gas projects from 2026.

Origin Energy (ASX:ORG)

Improving oil and LNG prices have "brightened the profit outlook" for this value play showing the sector is clearly moving in the right direction. The company announced it had triggered the sale of another 10% of the APLNH project for $2.12 billion with their existing partner to take up the share.

Origin will retain 27% of the important strategic asset amid the energy transition. Their investment in renewable energy group Octopus has now tripled in value in just 12 months, with their $505 million investment looking prescient as the technology edge of the company sees significant demand.

CSL (ASX: CSL)

CSL's share price struggled to keep up with the more popular, but lower quality cyclical and high growth sectors that have driven the index in recent months. The company failed in their bid to be compensated for the revenue impact of US/Mexico border closures on its blood plasma collection business.

Management confirmed their resilience with single-digit profit growth to be supported by a 2 to 5 per cent increase in revenue. The company looks to be successful in acquiring Vifor Pharma for $16.4 billion with the company's speciality in treating renal diseases and iron deficiency as a unique diversifier.

Ramsay Healthcare (ASX: RHC)

Ramsay outperformed after bungling one acquisition but ultimately delivering the second, the purchase of Elysium Healthcare. The group specialises in mental health treatment in the UK with over 70 individual sites, coming at a cost of $1.4 billion. It marks a return to their foundation for the Ramsay group.

Revenue growth remains capped by the ongoing impacts of the pandemic, with sales just 1.3 per cent higher and earnings down 30 per cent despite improving signs in both the UK and Australia. Given high vaccination rates, an impending boom in elective surgeries should provide an earnings tailwind in 2022.

Wesfarmers (ASX: WES)

Wesfarmers appears to have won the battle for Australian Pharmaceutical, owner of the Priceline chain of pharmacies, stating they would increase their off and were the natural partner after competitor Woolworths lobbed a competing bid above the $1.55.

Management highlighted robust sales at their dominant Bunnings franchise as trading exceeded pre COVID-19 conditions delivering outperformance in the quarter. This saw an earnings upgrade despite the Target and KMART businesses being the worst hit by lockdowns.

Magellan Infrastructure Fund

Despite being hit heavily by the pandemic; this infrastructure strategy is finally nearing previous highs supported by an increased wall of capital in the form of infrastructure stimulus focused on decarbonisation across the world. Shares in Spanish electricity generator Red Electrica benefits from the energy crisis.

It was a similar story for US generators Eversource and Xcel Energy. Toll road operators Vinci and Transurban struggled as the Delta variant hit earnings. The fund is now 50 per cent allocated to the US, 22 per cent integrated power and 15 per cent in toll roads both of which will benefit from higher inflation.

Nanuk New World Fund

Stock selection drove the sustainability-focused Nanuk fund to the top-performing fund for the quarter, with Accton and Ciena key contributors. Both sell digital networking equipment including modems and switches which have seen huge demand as the impacts of the pandemic linger into 2022.

Sprouts Farmers Market gained 30 per cent after the seller of organic produce delivered an earnings result that was 40 per cent ahead of expectations. Amphenol, which supplies fibre optics to the EV industry, and Tandem Diabetes Care were added, with industrials remaining the top sector exposures.

SMSFs, are you ready for the Director Identification regime?

- Drew Meredith -

The beginning of November welcomed a new identification regime from the Australian Tax Office (ATO). With most of us accustomed to the QR code and check-in apps that have come with the pandemic, the Director Identification Number (DIN) is likely just another hoop to jump through.
Launched by the ATO on the 1st of November, the legislation will require everyone who is a director of

any company, including SMSF corporate trustees and corporate beneficiaries, to obtain a DIN. Importantly, this is something that cannot be completed by your accountant, it must be done personally via the ATO portal.

The SMSF Association recently publicised a white paper to assist in navigating the legislation, defining and outlining the process of applying for a DIN.
So, what is it? A DIN is a unique identifier, not dissimilar to a tax file number. Every director will be required to have one, but those with multiple directorships only need to register once. DIN will not change and be in place forever, even if you remove all of your directorships or change your need.

DINs were introduced as part of the Government's Digital Business Plan, which is an effort to modernise its operations and business registers. Central to the premise is the prevention of false and fraudulent behaviour, and to improve the efficiency of the future registration obligations. Similarly, it will allow the ATO to better trace director activity and relationships while improving the integrity of the ATO's data.

When do I need to apply?

For those that was a director of any company or SMSF trustee before 31 October 2021, they will need to personally register for a DIN before 30 November 2022. If you establish a company between today and the 4th of April, you will have 28 days to register and from that point onwards you will need to be registered before even setting up an SMSF.

What is the registration process?

Importantly, everyone will need to apply for the DIN personally; accountants and financial advisers are not able to do this on your behalf. There are three key steps:

1. Set up your myGovID if you don't already have one;
2. Put together your identification information to ensure your accountants can be linked, including your TFN, passport and Medicare card.

Five reasons to review your will

- Rachana San -

Estate planning is among the least talked-about parts of any financial plan yet given the growing level of wealth in Australia it is likely to be one of the most important.

This is particularly so in an age where blended families are more common than ever, and we are about to see the biggest redistribution of wealth from one generation to the next in history.

It is around this time of year that we tend to be inundated with requests to arrange for reviews of wills, powers of attorney and the like, as family gatherings draw attention to what matters.

In my experience, wills and estate plans more generally should be reviewed at least every three years, if not before, when significant events occur. Here are the five key reasons why you should review your will today:

Divorce or marriage

Major life events can render your will invalid, or at worst result in your estate being paid to someone other than whom you wish to receive it. In this case, you will likely be awarded based on the advice of a court or a tribunal, attracting the associated legal costs. Therefore, the first trigger for reviewing your will is if you have divorced, married or remarried since your previous one was drafted.

Children growing up

While this wouldn't necessarily trigger a review, as your children grow up and have families of their own their circumstances, and your views may change towards their inheritance. That is, you may wish to provide ongoing specific support to education expenses of grandchildren, detail a number of bequests or something similar.

Don't include testamentary trusts

Testamentary trusts remain one of the most misunderstood parts of any estate planning package, yet they are among the most tax-effective. They are by no means forced on beneficiaries but rather allow them to receive their inheritance in the most tax-effective way possible. At best, these trusts allow your beneficiaries to distribute to children at adult marginal tax rates. Unless your will is 10 to 12 pages long, you don't have a testamentary trust, as the deed acts as your 'trust deed'.

Assets have changed

The world is moving so fast these days that our financial circumstances can change in any given year. If your asset base changes significantly enough, whether, through a business or investment windfall, or bankruptcy, you should pull out a blank piece of paper and reconsider your intentions. This also includes superannuation which is a non-estate asset.

Too specific/not specific enough

Similar to above, when drafting a will our views may be different to what they are today. When it comes to estate planning, you can be as prescriptive or flexible as you like, controlling income and capital distributions or allowing a 'free for all'. If your will is overly prescriptive, you have a spendthrift child or your views have simply changed, now is the time to review it.

Subtle shifts highlight new paradigm for fixed income

- Drew Meredith -

Change of objective highlights risk of negative bond returns

A quiet announcement from one of Australia's leading industry/union super funds at the beginning of December piqued my interest. The announcement came amid a busy week for investment announcements, with nearly every investor offering up an outlook statement.

But this one was much more straightforward and delivered without any fanfare. It was the decision by the super fund and its investment committee to change the investment objectives for one of its investment options. On its own, it wouldn't make the news cycle, but the message it sends may be significantly more powerful.

The decision related to a fixed-interest option within the fund's investment menu, with the current absolute-return benchmark, pegged to 1-2 per cent above the rate of inflation (or CPI), effectively being abandoned. The absolute-return benchmark will be replaced with one squarely focused on relative returns, being a combination of two of the major fixed-income benchmarks in Australia.

The Your Future, Your Super legislation, which came into force on 1 July 2021, may well have been a precursor to this decision. Under these changes, every major pension fund is now being compared to a series of passive index benchmarks with underperformance potentially resulting, in the worst case, in an inability to take on new members.

Naturally, in this environment, the first reaction is to simply gravitate towards said index rather than risk making active decisions that cost the fund members in the longer term. That may well have been the case for this change, but as an experienced adviser, there is another clear reason: bond rates.

For anyone that has been around long enough, it is now obvious that the precipitous fall in interest rates from as high as 19 per cent in the 80s down to 0 per cent today, has been a key driver of returns in both equity and bond investors for several decades. Yet as it stands today, there is literally no other way but up for interest rates in the next three decades.

While there is disagreement on how fast this will occur, there is clear agreement that this will be a difficult time for those investing in bond markets, but particularly those investing in passive index-linked strategies. This is because any increase in interest rates, or even prevailing bond yields, will result in capital losses, sometimes significant, for those holding long-duration bonds in their portfolio.

With the traditional fixed-income benchmarks carrying a duration of around six years, this means a 1 per cent increase in yields will translate into a 6 per cent capital loss. Now, you can likely see where I'm going. In an environment where inflation is increasing, and with interest rates likely to follow (at some point), attempting to outperform a CPI-linked benchmark with long-term bond investments is near-impossible.

For the true pessimist, you could suggest that the change in investment objective may well be the realisation and acceptance that fixed-income returns will be negative in the years to come.

Shipping coal, but doing it net-zero. Come again?

- James Dunn -

Is this greenwashing, or simply a business trying to ensure that its operations are conducted as responsibly as possible?

Dalrymple Bay Infrastructure Limited (ASX: DBI), which was listed in December 2020, is a unique business; it operates a major infrastructure asset – the Dalrymple Bay Coal Terminal on the central Queensland coast – that ships coal for export. That's all it does.

Last month, DBI announced that it had secured an electricity sale agreement, with 100% renewable benefits, through buying large-scale generation certificates (LGCs), to take effect from 1 January 2023, for an initial eight-year term.

This was reported in the renewable-energy media as DBI "going to 100% renewable electricity," but it is important to remember that these renewable consumption figures are not meant to be literal: the company isn't going to be "100% renewable-powered" – it will still be accessing its electricity from the grid.

Instead, DBI will acquire, and will voluntarily surrender, LGCs created by its partner, CleanCo Queensland Limited, a Queensland Government-owned renewable generator and retailer. CleanCo is expected to source those LGCs in the first instance through its arrangement with the Western Downs Green Power Solar Hub, which is expected to be commissioned in late 2022, and subsequently, the MacIntyre Wind Farm, which will be commissioned in 2024.

As Western Downs and the MacIntyre Wind Farm generate power and export it into the grid, CleanCo will create LGCs. The entity that buys, and then surrenders these LGCs to the Clean Energy Regulator – that is, DBI – is the entity that is deemed to be the user of the renewable electricity that is fed into the grid.

There won't be a renewable energy plant next door to the terminal – DBI will still obtain all of its electricity from the grid to power all the electricity for the conveyers and loaders that transfer coal from trains into holding yards and then onto the ships that are docked – but from 2023, DBI will be able to say that it has the equivalent amount of electricity that it uses from the grid created from renewable sources (that are all feeding their electricity production into the grid) and allocated to it through the LGCs.

It is different to using offsets, but it has the same effect, in that DBI will be able to "account for" all the grid electricity it uses, through the LGCs it buys and surrenders.

In this manner, DBI will meet a crucial plank of its sustainability strategy, in terms of its energy use, in negating the emissions generated by the electricity it uses and can be in a position where it can say that it is conducting its business sustainably.

That business being the shipping of coal for export. But don't rush off to tar-and-feather DBI for this.

As DBI takes great pains to point out, the great bulk of that coal is metallurgical, or coking coal, which is steelmaking coal – and the need for steel is not going away anytime soon.

To a large extent, steelmaking coal demand is underpinned by the fact that the dominant technology for reducing iron to make steel is the blast furnace which processes iron ore and metallurgical coal, and produces most of the world's steel, even though it is an emissions-intensive method.

Despite the growing use of electric arc furnaces (EAFs) in recent years – which use scrap steel and are lower in emissions – and direct reduction iron (DRI)-fed EAFs, the basic oxygen furnace (BOF), or "blast furnace" process, which uses iron ore and steelmaking coal, remains the dominant steelmaking process. The great bulk of China's steel production, for example, requires advanced high-strength steel, which cannot be manufactured by EAF.

The production of advanced high-strength lightweight steels used in auto manufacturing, construction and for infrastructure such as wind turbines requires tight control of steel chemistry, which can currently only be achieved with BOF. According to Reserve Bank of Australia (RBA) research, 90% of China's steel is made using blast furnaces, compared to about 55% in the rest of the world.

There is a lot of talk of using hydrogen and renewable energy to make "green steel" – a lot of that talk emanating from Fortescue Metals Group and its founder, Andrew Forrest.
Fortescue says it is building Australia's first green steel pilot plant this year and a commercial-scale plant in "the next few years." But meaningful scale will be decades away.

In the meantime, huge amounts of steelmaking coal will be needed – for many years. And a lot of it will be shipped through the Dalrymple Bay Coal Terminal.

Dalrymple Bay is the world's largest coking coal export terminal. The terminal ships 82.4 million tonnes a year (mtpa) of coal, 82% of which is steelmaking coal, with 18% thermal (electricity) coal.

It handles 26% of Australia's metallurgical coal exports, which means 17% of global metallurgical coal exports. The terminal ships coal to 23 countries, with the main markets being Japan, China, Korea, India and Taiwan. The terminal is used by 17 coal mines in the Bowen Basin.

Under the terminal's current 8X expansion plan (not eight times), potential capacity will grow from the current 84.2 million tonnes a year to 99 million tonnes a year. Then, it is projected that the "9X" stage of the expansion plan will take capacity to 136 million-tonnes-a-year.

Australia's exports of steelmaking coal are forecast to grow from 180 million tonnes in 2019 to 211 million tonnes in 2025, with Queensland and the Bowen Basin being the largest sources of increased volume. More than 60 million tonnes a year of new metallurgical coal production is expected to come onstream from the central Bowen Basin over the next 19 years, according to commodities research firm AME.

For DBI, the LGCs deal is a step towards its commitment to achieving net-zero Scope 1 and Scope 2 emissions at the coal terminal by 2050, with Scope 2 electricity emissions representing around 98% of the terminal's greenhouse gas emissions each year. (DBI's Scope 1 emissions, that is, direct emissions from activities undertaken, mainly come from diesel fuel; the terminal's Scope 2 emissions are indirect emissions due to electricity use.)

"As outlined in our 2021 Sustainability Report, we recognise that while the steel industry is carbon-intensive, it has an important role to play in the transition to a low-carbon economy," says DBI CEO Anthony Timbrell. "Through our efforts to minimise our energy intensity, we can actively contribute to the decarbonisation of the steel supply chain."

Of course, for hard-core greens, that is not great news, because even in steelmaking, coal is burnt, and creates emissions. DBI's Scope 3 emissions – the indirect emissions that occur downstream – don't bear thinking about, because steel mills and coal-fired power stations create a lot of greenhouse gas emissions.

Rather than see DBI become a net-zero-emissions business in terms of its operations, hard-core greens want it out of business altogether – because then, coal would be "dead."

But in the real world, steel is required (as is 24/7 dispatchable baseload electricity.) In the meantime, DBI will keep on shipping coal. And at the end of the day, that is the investment case for DBI – that it is a high-quality infrastructure asset, in an essential trade. And investors can clip the ticket on the coal shipments.

If your ESG views preclude coal exposure, of course, that will not interest you.

For FY22 (DBI uses the calendar year) the consensus of analysts polled by FN Arena expects a dividend of 18.6 cents from DBI and 18.7 cents in 2023. At a share price of $2.08, that equates to an unfranked yield of 8.9% this year and 9% in 2023. That is well and truly worth considering for an income-generating portfolio – especially with the consensus of analysts' target prices for DBI coming in at $2.59.

SMSF legal disputes on the rise

- Drew Meredith -

Most people are well aware of the many benefits of family trust and self-managed super fund (SMSF) structures, but less so about the potential drawbacks. That is something reflected in the surge in legal disputes between trustees of both structures thus far in 2021, according to Marie Brownell, national manager of estate planning at Equity Trustees.

"Legal disputes over trusts are on the increase," she said in a recent update to the market. As one of Australia's leading independent trustee services, Equity Trustees sees this firsthand.

The taxation benefits of trusts along with the significant control that both they and SMSFs offer to the trustees have been a driving force behind their popularity. So much so, that there are now 600,000 SMSFs, with more than 1.1 million-member/trustees.

Yet many people forget that both these structures are non-estate assets, meaning they are not automatically included in the distribution and consideration of your estate; in fact, by default, they may avoid it all together.

This is an issue highlighted in a recent court case by Brownell, dubbed Wareham v Marsella. In this case, an SMSF was established by the deceased, naming only her daughter as the other trustee of the fund. Upon the member's death, the daughter assumed control of the assets, paying them to herself and effectively cutting out the deceased's surviving husband.

Naturally, the husband challenged the will and won in all three of the claims made about the inappropriate transfer of the funds, but it isn't always this easy, and legal costs accrue regardless of the result.

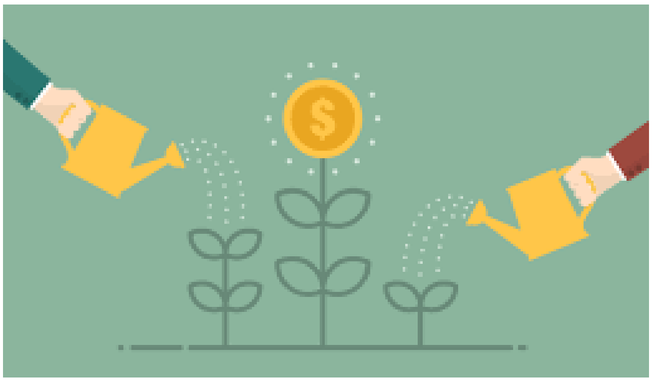
"A common issue we see with trusts is where someone has gone to their accountant to seek advice on how to minimise tax. The accountant then uses an off-the-shelf trust which is often not drafted properly," says Brownell. The use of DIY, low-cost trusts may be great in terms of quick implementation, but few give much flexibility in the long term.

The solution suggested in the case of SMSFs is to ensure you have a binding death benefit nomination in place at all times and that it complies with your trust deed. Similarly, in the case of trusts, review your deed regularly to ensure the passing of power, such as the role of the Appointor, is clearly defined in your will.

Most importantly, Brownell highlights that "what's usually overlooked is who that continuing trustee might be. If it's someone who stands to benefit themselves, in a manner contrary to your wishes, then you need to carefully consider what steps you need to take to ensure your death benefit is paid as you intend."

Passive investors 'losing out'

- Jamie Nemtsas -



The passive vs. active debate has now been around for several decades, effectively starting when Jack Bogle founded Vanguard in the 1960s. While headlines highlighting the below-average performance of 'active' managers make for great headlines, they offer little insight into what is actually occurring in equity markets around the world.

Peter Lynch is a well-known author and active investor, having written bestsellers including 'Beating the Street' and 'One up on Wall Street'. In an interview with Bloomberg this week discussing a significant charitable donation, Lynch suggested that those investors relying solely on passive options that track say, the S&P500 or S&P/ASX200, were "losing out".

In fact, he went even further, saying that "the move to passive is a mistake," and ultimately referring to the sustained success and outperformance of his original suite of active funds, dubbed Magellan, and run by the team at Fidelity.

His comments were echoed while mindlessly scrolling through social media late at night, as many of us do, and stumbling on the extensive comments list accompanying recent posts from "finfluencers" and other investment commentators. In this case, they were referring to the recent "blip" on markets that had seen the index fall as much as 5 to 6 per cent in a few days.

Passive index funds and ETFs have been among the most popular options recommended and utilised by millennials, given their low cost, diversification and ease of implementation, many of which attributes I agree with. But I couldn't help but feel the untested assumption held by many that investing is 'easy'. That is, there is a general feeling that by simply buying and holding any index fund, your money will always go up over time.

A similar trend is occurring in discussions around the residential property, with many people extrapolating recent returns into the future in perpetuity. They may well be right, but anyone who has been involved with investing knows that markets do not move in a straight line, nor do they always go up.

The investment conditions of 2020 and 2021, or even going as far back as 2015, have been near-perfect for passive investment strategies. Buoyed by what at the time was unconventional policy support, investors were rewarded for taking a risk in almost every asset class. But you only need to look closer at the long-term returns chart to know that markets can sustain periods of significant underperformance and in some cases remain flat for as long as a decade.

There was a great deal of encouragement about staying the course, investing in what are unique conditions, with a swift rebound from a 5 per cent drop seen as showing patience by not selling. Yet it was only 18 months ago that global sharemarkets dropped as much as 40 per cent in just a few weeks.

This isn't to say that investing in passive funds is wrong, quite the opposite. What I'm really trying to stress is that an investment in passive is just that, an investment in the index. You are guaranteeing a market return regardless of what that market does. Given the growing divergence, shifting geopolitical and economic landscape, it seems to me that it still makes sense to combine both passive and active approaches, not go all-in on either.

COVID winners dumped from S&P/ASX200

- Drew Meredith -

The future of the S&P/ASX benchmark may well have been on show this week when Standard & Poor's delivered the latest update to their key indices. There was little change at the top of the market, with neither the ASX20 nor 50 seeing any new inclusions.

That said, there are a number of major events on the horizon as the decision to remove the dual listing of BHP (ASX: BHP) is set to see its weighting in the index almost double to 10 per cent, whilst investors wait with bated breath for Afterpay (ASX: APT) impending takeover by Square Payments (NYSE: SQ).

Moving down the market capitalisation spectrum and it starts to get interesting, in fact it may well provide some insights into why several companies have been performing so strongly (or poorly) in recent weeks.

Entering the ASX100 for the first time is combined lithium miner Orocobre (ASX: ORE) which has surged to a market capitalisation of close to $6 billion after merging with Galaxy Resources (ASX: GXY) earlier in the year. The combination of surging flows into thematic ETFs and strong pricing of lithium as the electric vehicle production boom continues has benefited the group.

Link Administration (ASX: LNK) has been replaced by the surging new world stock, with Link clearly in the old-world camp. The company provides outsourced administration services to superannuation funds along with its share registry business. After knocking back an offer from private equity the share price fell significantly, only to see private equity return, hopefully a better result for shareholders this time.

Looking at the ASX200 and it is a story of 'what could have been'. Two companies that were the clear winners of the pandemic, being Kogan (ASX: KGN) and Redbubble (ASX: RBL) look to have fumbled the opportunity of a generation, with both down 63 and 47 per cent year to date respectively. Despite massive increases in sales and surging member numbers, one struggled with over stocking and the other an inability to cross sell products other than facemasks.

Two other beneficiaries at different ends of the spectrum are prospective uranium miner Paladin (ASX: PDN) who are seeking to restart operations after a close to a decade without revenue or income. Novonix (ASX: NVX) on the other hand has given back some recent gains dropping 30 per cent overnight with the battery commodity miner struggling to keep up with expectations.

The index provides somewhat of a warning sign for those chasing momentum or playing the small company sector of the market.

Market Thinkers

- Jamie Nemtsas -

Our Market Thinkers series has come to an end, after exciting sessions focused on retirement. We will be continuing this theme in 2022 and beyond and welcome your thoughts on potential topics both including and outside investment circles.

Each of our episodes are available here:

- Apple Podcasts
- Whooshka

Happy new year from Wattle Partners

It was a busy Christmas and New Year break for the growing team at Wattle. Here are some highlights:

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