SAFAA MONTHLY

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Stockbrokers and Financial Advisers Association

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BY JOHN WHELAN AND KEVIN BERTOLI, PM Capital

Loss of purchasing power emerges as key investment risk

New thinking on asset allocation needed as inflation and rates hit inflection point.

"A financial legacy of the pandemic will be a significant reallocation of assets that has barely begun. … It leads to a … questioning of the underlying assumptions used to form investment decisions. This includes an evolution of the proper measure of risk in a world where risk-as-volatility may clash with the risk of loss of purchasing power." – AllianceBernstein

Financial advisers face an unfamiliar risk this year when constructing and maintaining client portfolios: the loss of investor purchasing power as inflation rises.

Signs of higher inflation abound. In December, the US Consumer Price Index rose 7% from a year earlier – the fastest pace in almost 40 years.

It's no longer a question of whether higher inflation is a transitory response to supply-chain bottlenecks during Covid. The world is at an inflection point for inflation and interest rates that will take years to play out.

Persistent higher inflation could force the US Federal Reserve to lift interest rates faster than expected. That will fundamentally change investment dynamics this decade. Advisers will have to rethink asset allocation.

The big risk facing investors will not be market volatility, but rather loss of purchasing power. Portfolios designed to manage volatility risk through traditional asset-allocation methods face the prospect of low or negative real returns (after inflation).

PORTFOLIO CONSIDERATIONS AS INFLATION RISES

1. The world is at a turning point for inflation and rates. Persistent higher inflation will force central banks to lift rates faster than expected.

2. Traditional portfolio-construction techniques will be less effective. Diversification strategies across defensive asset classes risk destroying wealth.

3. A new measure of risk will be needed: loss of purchasing power. This will increase in weight relative to the notion of risk-as-volatility.

4. Equity volatility will be best managed by investing for the long-term and owning quality, undervalued companies with strong pricing power.

5. Passive funds and active funds that employ 'index-hugging' strategies should be avoided. As should funds that rely on momentum-based investing. Favour high-conviction value funds positioned for rising inflation.

Of course, nobody knows for sure how these trends will evolve. We do know that what worked well in the previous decade will not work nearly as well this decade. After years of low inflation and record-low rates, the tide is turning.

Also, investors will need to adjust to lower equity returns. High returns after the March-2020 Covid lows will not repeat anytime soon. Single-digit annual equity returns (on average) from equities in the face of higher inflation could result in crushed real returns.

Risks in traditional thinking

Diversification has been the main tool to manage volatility risk. Investing 101 calls for portfolios to be allocated across asset classes to reduce risk. A rule of thumb has been 60% of a portfolio in growth assets (equities) and 40% in defensive assets (bonds, property, alternatives and cash).

That strategy worked well in the previous decade when most asset classes rose. It's a bad idea in a rising inflation/rate environment.

Consider traditional defensive allocations within portfolios. PM Capital believes government bonds remain overpriced because of central bank buying. If higher inflation forces central banks to raise rates faster than expected, capital losses will mount. Every 1% rise in interest rates results in a near 10% capital loss in 10-year bonds.

Cash pays almost nothing and its real return is negative after inflation. There's been a view that cash is the worst asset to hold with rates near zero. But PM Capital believes portfolios need more cash to capitalise on bouts of equity-market volatility.

Property looks overvalued. Like other assets, residential and commercial property prices have benefited from ultra-low interest rates in the past decade. That tailwind will turn into a headwind in the next few years.

On the growth side of portfolios, equities have new challenges. Low rates boosted long-duration growth stocks, such as those in parts of the tech sector. As rates rise, growth stocks look vulnerable to a larger correction. Value investing is expected to outperform.

Clearly, portfolios spread across these asset classes risk capital destruction. Even if investors achieve low single-digit returns, higher inflation will erode the real return.

Sadly, more investors will find they have less income to pay for dearer goods and services, including energy bills, food and healthcare. That's the human cost of loss of purchasing power.

Adapting to change

PM Capital believes portfolios will need two things in a rising inflation/rate environment: more equities and more cash.

Granted, portfolios that comprise only equities and cash go against traditional investment thinking. But this is no time to be wedded to the past.

A higher allocation to the right equities will ensure more of the portfolio is exposed to assets likely to generate growing real returns. If well-chosen, equities can deliver higher returns that help investors maintain their real return as inflation rises.

More cash in portfolios will be needed to manage equity volatility risk. Cash provides optionality. It means investors can add to their equity exposure during inevitable market corrections. They can buy quality companies at lower prices.

Duration and value are other pieces of this puzzle. Having the patience and discipline to hold equities through investment cycles that typically take seven to 10 years has never been more important.

Value means buying companies when they trade at bottom-quartile valuations. We believe there is no better way to manage volatility risk than by owning quality, undervalued companies – and waiting until they reach top-quartile valuations before selling.

Fund selection is paramount. This is the worst time to use passive index funds that replicate equity indices. Many indices contain overvalued growth stocks and other companies that have low pricing power and will struggle as inflation rises.

Active management, too, is not without problems. Advisers should be wary of funds that only deviate slightly from their benchmark index. Or those that delivered strong past returns by owning momentum-based growth stocks.

The subset of good equity opportunities will narrow this decade. Advisers must ensure the funds they use to implement the equities allocation of portfolios are well-positioned for higher inflation and rates.

PM Capital is overweight banks and commodity stocks – sectors we believe will outperform as inflation rises. Owning companies with higher pricing power – and thus an ability to maintain margins as inflation rises – is central to our thinking.

We agree with US asset manager AllianceBernstein, which last year wrote that a clash is coming between risk-as-volatility and risk of loss of purchasing power.

Our expectation is the notion of risk-adjusted returns will have new meaning this decade as inflation rises and purchasing power contracts. ■

John Whelan and Kevin Bertoli are portfolio managers at PM Capital, an asset manager of global and Australian equities. www.pmcapital.com.au

Global government bond yields at record lows

Note:

The **blue circle** in chart shows when then US Federal Reserve chair Paul Volcker declared war on inflation in October 1979.

The **red circle** shows when current US Fed chair, Jerome Powell, declared war on deflation in December 2019.

Source: BofA Merrill Lynch Global Investment Strategy, Bloomberg, Global financial Data. Chart shows simple average 10-year yield. Chart at December 2021.

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Harness demographic trends shaping global growth *Wednesday 9 February | 1.00 to 2.00pm*

Join Lauren Jackson, as she sits down with Oliver Hextall, UK based Portfolio Manager of the Fidelity Global Demographics Fund, as they discuss the demographic themes of longer lives, better lives and more lives and where they are finding exciting new investment opportunities that capture these themes.

FASEA CPD: 1.00 hour Technical competence | RG146: 1.00 Generic knowledge


Lauren Jackson

Reference checking and information sharing protocol *Wednesday 23 February | 1.00 to 2.00pm*

On 1 October 2021 a new reference checking and information sharing protocol came into effect. Should only adverse findings, rather than the entire file, be provided? Are concerns about the breadth of the qualified privilege defence valid? Samantha Hills from Holley Nethercote will provide a comprehensive update.


Samantha Hills

Suspicious matter reporting *Wednesday 9 March | 1.00 to 2.00pm*

Richard Lee, Director of the Industry, Education & Outreach team at AUSTRAC, will provide an overview of reporting suspicious matters to AUSTRAC, including what AUSTRAC is seeing, some do's and don'ts when reporting and how they play a critical role in protecting the financial system from serious crimes.

FASEA CPD: 1.00 hour Regulatory compliance and consumer protection | RG146: 1.00 Generic knowledge


Richard Lee

An update on DDO implementation *Wednesday 16 March | 1.00 to 2.00pm*

In addition to providing an update on DDO implementation, Corey McHattan, a partner with Ashurst, will also discuss how to address the challenges of undertaking the reasonable steps obligations for general and non-advice clients and the danger of straying into personal advice.

FASEA CPD: 0.5 hour Regulatory compliance and consumer protection | RG146: 0.5 Generic knowledge


Corey McHattan

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BY DAWN LAY, Equity Markets Sales Manager, ASX

EQUITY MARKETS: Key 2021 trends and looking ahead to 2022

As the Australian economy continues to recover from the COVID-19 pandemic, how has the equities market been holding up? What major trends defined this asset class during 2021, and what's the outlook for the year ahead?

To help me answer these questions, I recently convened a panel of some of ASX's most experienced practitioners in the equities ecosystem, from listings to cash market trading, investment products and derivatives. This article captures their insights.

IPOs reach record highs

2021 was a record-setting year for the listings business. Globally, the initial public offerings (IPO) market reached all-time highs, both in terms of the number of IPOs and the amount of capital raised.

ASX experienced a similar pattern to the global trend, with over $11 billion raised through IPOs – the highest level in seven years. At the same time, we saw around 200 new listings, the largest number since the bull market and height of the mining boom in 2007.

As James Posnett, Senior Manager, Listings, points out, unprecedented levels of monetary and fiscal support have been a key factor driving investor demand. "Government stimulus has helped propel markets to record highs, and has also resulted in merger and acquisition activity reaching its highest levels in over ten years," he says. "A significant level of buybacks and special dividends also helped put cash back into the hands of investors, which we then saw redeployed."

This tremendous mobilisation of capital is also a testament to Australia's growing superannuation pool, which continues to provide tailwinds to the IPO market and equity markets more generally.

Cash equities react to supply chain disruption

With cash market trading, the ripple effects of global supply chain disruptions were a defining trend of 2021.

As lockdowns lifted and the global economy began to reawaken from the pandemic, demand rocketed. That's left companies struggling to keep up, especially with logistical bottlenecks affecting many supply chain links.

"The ongoing disruption is causing price rises for many commodities, which has led to an inflationary response," says Rob Nash, Head of Equities Relationship Management. "That in turn is triggering investor concerns that inflation could force central banks to tighten monetary policy. All this is having a fairly volatile effect on interest rates across markets, particularly at the short end of the curve."

As Rob points out, any changes to interest rate sensitivity usually have a strong knock-on effect on the Australian cash market, particularly around the resources and financials sectors.

Investor tolerance for risk has also been tested by recent volatility in the iron ore market. "That's affected trades by institutional investors over the last few months, but we're now seeing their levels of activity return to above 85 per cent of overall trading volume," he says.

Much retail activity, meanwhile, has been focused on chasing dividends from the major iron ore mining companies, including Fortescue and RIO. Overall, retail trade has held steady at around 15 per cent of overall trading volume, slightly down from the 20 per cent peak we saw in February following the GameStop frenzy and accompanying meme stock phenomenon.

ETF inflows surge

Exchange traded funds (ETFs) also attracted tremendous attention in 2021 as investors bet on economic recovery. The total amount of funds under management in Australia's ETF market surged to $124 billion, up almost 70 per cent over the past 12 months.

While fixed income ETFs gathered a lot of inflow last year, 75 per cent of this year's new money has gone into equity ETFs. "This is the first time in seven years that there hasn't been a fixed income ETF on ASX's annual list of the 10 most popular ETFs," says Martin Dinh, Senior Product Manager, ETFs and Managed Funds.

2021 also saw investors pour more than $2.1 billion into ESG ETFs – an uplift of more than 58 per cent compared to 2020 levels. "Increasingly, investors are looking for market areas that align with their values," Martin explains.

There are also signs that investors are becoming increasingly confident in using thematic ETFs to build portfolios. Over the course of 2021, trading volumes in thematic ETFs grew to more than $2.3 billion – more than one and a half times higher than 2020 levels. And when CRYP, Australia's first crypto-ETF, debuted on the ASX in November 2021, it broke ASX trading records within hours, with investors trading just under $40 million on the first day alone.

Derivatives maintain strong momentum

Equity derivatives also saw plenty of activity in 2021, with the total amount traded daily on the ASX reaching $9 billion.

One of ASX's most popular futures trading instruments is its gross total return futures contract, based on the S&P/ASX 200 Gross Total Return index that includes dividends within its valuation. "2021 saw a huge rise in the number of these contracts traded. Open Interest grew to $2 billion." says Graham O'Brien, Senior Manager, Equity Derivatives.

To help promote growth in the equity options market, ASX also introduced an options liquidity growth program during the first quarter of the year. This included rebating a portion of market makers' ASX market access fees, helping to improve on-screen liquidity for customers to transact against. "That led to increases in activity, especially among retail investors," Graham reports.

2021 also saw 15 new single stock options listed. The stocks that outperformed included 'buy now, pay later' provider Zip, and Perth-based mineral exploration company Independence Gold. "We're also increasingly seeing retail customers adopt trading strategies such as income writing and put buying, as they seek to protect their shares," confirms Graham.

Key drivers for equity performance in 2022

As the ASX experts agreed, the new year presents a complex picture as the global economy deals with inflationary pressures while continuing its climb towards recovery. "But as long as volatility remains at reasonable levels, we will see IPOs executed – and the listings pipeline is looking very strong," James Posnett reports.

One of the most significant companies in that pipeline is US payments giant Square, scheduled to commence trading on ASX early in the new year. As James points out, "This is a really important listing and a strong endorsement of the ASX tech sector globally."

In terms of ETF investments, the Australian Securities and Investments Commission recently gave its approval to fund managers looking to launch ETFs with underlying cryptocurrency assets. "So far, only products linked to Bitcoin and Ethereum will be eligible for approval but this is an exciting development for the investment community. We'll now be working towards quoting a Bitcoin ETF sometime in 2022," confirms Martin.

For the options market, key ASX focus items for 2022 include bringing more over-the-counter (OTC) trades to exchange. "We're seeing lots of client interest in utilising our clearing service tailored for buy-side customers as an alternative to OTC options trading," says Graham.

"We will also be making it easier for clients to expand their product set via our options on international ETFs, and improving our volatility surfaces at the exchange. These are just some of the ways we'll be working to ensure investors enter 2022 with the best chances of success." ■

To view more insights, go to www2.asx.com.au/markets, or email Dawn Lay on dawy.lay@asx.com.au

Market Manipulation & Other Prohibited Conduct

Tuesday 1 March 2022 | 11.00 – 1.15pm

This workshop on the prohibition on creating or maintaining an artificial price for trading in various financial products, including shares and futures, will benefit all who wish to gain an understanding of markets and the consequences of breaching obligations. Designed to suit the needs of financial market professionals from the front and back office, this is a great opportunity to brush up on your obligations, learn how to protect yourself and understand the difference between manipulation and ordinary market forces.

PROFESSOR MICHAEL ADAMS is a specialist in Australian corporate law and international corporate governance. Michael has expertise in financial services regulation, information governance, consumer protection and the broader area of legal technology and education. Professor Adams was Dean of Law at Western Sydney Law School from 2007 to 2017 and from 2019 the Head of the University of New England Law School.

Dates & Times (*includes 15 min break*)

Tues 1 March, 11.00 – 1.15pm AEDT

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BY BEN GILES, Solicitor, Speed and Stracey Lawyers

How ASIC investigates insider trading

Trading alert or tip off

The most common triggers for an ASIC investigation into insider trading are a trading alert by ASIC's electronic market surveillance system or a tip off of information given to ASIC.

ASIC has government-funded and expert-designed information systems intended to automatically detect insider trading and other market misconduct. Introduced in 2013, the Market Analysis Intelligence system triggers alerts for certain trades and patterns of trading, particularly in connection with price sensitive announcements and significant changes in the trading price or volume of securities. Numerous alerts are generated each week, and of course not all lead to a formal investigation by ASIC. But some of these alerts result in further enquiries being made by ASIC to see if a formal investigation is warranted.

Tip offs are a more informal and subjective source of information to ASIC. This includes compulsory reporting of suspicious activity by stockbroking firms together with licence breach reports where relevant. Tip offs may also be made privately to ASIC on a voluntary basis, or often in the course of investigating another matter where information is provided by a witness or a suspect, or where suspicions arise from documents gathered in the course of another investigation. The other more obvious source of such information for ASIC is where there are matters of public record in the media or occasionally on internet trading forums.

When the information obtained by ASIC appears sufficiently serious, ASIC commences a formal investigation in accordance with its statutory powers.

Obtaining documents and information

Leaving aside documents on the public record and documents provided voluntarily to ASIC, the most common method of ASIC obtaining documents is by it exercising its statutory document-gathering powers, mainly in sections 30 and 33 of the ASIC Act. These powers involve ASIC issuing a formal notice to an individual or a company to produce particular documents or classes of documents.

Unlike a police interview, there is no right to silence, however there are protections available to suspects and other witnesses to prevent their answers in an examination being used against them in any subsequent prosecution.

Such notices are very commonly issued to banks, to obtain banking records about money transfers, and to stockbrokers to obtain information about securities transactions by suspects. In the insider trading context, ASIC also issues such notices to listed companies, their advisors, and suspects in the investigation, in order to trace the flow of price sensitive information about a listed company. ASIC regularly seeks material such as email chains, telephone call lists or audio recordings, and records of meetings or attendances. Telephone and internet records are also commonly sought from service providers. Depending on the specific allegations being investigated, this type of information can be critical.

In addition to documents, ASIC also has the power to collect and search electronic equipment such as computers and mobile telephones, both in relation to suspects and their advisors or other contacts. SMS and other messages, emails, and internet search histories are often key to an insider trading investigation.

Search warrants

Typically, the most public and intrusive exercise of ASIC's powers is search warrants. Often involving armed Australian Federal Police officers, together with ASIC investigators, search warrants are normally exercised at the residential and business addresses of suspects and any other person who may be uncooperative in an investigation.

The search warrant involves investigators conducting physical and electronic searches at the address, and the collection and removal of material considered relevant.

Searches at residential addresses are typically unpleasant when other family members are involved, and usually involve searches through personal items to find relevant material. Searches at business addresses can be equally intrusive, given investigators may need to access and search through confidential or irrelevant material in order to look for documents of interest.

Compulsory examinations

ASIC can compel individuals to attend ASIC's offices for a recorded interview. This power is commonly used by ASIC. The power arises from section 19 of the ASIC Act, and is commonly known as a "*section 19 examination*".

Unlike a police interview, there is no right to silence, however there are protections available to suspects and other witnesses to prevent their answers in an examination being used against them in any subsequent prosecution. It is therefore strongly advisable for an examinee to seek the advice of a lawyer in advance of a section 19 examination, and to be accompanied by a lawyer during it.

The most common problem for witnesses at section 19 examinations is lack of preparation. Regularly, ASIC will be asking questions about events and documents many months or even years prior to the examination. ASIC will have the advantage of having collated emails, phone messages and other documents as a result of its investigation, and will present those to the witness during the examination. A witness who has not seen those documents for some time can be taken by surprise and may not have had an opportunity to think about the background to the documents and their context. Preparation should involve collating all available and potentially relevant documents, and a chronological review of that material to anticipate questions which ASIC might ask.

Before and after a formal section 19 examination, it is also common for ASIC investigators to speak to suspects informally. Answers given to ASIC on an informal basis are not subject to the same protections as a formal examination, and can be used in a subsequent prosecution.

Witness statements and seeking the DPP's approval to prosecute

If ASIC decides to pursue a prosecution or other enforcement following its investigation, it will then obtain witness statements from relevant individuals. In an insider trading investigation, this would include evidence of the existence of information being price sensitive and not publicly available, the communication or availability of that information to a suspect, and the use of that information by a suspect to conduct trading in securities or to encourage another person to do so. ASIC will also obtain evidence from a stock market expert to prove that the information was price sensitive.

At this stage ASIC also typically gives a suspect a final opportunity to explain why that person should not be charged. Unless some new exculpatory material has come to light since the suspect's section 19 examination, there is usually little to be gained and much to be risked, by a suspect agreeing to speak to ASIC at this point.

Once ASIC is satisfied that it has sufficient proof via documents and witness statements, then it will submit that material (called a "*brief*") to the Office of the Commonwealth Director of Public Prosecutions, to seek approval to prosecute particular individuals for insider trading offences. Once that approval is given, ASIC will then proceed to file charges with the Court and to commence the criminal prosecution procedure. ■

BY DEAN WEINBREN, Executive Director, Pengana International Equities

How a 32-year long investment strategy sustains profitable growth into an uncertain future

Investors are keenly focussed on how policymakers will react to current levels of inflation. Will it subside without robust intervention (as supply chains overcome logistical bottlenecks and new capacity comes on), or will persistent price pressures force central bankers' hands to tighten monetary policy significantly, in order to avoid inflation becoming embedded in consumer and business expectations?

When investing in long-duration stocks, valuation methodologies typically entail discounting earnings from far in the future back to the present stock price. These future-earnings are then subjected to significant influences such as inflation and interest rates.

These external influences pose a real challenge to valuation methodologies given an investor's inability to predict or control them.

Pengana International Equities Limited (trading on the ASX as 'PIA') is a Listed Investment Company ("LIC") that exists to provide shareholders with continued capital growth as well as regular, reliable, and fully franked dividends. In order to achieve these aims, PIA has appointed New Jersey-based Harding Loevner, a global equity fund manager formed in 1989 with over US$86 billion in Assets under Management, who are tasked with delivering sustainable and profitable growth through all market cycles.

The investment team has no process for, nor professed skill at, predicting either inflation or its policy responses. They are not practitioners of the (futile, in their opinion) arts of interest rate prognostication, or stock market timing – nor even market-style timing. As hard as they work to value companies, they are cognizant of the imprecise nature of that art.

So how then, can an investment team deal with prospective inflation?

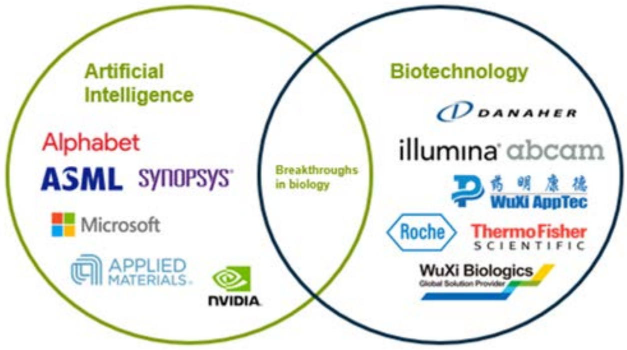
Rather than trying to predict inflation, we suggest analysing industry and company specific vulnerabilities to inflation through the lens of Michael Porter's "Five Forces", especially through the relative bargaining power of buyers and suppliers.

That is, identifying which businesses will be resilient in an inflationary environment due to their ability to pass on whatever higher costs or supply chain frictions they experience.

More broadly, evaluating all the forces that shape and define industry profitability, and assessing the efficacy of the capital allocation decisions that underpin each of the company's long-term growth trajectories.

With inflation merely one variable in, or facet of, that analysis. This bottom-up analysis has kept the investment team optimistic about the potential for continued strong earnings growth from investee companies, especially considering high, and sustained, levels

Convergence of innovations in AI and biotech



“The software revolution of deep learning is coming to science. We are witnessing the dawn of the biology revolution.”

Jensen Huang, NVIDIA founder & CEO, November 2021

of innovation and secular growth in their target markets.

However, that optimism is tempered by the knowledge that, when it comes to precisely assessing stock prices, vulnerability remains to significant and persistent changes in inflation or interest rates.

The dual existence of a business and its share price underpins the need to be careful to distinguish companies from stocks. These valuation efforts are part of a quest to detect unsupportable optimism or unwarranted pessimism embedded in share prices, rather than arraying companies precisely along an orderly spectrum of expensiveness with a finely tuned financial model.

The investment challenge boils down to identifying which companies can sustain profitable growth into an uncertain future.

We are living in a time of profound technological innovation enabled by rapid advances in semiconductors and their information processing applications. Companies that substantially contribute to, or benefit from, these innovations enjoy enormous growth tailwinds.

One such example of technology-enabled innovation is the application of artificial intelligence (AI) to drug discovery.

In December, Science magazine designated the use of AI to predict the three-dimensional structure of proteins as its 2021 Breakthrough of the Year. Alphabet's AlphaFold2 program and another, non-profit effort known as RoseTTAfold (supported in part by Microsoft) are now able to simulate the 3D structures of proteins rapidly, allowing scientists to model proteins binding and inhibitory functions in the pathway of a disease.

The significance to our investment products, Pengana International Equities Ltd (trading on the ASX as PIA), and the Pengana Harding Loevner International Fund, is two-fold.

First, are the direct applications to the holdings. In health care these include the state-of-the-art providers of drug development services Wuxi Biologics and Wuxi Apptec, as well as life sciences services and consumables companies Illumina, Thermo Fisher, Danaher and Abcam – the “picks and shovels” suppliers to the AI-wielding scientists and biotech firms on the frontlines of this golden age of drug discovery. The life sciences breakthroughs are but one example of the remarkable impact AI is having across autonomous transport, logistics, automation, climate science and many other fields.

The second significance to the portfolio is through the companies helping to make AI possible. Alphabet is one company helping to drive these breakthroughs, as well as NVIDIA, the chip designer whose signature graphic processing units and complementary software is at the forefront of providing the tools to unlock the potential oceans of data involved in AI development. Another key enabler is Synopsys – one of few key providers of software to design chips for the AI age – as are ASML and Applied Materials who provide the critical equipment needed to turn sophisticated chip design into real products.

Companies owned in PIA aren't just drivers of change and innovation, they are also subject to its consequences. The disruption that many of these enterprises have unleashed has upended whole industries, creating waves that reverberate back to shake the companies themselves. Paypal, the online payments company that helped eBay disrupt e-commerce, has evolved to become a frenemy of banks and credit cards, as it pursues its goal to become the default digital wallet and singular medium of commerce for consumers worldwide.

The investment team have been long-time owners of the company because they recognized how ripe the worlds fragmented, byzantine payments systems are for disruption. Paypal has lived up to expectations as these trends they identified have unfolded. The company has received an added boost from the acceleration of online payments during the pandemic, the rising popularity of cryptocurrencies, and the positive reception of its Buy Now, Pay Later plan (consumer credit updated for the digital age). Unsurprisingly, the success has caught the attention of venture capitalists and entrepreneurs, who are bringing forth innovative payment technologies from new entrants (Bakkt), older players (Stripe, Chime) and newly renamed ones (Block, nee Square) alike. These incursions have slowed PayPal's growth and given its high valuation; investors have reacted negatively.

However, there is more to the PayPal story. As digital payment services become commoditized, it takes a company of vast scale to be able to cater to the evolving expectations of users at low marginal cost. CEO Dan Schuman makes this point. "When something becomes commoditized, then distribution, like massive distribution, is important because your margins are low, so you want the maximum amount of distribution." At this point, PayPal is operating with a base of over 400 million consumers, eleven times its next largest competitor, Cash App – and is interacting with some 30 million merchants worldwide. We are watching how PayPal grapples with its competition as it attempts to navigate the next stage of its quest to become the financial super app for consumers globally.

Now, as always, part of the challenge of assessing the sustainability of company's growth at rates that are sufficient to justify their elevated valuations comes from the ready availability of less-rapidly growing companies trading at more modest valuations. Time will tell how well these assessments have been made, in the meantime, the shifting views of other investors and changes in the discount rates they employ will have equal or greater impact on the relative performance than the verifiable progress of the companies themselves. ■

Pengana International Equities Limited (trading on the ASX as 'PIA') is a Listed Investment Company ("LIC") that exists to provide shareholders with continued capital growth as well as regular, reliable, and fully franked dividends.

The strategy aims to generate superior risk-adjusted returns, through investing in an actively managed portfolio of global companies that meet the team's high quality and durable growth criteria at reasonable prices. A robust responsible investment framework provides an added layer of risk mitigation.

These companies are identified through the conduct of fundamental research, with a long-term, global perspective, and must exhibit the following four key investment criteria: competitive advantages, quality management, financial strength, and sustainable growth potential.

Harding Loevner was appointed the investment manager on 10th May 2021. Harding Loevner is a New Jersey-based global equity fund manager formed in 1989 with over US$86 billion in Assets under Management.

More info on PIA can be found at: pengana.com/PIA

SUPER SNIPPETS | **Darin Tyson-Chan,** Editor, *selfmanagedsuper*

Your Future, Your Super having an impact

Engagement has been a big issue pretty much since the compulsory superannuation regime was introduced back in 1993. And understandably so seeing retirement for most Australians in the system was so far away given where they were in their employment life. This meant it was difficult to contextualise the significance of their total retirement savings amount and the returns they were earning on it.

Almost 30 years down the track, engagement between super fund trustees and their members remains a challenge, but a well-publicised recent legal change seems to have had a positive effect in this area – that being the Your Future, Your Super legislation.

The act came into effect on 1 July 2021 and one of the key features involves having the Australian Prudential Regulation Authority (APRA) conduct an annual performance test on the MySuper offerings for consumers based upon fees and returns generated.

The first APRA MySuper performance test outcomes were released in August 2021 and seeing it's a brand new measure, I'm sure many people would have been wondering how much interest it would really attract.

Well according to figures released by Superannuation, Financial Services and the Digital Economy Minister Jane Hume, the government's Your Future, Your Super comparison tool had recorded 1 million hits as at 6 January 2022. This certainly indicates the initiative has sparked a degree of curiosity among Australians to see how strong the returns on their retirement savings are and in turn could increase the level of engagement with their super funds, particularly if their chosen MySuper product is underperforming.

With regard to the results themselves, 80 MySuper offerings were tested, with 67 products, or 84 per cent, registering a pass for the performance test, and 13, or 16 per cent, registering a fail.

It's early days yet and it will be a good thing if this level of interest from consumers continues in the years to come. But there are other questions the legislation raises.

Under the new rules if a super fund fails the performance test two years in a row, it will be required to take formal steps to address its lack of results and will not be able to accept any new members until this is done. This is a significant penalty and it will be intriguing to see how the funds go about the process with 13 already in the gun.

It will also be fascinating as to how the funds that register a fail are perceived by their members. To this end, will it be of concern enough for them to go down the path of switching funds?

And if the performance test does prompt this reaction, one wonders how the use of this new information aligns with the disclaimer we've been provided with since superannuation marketing entered our lives – that past performance is no indication of future performance.

Surely the last thing Canberra would want to encourage is a lot of fund switching in the name of chasing better superannuation returns. I suppose this scenario could come with a bit of a twist whereby individuals will be looking to avoid poor returns as opposed to deliberately chasing the best returns in the market.

Further, it could result in a situation where superannuants actually lose out the other way as they end up forgoing the improved performance of a MySuper product they were in after it had been named and shamed due to a fail in one particular year.

So there are plenty of unanswered questions when looking at the implementation of the Your Future, Your Super legislation and I suppose we'll just have to wait and see how it all plays out over the coming years. ■

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