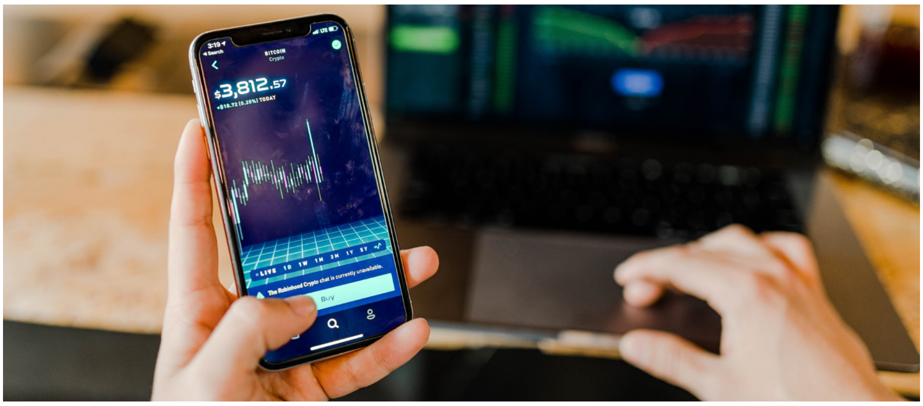
The INVESTMENT COLLECTIVE

INVESTMENT MARKET UPDATE

ISSUE 82 Winter 2022

"OUR DUTY IS YOUR FUTURE"™



MESSAGE FROM MANAGER

Recently a long-term client noticed a significant variation between his nominated 'growth' risk profile and the risk profile of his actual portfolio, which was much more 'defensive'. This was something I have been thinking about for months, and the question provided the impetus to write something on the deeper aspects of the portfolio work we do at The Investment Collective. I thought I would share some of those insights here.

The first thing to say is that despite what looks like black and white numbers, there is an art to determining a client's risk tolerance, and also in finding assets via which we can build a suitable portfolio:

- You will no doubt remember the questionnaire we asked you to complete when you first joined us, covering tolerance to risk, the requirement for income and other things. Even though we take care to try and have people understand what is being asked of them, it is just a matter of fact that responses can be distorted as a result of personally held views (house prices never fall) or propensity to see things as glass half full (high risk equals high returns so back the truck up on speculative mining stocks!), or half empty (investing in the share market is always very risky).

- Investments are categorised according to generally accepted parameters. For example, Australian shares and international shares would normally be categorised as growth assets. Bonds would generally be thought of as defensive assets. The extent to which these generalisations are true to real life depends on a more granular consideration of the characteristics of each individual investment.

As professional financial advisers, it is our job to be aware of these nuances and how they apply to the individual we are advising. Over the years, this approach has been of immense benefit to clients.

Risk tolerance

When we look at risk tolerance and responses to the questionnaire, we also look at the reality of people presenting. Many times, I have had people saying they want to take a lot of risks to achieve a higher return because they have heard that high risk = high return. Economic/finance theory does not say that high risk equals high return. What it says is that:

- People require the expectation of higher returns to be encouraged to invest in higher risk assets. Regarding any particular asset, those expectations may or may not be realised. Indeed, it is more than likely the investor will lose their money or at least part of it.

- Assuming an appetite for risk, this can be managed by having a diversified portfolio of (in this case) high risk assets. Achieving genuine diversification is not all that easy (for one thing all assets are intrinsically linked to bond markets), but we do know that some funds specialise in this type of high risk investing and their experience is that they often lose all their money on say four out of ten investments, two will shoot the lights out (perhaps earning thousands of a percent on the original capital) and the rest of the investments are ho-hum. The trick, therefore, is not only in finding investments with decent prospects, it is in being able to find several investments that are sufficiently diversified such that the ratios mentioned (40/20/40) above (or something like it) hold true.

Do clients understand these things about their investment portfolios? Can I deliver on the promise of high returns, given the client's circumstances and available investments? Or are clients better served by having a middle of the road portfolio, picking up on value adding opportunities as they arise?

Regarding the glass half full/empty aspect, we see different demeanours in people all the time. It is really common for a husband and wife to have quite different risk tolerances. And people can be successful in one field and generalise that to being (in their mind) good at 'everything'. I can provide several personal examples! Conversely, there are Eeyore types who miss every opportunity because things are always going to get worse.

Again I have to work that out. A brain surgeon may not be an astute business person, even though they are relatively wealthy. A positive future-focussed business person may be predisposed to unnecessary risk, thereby undoing a lot of good work when things go unexpectedly bad.

> "Making money is no easy thing, and so managing the risks we might bring on ourselves is a wise thing to do."

It is part of the job (I'd say a critical part) of a competent adviser to take these things into account when making recommendations for investment portfolios for clients. I guess you could be cruel and say this is being over-protective in some way, but I would reply that generally speaking, making money is no easy thing, so managing the risks we might bring on ourselves is a wise thing to do.

Categorising investments

The investment side of this, is to my mind, equally interesting. As I said above, shares are often considered growth assets, and conversely, bonds/debt are considered to be defensive assets. To what extent are these asset classes true to label?

Shares and many other ASX traded assets represent ownership of a company or other entity. To see whether assets are truly growth or defensive you have to look at the companies themselves. Even within each of these categories, there is a detail that needs to be thought about. Take CSL and Macquarie Bank for example. Both of these companies are considered to be genuine growth stocks. But Macquarie is inherently more volatile because its fortunes are directly linked to the state of investment markets. CSLs fortunes on the other hand are reliant on the success of pharmaceutical products and the ability to acquire and integrate businesses successfully.

Conversely, Transurban which is also listed on the stock market, would not normally be thought of as a growth stock. That's because once a road is mature, the number of vehicles travelling along it becomes reasonably stable. But Transurban's success in building and operating toll roads combined with the automatic CPI adjustments included in its pricing has made it an outstanding performer.

It is the same when we consider bonds and loans (different names for essentially the same thing). Without going into how these assets are valued, they can themselves be volatile, even though they offer a known (or at least calculable) rate of return and parameters around when they will be repaid. On any particular day though the amount someone will pay for these assets (their traded value) may or may not reflect the repayment amount at maturity. This can be exacerbated when a portfolio of bonds is wrapped up in an ASX-listed investment vehicle, because if market conditions are bad, people may embark on a wave of selling no matter the security of the underlying asset. In these cases, the 'defensive' nature of the asset is not apparent at all, unless you hold it until all the underlying bonds are repaid.

To round off:

- The intended guidelines for the splits between growth and defensive investments are a guide based on client responses. Those responses need to be tempered by professional judgement as regards to an assessment of whether the client is in a position to internalise their feelings/attitude toward actual future outcomes.

- The weightings are based on generalisations concerning the characteristics of numerous asset classes. The problem is that within any asset class the characteristics of individual investments may not reflect those generalisations. It is really important to know the characteristics of each investment.

Perhaps this is a little long and detailed, but the client's question meshed with recent musings and deserved a thoughtful response. It cuts not only to the concerns and attitudes we bring to helping manage your affairs, but also to the simplistic and often quite damaging way the industry is regulated. I hope you enjoyed the read.

David French
Managing Director

The human brain and investing

Although Oreo has his own letterbox next door, he likes nothing more than watching the world from ours. Perhaps it is a better vantage point; perhaps he likes to look at things from different perspectives; or, perhaps he sees an opportunity to seize more territory (or wealth), at Molly's house while Molly's asleep at the wheel (inside in front of the heater).

Robert's next door neighbour, Oreo.

We will likely never know Oreo's motivation, but there's five things I have learned from watching Oreo and Molly and the choices they are making:

1. Cats live in the moment. They take time to enjoy the sunshine, or a warm fire. We should too. There are a lot of pleasure in life's small moments, if only we stop, breathe and take it all in.

2. Curiosity doesn't kill the cat; it keeps the cat alive. Cats are attuned to changes in their environment. They do not get emotionally invested in catching that mouse if a vicious dog is barking at them. But, if they learn that the dog is contained by a fence, they may well go back to hunting that mouse. They stay alive to what's happening around them, making adjustments as necessary, without being consumed by it.

3. You don't need to lick all four paws at once. Sometimes the right decision is to start smaller, and to invest just a little. You may elect to clean just that one paw, or you may decide to make a bigger investment and wash all four. But not everything is an 'all or nothing' decision.

4. Cats land on their feet – probably not if you drop them from a 30 storey building (please don't try) but, like walking a tight-rope, they move with such precision, grace and steeliness that, even faced with volatility, they get safely to the other side.

5. Cats do not really have nine lives; they are just good at assessing their risk. Oreo knows that as a strong, young cat, he can be a little braver. He does not need to spend as much time lining up his jump. His inherent strength, agility and balance allows him to take a risk. And, if he does get it wrong, he has a lifetime ahead of him to correct his error. Molly, on the other hand, as a much older cat, knows she needs to play it safe. She adopts a lower risk strategy, opting to protect what she has, resisting the urge to chase the shiny new object promising high yields (that may not deliver). Like Molly, people generally become more risk averse as they get older meaning that investment strategies that work for a 25 year old with no dependents probably won't work for a 75 year old.

While I draw some wonderful lessons from watching these two felines, for humans, the world is much more complex. Our brain is both amazingly evolved and concerningly flawed. We are filled with cognitive biases (it is estimated there are in excess of 200 biases) which can lead our thinking away from the correct judgement, without us even knowing. There are reasons for this.

Our brain is a slave to speed, efficiency and comfort. It dislikes uncertainty and it dislikes dissonance (two conflicting thoughts). Fortunately, or unfortunately, the brain is also a prediction machine. Where information is unknown, our brain will simply predict. And, to do that, it uses our past experiences. You see, when making decisions, we do not jump forward to a clean sheet of white paper and consider all information anew. No, we travel backwards into our memories and experiences – but not all of them, because not all memories are created and stored equally. And not all memories are real (yes, made up memories really happen).

We do not store memories as they have occurred. We store them as we interpreted them at the time, which is why two people can have different recollections of the same event both vehemently believing they are right. Plus, we attach emotion to our memories meaning that a more emotional event will feature more heavily in our memory. That stands to reason, but it can also lead us to over-weighting one experience while discarding or ignoring another that may be equally or more relevant to the decision at hand.

In essence we think, when we make decisions, that we are being rational, objective and well considered. When, in fact, quite often, we have formed the decision in our subconscious and everything else is a rationalisation after the fact. Our brains are almost too smart for us.

> "The human brain is a slave to speed, efficiency and comfort."

No-one can completely overcome the flaws of the human brain (thought to be the most complex structure known to man). However, our aim, as your financial advisers, is to bring a balance of this type of awareness, robust analysis and empathy to better understand, identify and help implement a financial strategy that is tailored to you so that if we were all cats, Oreo can enjoy the letterbox and Molly can enjoy the fire.

Robert Syben
Head of Financial Planning

Save or invest - what is right for you?

When introducing children to money, we often think of the historical "Dollarmite" and bank programs many of us had through our school days, or perhaps it was giving pocket money to the piggy bank. As we progress to adulthood, we still rely on our everyday accounts to help us save money towards our financial goals.

With the official cash rate still at low levels, the interest rate in savings accounts not meeting inflation, and term deposits locking money away for a return below inflation, do we need to consider investing as the new saving?

Saving

We will define this as investing in an everyday bank account.

Investing

We will say this is the purchase of shares and managed funds.

Why do we save our money rather than invest? The answer is lower volatility (the amount we have does not go up and down), we do not have to change our savings to cash to purchase goods and you need to save first to invest. However, savings often fall behind the inflation rate and will typically deliver a lower return than investing over the long term.

As with many aspects of financial advice, the right answer will depend on your financial requirements. Understanding your goals and your willingness to take on risks will help determine the correct strategy. Another factor is the length of time for your savings/investment.

Goals

If your goal is to hold emergency funds, then cash is the answer. It is there and ready when you need it. Often, a smaller dollar value goal required in the short term will result in saving as the answer (eg. paying rates, household expenses, domestic weekend holidays). The bigger the goal or the longer duration to achieve it will suggest investing as the preferred medium (eg. home deposit, new car). For many years, a savings account was the key avenue for these longer-term goals. However, many are now switching to include some investing to 'speed' up the goal timeframe.

Saving and investing incur differing levels of risk. Money in a bank account is low risk, whereas investing holds greater risk (with each investment having a different risk level from the next). Of course, the more risk, the more potential for return as per the classic risk versus return graph. So, if you are just starting and have a solid income, you might have higher acceptability of risk, as opposed to someone in retirement mode who wants to preserve their hard-earned wealth.

Saving and investing can both be sound financial strategies to help achieve your goals. The choice you make should depend on you and your own circumstances.

If you are looking at saving for a short-term goal or investing for your future, our experienced team of financial advisers can help determine the right avenue for you.

Allan McGregor
Financial Adviser

Quotes to embrace during volatile markets

2022 has been a volatile year for financial markets, with inflation at all time highs and central banks around the world attempting to play catch-up via steep interest rate hikes. Global supply chain constraints, exacerbated by the war in Ukraine and lockdowns in China have led to fear of a potential recession.

Australian markets have performed better than global counterparts, yet unfortunately, nothing has been safe (except cash). Global markets are down 10-20 percent for the year, bond markets have crashed 10 percent and the ASX is down nearly 10 percent as well. Property prices have also begun to stagnate, especially in the capital cities as the rising cost of borrowing puts a stop to the post-covid property boom.

Investors need to realise that corrections are normal and are part of a healthy market. A steep pullback in the market may provide opportunities to buy good quality companies at a lower price. This makes it even more important to turn down the noise, remain disciplined and stick to a long-term investment strategy. The following quotes should be kept top of mind when investing during volatile market conditions.

1. "The stock market has predicted 9 of the past 5 recessions."

- Paul Samuelson

It does not mean much knowing or expecting an incoming recession as you will always be better off if you remain invested and more importantly, continue to invest during downturns.

2. "Everyone has the brainpower to make money in stocks. Not everyone has the stomach. If you are susceptible to selling everything in a panic, you ought to avoid stocks and mutual funds altogether."

- Peter Lynch

The only way to guarantee a loss is to sell during a correction and crystalising paper losses.

3. "In the short run, the market is a voting machine, but in the long run it is a weighing machine."

- Benjamin Graham

Markets are impossible to predict in the short term, however, quality companies will continue to perform in the long term.

4. "More money has been lost trying to anticipate and protect from corrections than actually in them."

- Peter Lynch

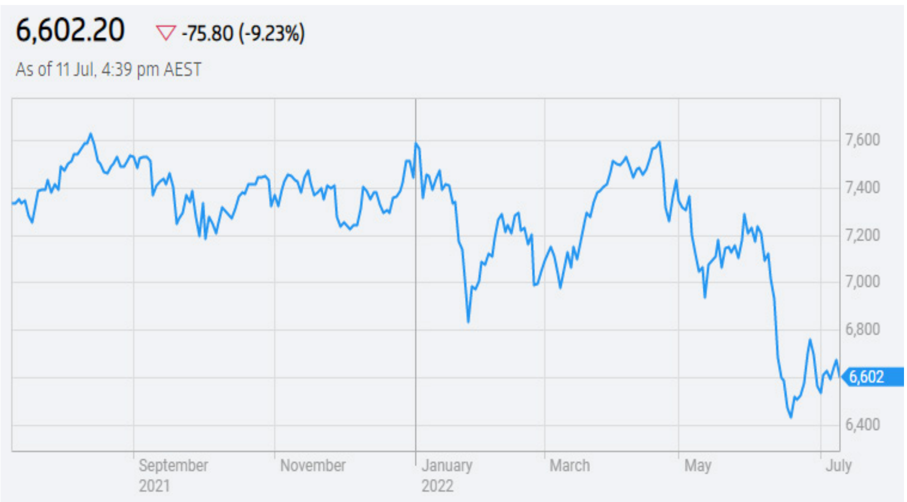
History has shown that corrections are nothing more than a temporary reset for the market if you remain invested.

5. "Be fearful when others are greedy and be greedy when others are fearful."

- Warren Buffett

The oracle of Omaha (Warren Buffett) has outlined the importance of avoiding herd mentality. Do not buy during market peaks and add to your positions during steep downturns.

If you need assistance with your long-term investment plan, please reach out to your financial adviser.



Cheng Qian
Managing Adviser

*ASX 200 performance over last 12 months to 11/07/2022

Events Update

Ladies Golf Day

In May, The Investment Collective sponsored the Rockhampton Ladies Golf Championships for the 16th straight year! The event proved to be a success with over 70 competitors from across Central Queensland competing on the day.

Fitzroy Frogs GKI Trail Run

The Investment Collective were proud to once again be the major sponsor of the Fitzroy Frog's GKI Trail Run! Taking place on 12 June 2022, various staff were in attendance and competed in events ranging from the 10km "Keppel Enticer" to the 22.2km "The Wreck" trail runs across Great Keppel Island.

Camberwell Art Show

From 25 June - 3 July, the Camberwell Art Show took place at Swinburne University located in Melbourne. The Investment Collective were glad to support an event which is chaired by one of our clients. Judging by our staff reactions, it was very well run and some terrific artwork was on display!

New Staff

Elijah Tanarte
Trainee Portfolio Manager
Melbourne

Shobi Salam
PAMA Liaison Officer
Rockhampton

Laura Sciacca
Reception/Admin Support Officer
Melbourne

Lisette Swanink
Advisory Assistant
Melbourne

Congrats Bronwyn!

Back in 2007, Capricorn Investment Partners recruited Bronwyn Nunn. In the years since, Bronwyn has played an integral part in the business working in various areas including portfolio administration, reception, share trading, compliance and training, just to name a few. Over the past 15 years, Bronwyn has married and had two children while supporting the company through extensive growth and rebranding.

The Investment Collective currently employs over 40 staff and almost half of our current team have been with with the company for more than 5 years. Bronwyn has always been there to offer her knowledge, mentoring and support. We are extremely proud of our professional collaboration and truly appreciate Bronwyn's contribution to our success.

Congratulations Bronwyn on 15 years of employment with The Investment Collective and we look forward to many more years of working together!

Time for a haircut?

As I write this article, we are now seeing an increase in COVID-19 cases presenting at hospitals and rising workplace absenteeism. The media is now discussing mandates, working from home, vaccine boosters and support measures. It is almost as if we have progressed back three years. Is it a case of Déjà vu?

The world has changed since 2019 and economic conditions globally are now very different. We are seeing global inflationary pressure driving up interest rates and the ability for governments to prop up economies has diminished following several years of borrowing to cover the costs of managing the pandemic. Rising costs of living has seen the passing of increases to the minimum wage and one-off payments to pensioners, but with inflation likely to exceed this rise, some further belt tightening is going to be needed. For retirees, the markets have taken a hit and the majority of superannuation funds have experienced a negative return over the past 12 months. This can be a scary time when there is no income being generated from employment.

So as I line up for my fourth shot and my free flu vaccine, it is time to reflect on my own budget and where haircuts may be required. What do I need to anticipate and review for my overall goals?

Goals

Everyone's goals are different and prioritising/determining how much to allocate to goals is an individual choice. Let's look at how you may review some of your goals.

Retirement – less superannuation may mean reviewing whether you want to work one more year. Could you save enough from your budget for more salary sacrifice, do you downsize or relocate to cheaper housing?

Buy a house – interest rates are rising, so how much of your budget can you allocate to your loan (how does this compare to rent), will prices in your area come down or rise, do you delay a year to save a bit more for a deposit?

Holidays – set a budget and maintain it (also, involve the kids). Rising fuel costs and prices may mean some adjustment on expectations.

Needs versus wants

Budgets really are a case of needs and wants.

Needs will consist of fundamental items that are essential – roof over our head, clothing, food and water, essential health. Review your budget, where can savings be made? Have you shopped around on your home loan and general insurances? Challenge them to do better. Do you need the 'name' brand clothing or can a basic outfit suffice? Plan your meals and review the catalogues for food savings and plan meals around what is on special, could you grow your own vegetables? Look after your health. Flu vaccines are free so whilst they may not 100 percent guarantee prevention of flu, they will certainly help to prevent it (and with the amount of code reds in Victoria, lessening the load on the hospitals will be a good outcome also).

Wants are items that are great to have, but if they were not there, life will go on. Where can we find savings? With petrol topping $2 per litre, this is a good starting point. Use petrol apps to find the cheapest fuel. Premium versus regular, are you transporting extra weight in the car, could a ride on the pushbike achieve the same goal? Take-away, the morning coffee is the obvious one, but dinners out, take-away foods and pre-prepared meals will cost you more than a family dinner prepared at home. The fitness membership gathering dust, can you sell it or instead of renewing, you could exercise in the park? Streaming services, how many do you have and are they really needed?

> "The world has changed since 2019 and economic conditions globally are now very different."

Summary

At an individual level, we cannot influence the world around us to stop the conflict in Ukraine, improve trade relations with China or halt natural disasters, but we can focus on managing our discretionary spend and on our personal health. The ideas above are just a sample of how you can help yourself to combat costs of living. Do not assume that the government will provide relief as they manage their own debts incurred through the pandemic and sometimes having a budget haircut can provide a sound financial outcome.

Allan McGregor
Financial Adviser

Investment Update

BHP and Woodside merger

BHP and Woodside (WPL) are both in our top 10 holdings for domestic equities and hence the transaction between the two entities is a significant event that impacts our clients.

The merger transaction sees BHP sell its oil and gas assets to WPL. Shareholders voted overwhelmingly to approve the deal, 98.66 percent voted in favour. The transfer of BHP assets to WPL will be satisfied by BHP shareholders getting an allocation in WPL. Woodside has announced that it will change its name to Woodside Energy Ltd. The ASX code has become WDS and trading commenced from 25 May 2022.

Issues facing WDS in the short term are BHP shareholders that do not want or cannot hold WDS shares potentially creating short term selling pressure. As seen through the dismantling of the BHP dual-listed structure, it caused some short term weakness in BHP. The BHP/WPL deal may produce the same for WPL.

On 1 June 2022, BHP sold its oil and gas division to Woodside in exchange for 914.7 million Woodside shares. There will be no cash consideration.

BHP will distribute these shares to BHP shareholders on a 1 for every 5.534 (or 0.18 for 1) basis. For example, if you have 1000 BHP shares on 31 May 2022 you will have 181 WDS shares on 1 June 2022.

The distribution will be treated as an in-specie dividend. It will be fully franked. As WDS has $1.7 billion of surplus franking credits, we would expect a fully franked dividend of more than $2.00 per share.

Woodside outlook (ASX:WDS)

WDS has estimated that annual operating synergies of $400 million can be expected post-merger. The company had gearing of 16 percent on 31 December 2021. By the end of 2022, it could be nearly debt-free.

Longer term, the increased scale of the business ought to enable easier financing of major projects. In November, WPL committed to the Pluto Train II LNG expansion along with the Scarborough Gas Field development.

Long term, this is a good deal for WDS and positive for long term value for shareholders. However, in the short term, we could see some pressure on the price as traders get set for the expected selling.

BHP outlook (ASX:BHP)

For BHP shareholders, the demerger of its petroleum business has concentrated BHP's earnings, while improving its Environmental, Social, and Governance (ESG) profile. Our positive investment view on BHP remains unchanged.

Market overview

The markets continue to struggle as rising inflation fears coupled with hawkish central banks who escalated concerns of a global slowdown in economic growth. U.S. stocks have experienced their worst ever start to a calendar year with the Nasdaq falling 29.5 percent in the first half of the year, Dow Jones down 15.3 percent and the S&P 500 falling 20.5 percent. Domestically, the All Ords Index fell 13.2 percent during the same period, outperforming most major developed markets. This is primarily due to its greater exposure to resources and lower exposure to technology stocks.

Mathew Caskey
Head of Portfolio Management

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*Please note that the content in this newsletter is general in nature and has not taken your personal or financial circumstances into consideration. If you have any questions please contact your adviser.

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