Elizabeth Redman reports from Wall Street on changing fortunes for top tech stocks **in WEALTH on TUESDAY**

Don Stammer finds five lessons for recent Sharemarket turbulence **in WEALTH on TUESDAY**

Time to check on insurance cover

Your policy holds the key to payout in case of illness or injury

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This week's controversy over CommInsure's hardline treatment of some insurance claims on *Four Corners* and the complaints reported in *The Australian* from the family of late cricketer Tony Greig are a timely reminder for all Australians to check their own personal insurance.

How people got their insurance and the nature of the policies involved — as well as the specific terms and conditions of each policy — could make a big difference to any payout in case of illness or injury.

These days life insurance is just as likely to be acquired by default through a person's superannuation policy as through an active decision to buy it. Some level of life insurance is now included in the basic MySuper products that must now be provided as a default super option.

This means that, with the current compulsory superannuation regime, Australians can easily find themselves being charged for insurance cover they didn't specifically opt for. Conversely, some people who are faced with illness or injury may find they do have insurance cover they didn't realise they had, which could apply to their circumstances.

Most consumers will opt to buy their insurance from what they believe is a reputable company, if they have say in the matter. But in reality it is very difficult for them to make an accurate judgment on the likelihood of whether the insurer will take a hardline approach to paying out on claims.

In a bid to head off market concern, CommInsure has announced it will be "accelerating the planned upgrade" of the definitions of heart attack and severe rheumatoid arthritis in its trauma insurance policies.

Apologising to the customers highlighted in the program who had been battling to get their insurance claims paid, the insurer has also announced it would be referring complex claims to an independent panel for a review.

But the question may be whether the mea culpa from CommInsure and CBA chief executive Ian Narev will be enough to allay concern of superannuation funds and individuals who have policies with the insurance giant.

Australians have traditionally had a "set and forget" attitude to their insurance, particularly those associated with life insurance.

In 2014 the Financial Services Council teamed up with MetLife to produce an "Apathy to Action Report".

It found that 75 per cent of Australians believed that "life insurance" only involved death cover, with most Australians failing to understand what life insurance coverage is or should be.

FSC boss Sally Loane says a new industry code will enhance consumer protections

Only 48 per cent of those surveyed owned or knew they owned a life insurance policy. Two-thirds of these did not know how much they were covered for. The report found that "Australians overestimate the cost of life insurance and underestimate its value."

Life insurance is increasingly being linked or even sold with other products that pay out in the event of illness or injury. These include:

- Trauma insurance, or critical illness insurance, pays a lump sum in the event of a specific event such as heart attack, cancer or a stroke, as defined in the policy.
- Total and permanent disability (TPD) insurance is often sold these days in connection with life insurance, paying out a lump sum if a person becomes disabled and is unable or unlikely to work again.
- Income protection insurance, which can be taken out in connection with a superannuation account as part of a package with life insurance and TPD.

The focus on life insurance has provoked differing responses.

Industry Superannuation Australia, which represents the industry superannuation sector, says commissions on life insurance should be banned and that a code of conduct is needed for the life insurance industry.

But the FSC counters this by pointing out that the life insurance industry is working on having a code of conduct in place by July next year following the 2015 Trowbridge review of the sector.

FSC chief executive Sally Loane says the code, "an industry first for life insurance", is being developed through extensive public consultation with industry stakeholders, consumer groups and regulators.

"The code will commit life insurers to strong standards of customer service, and will enhance consumer protections in the key areas of underwriting and claims," she says.

If anything the controversies have strengthened the argument for having a financial adviser to help consumers understand the complexities of life insurance products and how they relate to their own circumstances.

Simon Swanson of ClearView says people who approach insurance companies themselves, without any advice, risk being sold cover that is not as comprehensive as the cover offered by financial advisers.

"People who buy direct insurance on the internet or through call centres often don't understand all the issues involved. While it is a relative short process, it is not a great process as there is no advice," Swanson says.

He argues that financial advisers can often access premiums for people that are comparable to those in group insurance and the cover is more comprehensive with fewer limitations.

"The trouble with group insurance is that it has nothing to do with your needs. It is just there," he says. "It is a wild guess at what you need for your insurance ... and you can't get trauma insurance through your superannuation."

Swanson says people who have group insurance in their employer superannuation also need to check what happens if they change jobs or leave the employer.

"My advice is to go and see a financial adviser and make sure that your insurance is related to your needs," he says.

Tech savvy: a new wave of youth-focused China consumer stocks

STIRLING LARKIN
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This week marks the seventh anniversary of the technical beginning of the current US stock bull market.

As this ageing cycle is recognised as the third-longest in US history — running for 84 months — the question now for global investors is where else to turn their investment attention, positioning today for the next bull opportunity.

One strong candidate must surely be China.

It is generally accepted the Chinese are moving towards a services-heavy, consumption-driven economic model, where millennials are driving change — if for no other reason than they represent 415 million consumers, or one-third of the total Chinese population, which is larger than the entire working populations of the US and Western Europe combined — and where investments towards software will outpace those made in hardware.

In the wake of last year's listed Chinese stock and future markets retracements, alongside equally confusing guidelines to acceptable venture capital (VC), private equity (PE) and foreign direct investment (FDI) channels within China proper, what remains unclear for the global investor in early 2016 is how best to access, invest and trust direct or proxy "China tech" investment opportunities, if at all.

At face value, there is a wealth of opportunity. Yet in addressing this opportunity, the global investor needs to first appreciate that what rings true for "digital natives" in the West, does not, necessarily, remain so for the Chinese consumer.

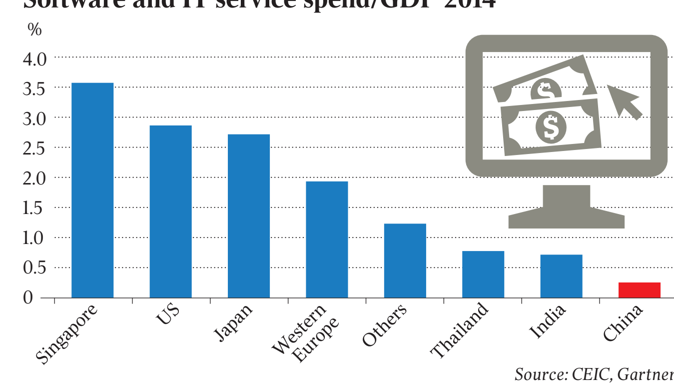
A specific example of this is referred to as the "first-mover disadvantage" principle.

This runs contrary to that which succeeds in the West, where first-mover technology companies dominate market share because of an early acquisition of superior brand recognition and customer loyalty.

In China, first movers often succumb to failure because of a fragmented product or service offering that does not touch the intended client audiences proportionately.

Primarily this is because of a continued heavy reliance on traditional distribution channels that remain focused on antiquated frameworks. Accepting that the newer sector greenhorns in China often benefit from "late-mover advantages", the discussion then turns to which China technology trends deserve our investment attention.

Software and IT service spend/GDP 2014



In determining this, look to the US post-2001 experience with off-market "unicorns" — those private companies with valuations in excess of $US1 billion — that subsequently went public alongside current Chinese privately held, listed plus US ADR (American depositary receipt), quoted favourites.

Up from 80 such firms in 2014, 45 per cent of the total $US532bn is represented by the following techs.

- **Uber (US)**: Ride-sharing app matching passengers to drivers, servicing 58 countries.
- **Xiaomi (China)**: The world's fourth-largest smartphone developer, based in China and valued at more than $45bn.
- **Airbnb (US)**: The San Francisco-based accommodation service that allows individuals to rent their homes to holiday-makers, now worth more than $25bn.
- **Palantir (US)**: Privately owned developer of anti-terrorism software, with major clients including the US government — valued at $15bn last year.
- **Snapchat (US)**: Popular video messaging app developed by Stanford students; customers now use it to send two billion images each day.
- **China Internet Plus Holding (China)**: Newly merged entity of China's classifieds business Meituan and on-demand restaurant listing service Dianping.
- **Flipkart (Singapore/India)**: The Singapore owned/India-based online shopping platform, which Morgan Stanley estimates is worth $11bn.
- **Didi Kuaidi (China)**: Uber's Chinese rival, which recently announced a $1bn capital raising from investors.

What this grouping naturally communicates to us is that software-oriented unicorns lead the herd.

Accepting this and circling back to the question of where to direct investment focus today as an external global investor entering China, a determination of how contemporary millennial trends will impact the China of 2019 and beyond is required.

China's demographics are very different from those of the West.

For instance, "balinghou", refers to Chinese who today are aged between 27 and 36 and were born in 1980-89, when the one-child policy was both introduced and enforced.

Even more specifically, "bawuhou", refers to only those born between 1985 and 1989, while "ji•linghou", recognises millennials born between 1990 until the millennium.

Balinghous, who represent roughly a quarter of Chinese millennials, have become young parents themselves and are driving mainland demand for premium family services, which are now, more commonly being found and delivered online.

Importantly, this group is also recognised as being the prime consumers of property and cars, which heading towards 2019 and beyond will be fronted by Chinese technology providers.

Ji•linghous, the youngest Chinese millennials — who know nothing else but the mobile computing and internet era — are bringing significant changes to consumer preferences, which is having consequences on behaviour as this generation enters the workforce.

And surely all of this leads the global investor to focus on software solutions, which — in a similar way to the boon in consumer staples following the West's baby boom — will result in Chinese millennials' uptake of online and digital services as they transition towards adulthood.

Of course, such potential does not automatically lead to better investment opportunities or outcomes.

But China tech does present the global investor with plenty of potential, which in the multi-asset-class investment rut of 2016, becomes highly valuable in and of itself.

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Rising rates don't have to hurt your portfolio

ROGER MONTGOMERY

It's a little known secret but interest rates are perhaps the single most important determinant of the returns your investments will generate in coming years.

And with so much of the world's uncertainty and the market's volatility centred on this variable, it's worth exploring just how they work to impact on your performance.

Many investors appreciate that an inverse relationship exists between the interest rate on a bond and the bond's price. When a bond is issued, it is done so with a coupon payment fixed until maturity. A $100,000 bond with a 2 per cent coupon will make two six-monthly payments that amount to $20,000.

If, after the issue of the bond, interest rates rise, then any subsequent investor who buys this bond in the secondary market, will want the $20,000 to represent a higher rate of return than 2 per cent. To achieve this, they must pay a lower price. So when interest rates rise, the price and value of the bond falls.

While this relationship in the market for bonds is well known, it comes as a surprise to many that an identical relationship exists between interest rates and all assets. That is, if interest rates rise the underlying value of the asset declines. It matters not whether the asset is a business, a stock, land or any other income-producing asset — when interest rates go up, the value goes down.

Imagine for a moment you had an asset — any asset — and it produces an annual cash return of $1 million for 10 years. Now, you know $1m at present is worth a great deal more to you than $1m in a decade's time, and so we have to discount the future years' cashflows to arrive at a present value. For example, adopting a 2 per cent interest rate as our discount rate, we find $1m in 10 years is worth $820,000 at present. This makes sense: if we had $820,000 now and invested it at 2 per cent for 10 years, we'd end up with $1m.

But if the interest rate we require is higher, say 10 per cent, that $1m in 10 years is worth just $385,543 now.

The value of a future cashflow is lower when interest rates are higher and vice versa. That explains why Warren Buffett likened interest rates to gravity in 2013: "Interest rates are to asset prices what gravity is to the apple. When interest rates are low, there is a low gravitational pull on asset prices."

The intrinsic value of an asset is simply the sum of the present values of all the cash that can be extracted from an asset over its useful life. Add up all the present values of a $1m received every year for 10 years and we arrive at a total of $8,982,585 at 2 per cent and $5,604,264 at 10 per cent.

Once again, we observe that when interest rates are higher the value of an asset is necessarily lower.

So why do we care so much about interest rates and their gravitational effect on an asset's intrinsic values? Because in the long run, market prices follow changes in intrinsic values. You can pretty much forget China, Greece or "Brexit" — these things will have only a fleeting impact on the market value of your investment portfolio. All that will matter in the long run is the change in intrinsic values. And interest rates will matter more than almost anything else.

Right now, interest rates are low and it's reasonable to assume they will stay low for a while.

But what happens to asset prices when interest rates eventually rise again? Let's not be mistaken — they will fall and impact overall returns, and "this time" will not be different.

We can actually see this observed in recent history. In the US, between 1964 and 1981, interest rates rose — materially.

During this period, the average return from the US S&P 500 sharemarket index was in the low single digits — about 3.6 per cent a year. Then,

> When interest rates are higher the value of an asset is lower

between 1981 and 2000, interest rates declined substantially. During that period, the average annual return from the S&P 500 was almost 15 per cent.

And since 2000, interest rates have continued to decline. But when the implied equity risk premium is accounted for, the combined total has remained flat. In this environment the S&P 500 has returned just 2.5 per cent a year.

In summary, when interest rates fall, the sharemarket does well. When interest rates remain flat or rise, it does not do so well.

Interest rates are now at record lows across the globe, and while we might like to wish that will be the case forever, it won't be. Eventually interest rates will rise — and when they do, asset values will not perform as well as in the past.

Of course here we are talking about the broader sharemarket as measured by the aggregate market index. But I don't invest in the index, I invest only in the highest quality companies — and only when they are available at bargain prices.

You should be able to beat the sharemarket by owning a portfolio of extraordinary businesses, those that grow in intrinsic value at a rate that more than offsets the decline from rising interest rates.

So as speculation about a slowdown in Chinese growth and whether Australian property is in a bubble reaches fever pitch, just remember how important interest rates ultimately are in determining long-term returns.

Roger Montgomery is founder and chief investment officer of the Montgomery Fund.

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