Facebook makes things better, but there's a catch

ROGER MONTGOMERY

When a single tycoon apologises personally for failing for three years in his duty to notify millions of customers that their trust has been breached, the obvious issue that needs to be corrected is that one man remains responsible: I'm talking about Mark Zuckerberg and Facebook.

Mark Zuckerberg said: "I apologise for any harm done as a result of my neglect to consider how quickly the site would spread and its consequences thereafter."

Now here's the thing: that statement was not made during Zuckerberg's recent Senate testimony. He offered that apology in a 2003 — 15 years ago — in a letter to the Harvard University student body after building the Facemash website for rating female students on appearance.

Recently, *Wired Magazine*'s Zeynep Tufekci laid to rest any residual belief in Zuckerberg's claim that next time will be different, documenting Facebook and Zuckerberg's "14-year apology tour", and listing a conga-line of profit-motivated management fumbles.

What is being revealed through this year is that a major regulatory overhaul could change the landscape for investors in a raft of Big Tech names well beyond Facebook.

Facebook has arguably constructed not only the most pervasive surveillance systems in the world, it has built one with hitherto unknown powers of persuasion, a propaganda machine World War II combatants could only have dreamt about.

Regulator trust has understandably plummeted, and it would be surprising, if not stunning, were Big Tech permitted to continue self-policing.

Facebook's listed company status and profit motive, and the elevation of its leader to demigod status, have resulted in a failure that has compromised democracy and delegitimised the outcome of the Brexit and Donald Trump elections.

A regulatory backlash is a serious risk and investors cannot overstate the consequences; as the nine-year bull market has progressed, an overdependence by US index funds on a hyper-narrow band of technology stocks has transpired and never has so much capital been concentrated in a single sector that, through exchange-traded funds, can be sold at the click of a mouse.

It is the weighting of tech stocks in the indices that investors should be concerned about in light of a regulatory backlash.

A handful of Big Tech companies including Apple, Netflix, Google, Facebook, Microsoft and Nvidia speak for 15 per cent of the S&P 500 and 50 per cent of the Nasdaq 100, and in a recent report, analyst Michael Hartnett aligned Big Tech today with the tobacco industry in 1992 when the Supreme Court ruled it liable.

While the US Senate is beginning to discover what is possible when big data analysis manipulates the democratic process, what happens when corporations' websites and technologies (think Amazon's Alexa, Google Home, Microsoft's Cortana and Apple's Homepod) infiltrate schools and homes, and our personal lives and minds?

On Twitter, Jeremy Ashkenas tracks the thousands of patent applications being made by the likes of Google and Facebook that "indicate corporate intent and direction"; from Facebook "the log may record information about actions users perform on a third party system, including web page viewing histories, advertisements that were engaged, purchases made, and other patterns from shopping and buying".

Facebook reads your comments for positive or negative "affinity scores", and generates "trust scores" for strong feelings; "Data sets from trusted users are then used as a training set to train a machine learning model".

Meanwhile, Amazon, Google, Oracle and Microsoft are competing to secure a $10 billion contract with the Pentagon and thousands of Google employees are reported to be revolting, sending letters to CEO Sundar Pichai stating: "We believe that Google should not be in the business of war."

It is safe to say that smartphones, Google Earth, and the internet are no longer merely modern conveniences for consumers. Having the data from those assets concentrated in the hands of a few powerful companies represents a vulnerability. The data looks a whole lot more like "national security assets", with major consequences for their regulatory outlook. Understanding Big Tech's massive contribution to investor returns over the past few years and their weighting in the major indices, and appreciating the significant shift in the regulatory environment, investors need to be prepared for unanticipated consequences.

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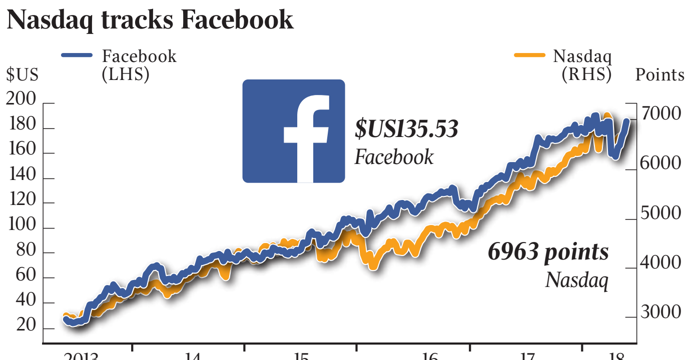
www.montinvest.com

Nasdaq tracks Facebook



Source: Bloomberg

Airport economist's tick for budget

MY WAY
Tim Harcourt says invest in what you are interested in and stick with it

GLENDA KORPORAAL

HOLLIE ADAMS

Tim Harcourt say the budget points to a strong Australian economy in the medium term

What did you think of the budget?

I think this budget finally buries the debt and deficit horror 2014 budget of Tony Abbott and Joe Hockey and the deficit fetish foolishness of Wayne Swan. Government finances are not like household finances and it makes sense to run deficits when economically necessary and for governments to borrow to pay for large-scale infrastructure that the private sector and individual households couldn't and shouldn't pay for.

Can investors profit from the budget or limit the fallout from the budget?

It does point the way to large-scale infrastructure projects that institutional investors and superannuation funds will invest in so individual investors can ride on those coat tails. It probably points to a strong Australian economy in the medium term, so investors will still play at home rather than away.

Are there any longer-term messages in the budget for ordinary investors?

There's some tax relief, at least in the medium term over seven years, so middle and upper-income earners will have more surplus funds to invest. So, Peter Costello's "forgotten people", the upper middle class, could be beneficiaries once again ("Never has so much been given to so few by one treasurer"). There have been some sensible changes to aged care, pensions and superannuation so the baby-boomers' golden run can continue. The government is also conscious of bracket creep, so that will help investors, too, as surplus funds don't get eaten up in taxes.

If the economy is so buoyant, will we see interest rates go up?

The budget is consistent with the Reserve Bank of Australia's governor's suggestion of not much action on the interest rate front. The revival of the mining boom suggests a slightly stronger Australian dollar, although US President Donald Trump's trade stance may cause friction and Australian housing will continue to be a good investment for baby-boomers and a pipe dream for millennials.

> 'Malcolm Turnbull and Scott Morrison are being cautious. They have abandoned the overblown budget emergency rhetoric of 2014'
>
> TIM HARCOURT
> THE AIRPORT ECONOMIST

You've seen your fair share of budgets ... how does this one rate with past efforts?

This is a "safe pair of hands" budget ahead of a federal election late next year or in the first half of 2019. The Coalition has been spooked by the 2014 budget that eventually cost Abbott the prime ministership and Joe Hockey the treasury, so Malcolm Turnbull and Scott Morrison are being cautious. They have abandoned the overblown budget emergency rhetoric of 2014 but are still trying to present themselves as the low-tax party, despite the evidence.

The case for corporate tax cuts has been bungled by the Business Council of Australia as the government's main politically ally ... with friends like these, do you really need enemies? I think that's why the government has quickly switched the spotlight to personal income taxes.

How did you become The Airport Economist?

I started travelling when I was chief economist with Austrade and I think I have been to about 60 countries in about five years — all for three days each — hence the Airport Economist tag. My first book, *The Airport Economist*, came out at the same time as *Freakonomics*, and *The Undercover Economist* (by my almost namesake Tim Harford) so I surfed the wave of popular economics literature.

Then David Koch said I should make the book into a TV series, which now airs on Sky News, Qantas and soon LATAM Airlines (for the Latin America series). When I was a kid I always wanted to work for the ACTU, like Bob Hawke. When I went to the ACTU they said I should study economics or law, but they had plenty of lawyers so really needed economists like Hawke and Ralph Willis.

I was hooked and went on to become chief economist of Austrade and now at the University of NSW I research and teach international trade and international business.

Does having an economics background help you as an investor?

It helps you think about long-term fundamentals and to avoid jumping on fads.

You are regularly travelling the world. What sort of global outlook are you seeing?

The emerging markets — Asia, Latin America are still holding up OK and the US is doing better. Naturally, there's nervousness about Trump's trade protectionism but the US labour market is doing OK thanks to (former US Federal Reserve chief) Jane Yellen's hard work. I don't think the UK will face a Brexit armageddon although its bargaining power would have been stronger as a troublesome little island within the EU tent.

Australian companies have a history of not doing well overseas ... any views on investing overseas or Australian companies investing overseas?

On the contrary, Australian companies are very successful overseas, especially the SME sector. I meet Australian architects in second-tier cities in China, South Australian wine marketers in Mendoza Argentina, Australian hoteliers in Lima, Australian technology companies in Colombia, Chile, India and Russia.

There's a lazy business press that says Australian businesses don't do well because of one instance of Foster's not doing well in China 20 years ago or something like that.

Tell us about your own experience as an investor.

My simple tip is to invest in what you are interested in and take a lot of notice of (I don't think barristers should invest in dry cleaning businesses, for instance) and if you stick at it long term you'll do OK.

Advice sector shake-out could spur consolidation of service stocks

RICHARD HEMMING
UNDER THE RADAR

Now that the royal commission is in full swing, it's clear one of the big problems in financial advice is the "vertical integration" model that allows the big banks and the likes of AMP to push their own products down the throats of unsuspecting customers.

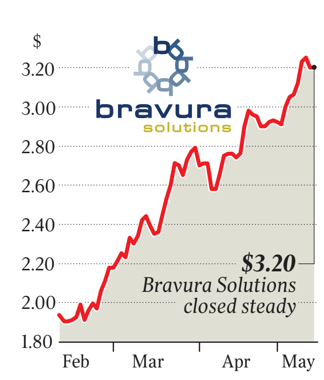
What will it all mean for the selection of financial advice-linked small caps on the market?

This group of companies has emerged in recent years as service providers to the advice sector.

Bravura Solutions, for example, has been in the market for a number of years as a leading provider of software for wealth managers. The stock was beaten up in the financial crisis after which I became interested in 2012, but so did private equity. Bravura was taken private and then refloated by private equity and it's now worth well over $600 million.

It's a great business but, trading on a price earnings ratio of over 35 times, it looks expensive even though it has just won the plumb Commonwealth Super contract, which covers some 700,000 civil servants across 11 super schemes.

Then there is platform stock HUB 24, where the shares have more than doubled in the past year and is now worth more than $700m. Its business is based on a product platform, which gives investment advisers and financial planners all the tools they need to manipulate and manage their customer relationships.



Source: Bloomberg

Like Bravura, HUB 24's business model is capital light, which means it doesn't need much capital to generate a return.

Consequently its return on equity is very high at just over 40 per cent, although it's noteworthy that the stock has only just turned profitable, even though it's been listed for more than a decade.

Again, even considering its high return on equity, this stock is expensive, trading on a sales multiple of over 11 times.

Then there is Praemium, whose board and management got all the wrong sort of attention after the dismissal of its CEO followed by his reappointment by a new board in 2017.

After a series of disappointing results, the stock roared back to produce a stellar first-half result in fiscal 2018, but what next?

My ardour has cooled because this stock trades on a sales multiple of eight times, which is also too high.

The point is, the world is "over-platformed" (that's not a recognised word just yet), but keep in mind there are more than 20 competitors in the space in this market alone.

In other words, competition is fierce and the coming shake-out of the large adviser groups may trigger a consolidation.

One stock that is interesting is Centrepoint Alliance, which provides a licence umbrella for financial advisers as well as services such as compliance monitoring, training, provision of technology and third-party platforms.

The stock has fallen on hard times and is down 40 per cent in the past six months or so and looks exceedingly cheap. The good news is that new CEO Angus Benbow is fired up about the group's prospects, considering the banking royal commission.

"We're entering a strategic reset and the royal commission is a good backdrop. We're looking to attract more advisers but, I stress, the right advisers," Benbow says.

For the past five years, Centrepoint Alliance has been working through one of ASIC's "enforceable undertakings", so this company should know what it's like to be under the gun, so to speak.

In Centrepoint's case, those tricky legal issues are fading. Most of the legacy claims relate to the financial crisis, and the six-year statute of limitations has given the company breathing space.

Unfortunately for the likes of AMP, this isn't the case.

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