FROM DECIMAL TO DIGITAL

Lessons from 50 years of investing in Australian shares

Perpetual

$1,000 dollars invested in the Perpetual Industrial Share Fund in December 1976 would today be worth over $212,000 – around twice the result achieved by the All Ords Accumulation Index.[1]

1. Audited results available as of December 1976. Returns as of June 2016.

The current benchmark for the Perpetual Industrial Share Fund is the S&P/ASX 300 Industrials Accumulation Index. As the Industrials Index series is not available prior to 1979, the S&P/ASX All Ordinaries Accumulation Index has been used for reference purposes. Total return shown for the fund has been calculated using exit prices after taking into account all of Perpetual's ongoing fees and assuming reinvestment of distributions. No allowance has been made for contribution or withdrawal fees or taxation (except in the case of superannuation funds). Past performance is not indicative of future performance.

50 YEARS OF INVESTING

"The 50-year history of Perpetual's Industrial Share Fund tells its own story about Australia – of change and turmoil but also of ever-growing prosperity. Above all, it's about the life-changing rewards you can reap from investing in Australia, with patience and an active, questioning intelligence."

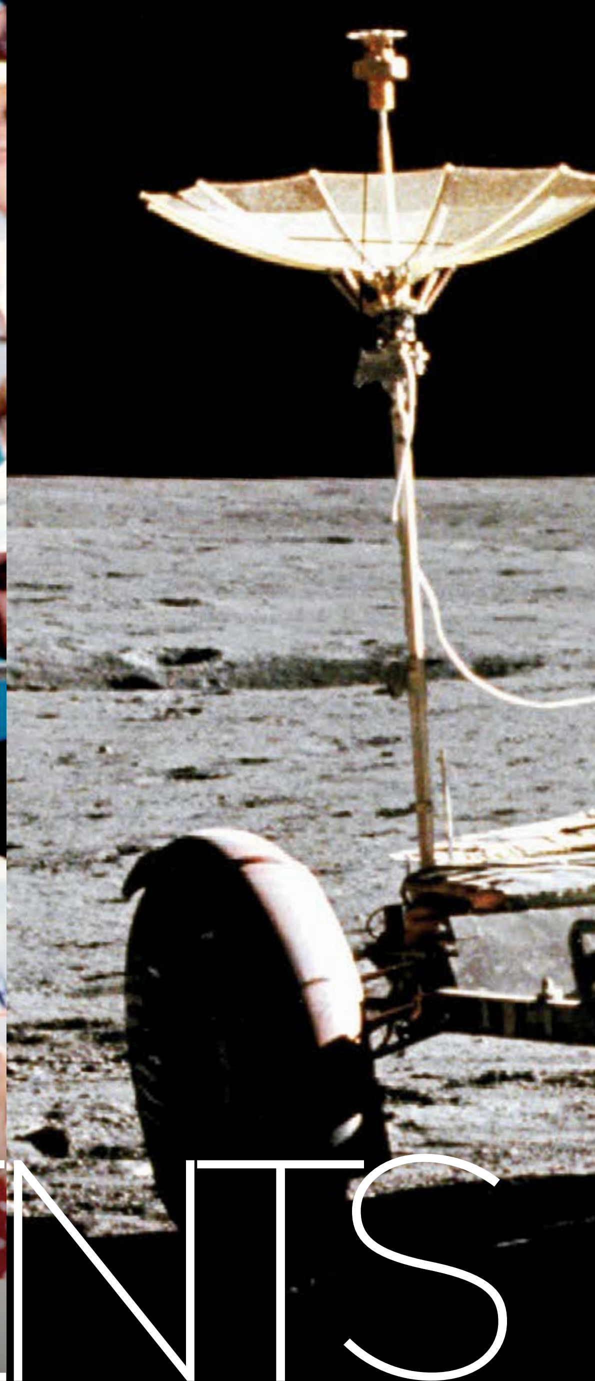
Geoff Lloyd CEO and Managing Director, Perpetual

"Decimal currency has told our nation's story for the last 50 years, echoing the growth and development within Australian society since 1966."

Ross MacDiarmid CEO, Royal Australian Mint

1966

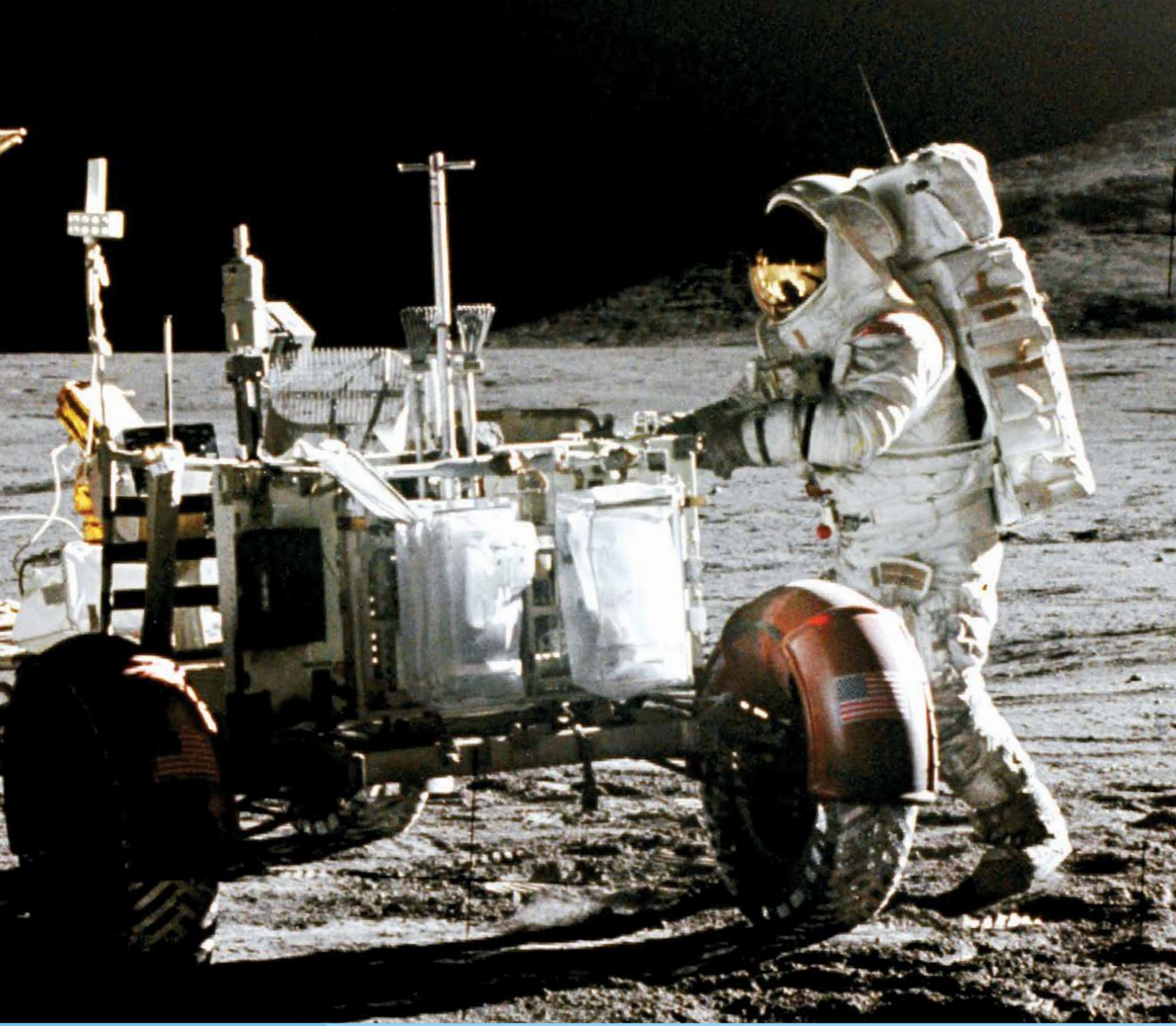
Image: One dollar note. *Source: Australian Coin Collecting Blog.*



CONTENTS

Images from top left: Greg Norman in action at the Australian Masters. *Source: The Age (Melbourne), Fairfax Media.* Apollo 11 moon landing. *Source: NASA.*

Images from bottom left: Australian troops in Vietnam. *Source: Stuart MacGladrie, Fairfax Media*. Prime Minister Gough Whitlam. *Source: Graeme Thomson, Newspix*. Australia II wins the America's Cup. *Source: News Ltd, Newspix*. Prime Minister Paul Keating. *Source: Fairfax Media*. Mining in Australia. *Source: Alice Nerr, Shutterstock*. Apple Store Sydney. *Source: Fairfax Media.*



2010s

"…you're here because there's no one else, and everyone's got to be somewhere and you're here, so get used to it."

Harry (played by Graham Kennedy) *The Odd Angry Shot*

Image: Australian troops in Vietnam. *Source: Stuart MacGladrie, Fairfax Media.*

1966 Decimal currency is introduced on 14 February in what's described as 'the greatest movement of money in our history'.

1966 At the Battle of Long Tan, 108 ANZACS fight and hold off an overwhelming enemy force of 2,500 Viet Cong and North Vietnamese soldiers.

1966 'There's a bear in there.' The very first episode of Play School airs on the ABC featuring Big Ted, Humpty, Jemima and the Rocket Clock.

1966

1966 – Dollars, sheep, shares

1966 was a year of shiny new things. We emptied our pockets of pounds and pence and filled them with dollars and cents. Japan replaced Mother England as our biggest trading partner and our new Prime Minister, Harold Holt, promised to "go all the way with LBJ".

Music critic Jon Savage says, "1966 began in pop and ended with rock." So it was in Australia – Bob Dylan and his band – *the* Band, toured the country. So did the Rolling Stones. In Victoria, you could now stay at the pub till after six. In Sydney, you could buy a beer on a Sunday. In Queensland the rains came and they found nickel, lots of nickel, in Western Australia.

Australia still rode on the sheep's back. So much so that the managers of a large public trustee company – Perpetual Trustees – noted in their 1966 Annual Report that the company had shorn 270,000 head of sheep on properties it managed for clients.

But Perpetual and its clients wanted more than a sheep clip. The chairman bemoaned rules that limited the assets it could hold for clients; "It is strongly urged that the investment powers of corporate trustees be widened so that fuller advantage can be taken of the investment opportunities that exist in Australia today."

The end result of this push was the launch, internally, first as a common fund and then a managed fund, of the Perpetual Industrial Share Fund. A fund designed, as legend has it, for 'widows and orphans', trustee clients who needed good returns to get them through difficult times – but also expert management to reduce the risks.

In 1968, the Perpetual Annual Report was saying, "All investments are kept under constant review by research and analysis. Pursuance of this policy over many years has resulted in substantial gains by way of capital appreciation and increased income for our clients."

Not much has changed. But everything has changed.

This book is not all about the Perpetual Industrial Share Fund – though it celebrates 50 years of that fund. It's about the country the fund invests in, how it's changed and why.

It's also about the lessons people can learn from the investment approach of a fund that's half a century old. Our premise is that industrial shares remain an irreplaceable investment choice. That investing conservatively, patiently, yet decisively has created wealth for decades and can do so for decades to come.

Mostly it's about the people who invest in the Perpetual Industrial Share Fund. Those who believe in Australia and its companies and its people. And who reap the rewards...

Image: 50 cent coin, 1966. *Source: Cruiz's Coins.*

The changing face of Australian business

COMPANY	MARKET CAP ($M)
BHP	3,049
North Broken Hill	1,583
Conzinc Rio Tinto	1,490
Hamersley	1,250
MIM	749
Western Mining Corp	660
CSR	363
Myer Emporium	295
New Broken Hill Corp	235
Ampol	196

Source: InvestSMART. Data as of May 1968.

In May 1968, seven of Australia's top ten companies by market capitalisation are miners. CSR manufactured building materials, Myer was a retailer and Ampol a petrol distributor.

Images clockwise from top: Sheep shearing. *Source: Fairfax Media.* Harold Holt and Lyndon Baines Johnson. *Source: Yoichi Okamoto, Lyndon Baines Johnson Library and Museum.* Typical Australian pub in the 1960s. *Source: Fairfax Media.*

70s

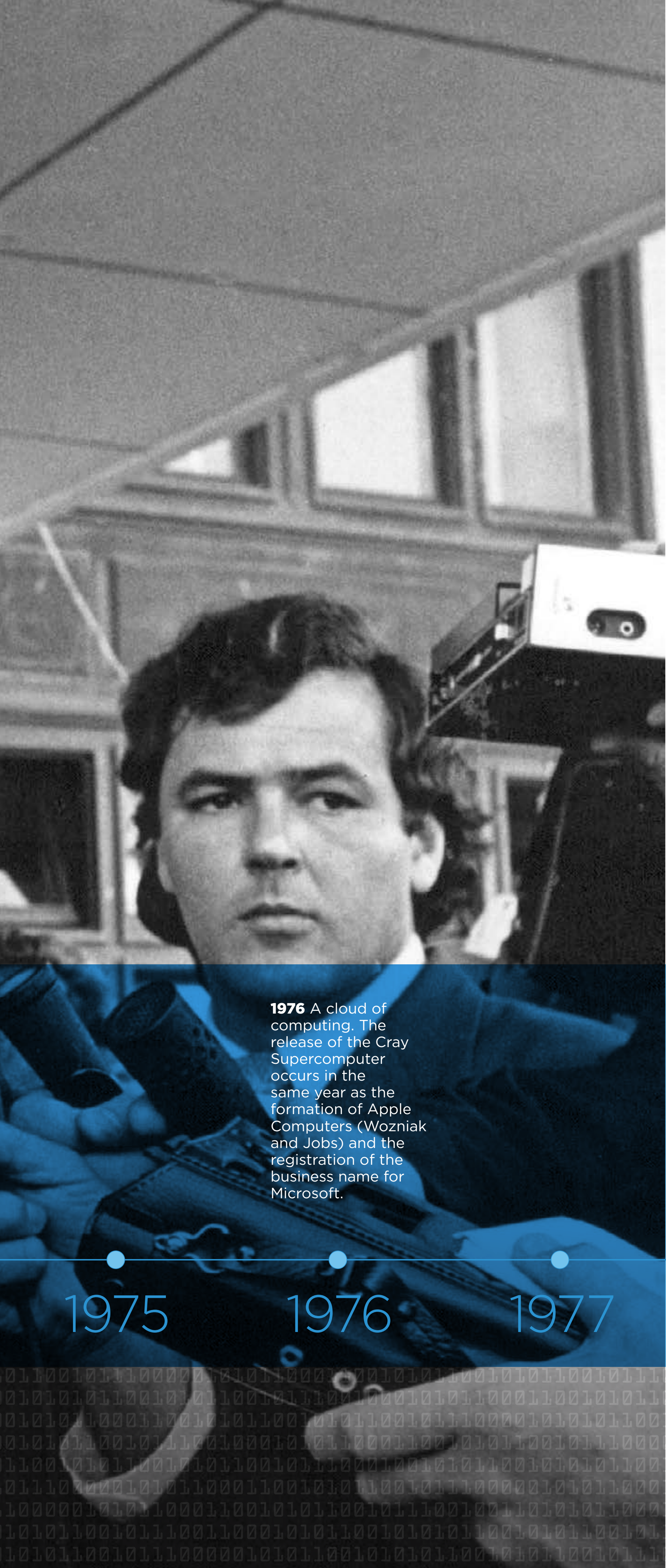
1971 Evonne Goolagong beats fellow Australian Margaret Court to win Wimbledon. She wins seven Grand Slam titles in total. She played in seven successive Australian Open finals and won four.

1972 Black September terrorists storm the Israeli team rooms at the Munich Olympic Games. Eleven athletes die, nine of them in a rescue attempt by the West German police.

1974 Cyclone Tracy hits Darwin, killing 65 – a gust of 217 km/h is recorded. Some of the relief effort is funded by the song, *Santa never made it into Darwin*.

1970 1971 1972 1973 1974

Image: Prime Minister Gough Whitlam.
Source: Graeme Thomson, Newspix.



"I've never said I'm immortal. I do believe in correct language. I'm eternal; I'm not immortal."

Gough Whitlam Prime Minister of Australia, *The Telegraph, 1989*

1976 A cloud of computing. The release of the Cray Supercomputer occurs in the same year as the formation of Apple Computers (Wozniak and Jobs) and the registration of the business name for Microsoft.

1978 The first Sydney Gay and Lesbian Mardi Gras. The lead float was impounded and there were 53 arrests. By 2012, there were 12,000 paraders.

1979 The Ferrous Lady. The UK elects Margaret Thatcher Prime Minister – who apparently is more proud of being the first PM with a Science degree, than its first female leader.

1975 1976 1977 1978 1979

1970s – Australia unsettled

For cricket fans, the 1970s were a time of moustachioed pre-eminence, with Lillee, Thomson and the Chappell brothers defining an era of brash Aussie confidence. Economically we started the decade still surfing the crest of a long commodity/agriculture boom.

Yet the economy was more unfit than it appeared. Today we are a leader in the fight for freer trade. In the 1970s we reduced our involvement in the General Agreement on Tariffs and Trade because it didn't suit a nation where we dug money out of the ground.

OPEC flexes its muscles

The 1970s set Australia's long-established economic structures a series of big tests and marked them FAIL. The long commodity boom came to an end as other quarry countries fought for buyers and the global economy weakened.

The big blow was the OPEC oil crisis of 1973, after which oil prices rose fourfold. Unlike today, our economy – and its price-finding, currency-pricing, rate-setting and wage-paying – was too inflexible to respond. We had a high inflation economy (in the March quarter of 1975, it hit a high of 17.7%). Former RBA boss Ian Macfarlane said, "Economically, the first half of the 20th century was disfigured by the Great Depression of the 1930s, and the second half by the high inflation of the 1970s." Australia's unemployment rate effectively tripled in ten years.

Fade to new

The mid-decade credit squeeze and the economic troubles of the Whitlam government (counterpointing its social advances) ended with the Dismissal. But Australian economic policies drifted into the end of the decade little changed from the creaking ones which preceded the Whitlam experiments. By the end of the decade our cricketing dominance was challenged by the calypso kings of the West Indies. In our economy too, it was time for a change of tune.

Image: Dennis Lillee dismisses Viv Richards.
Source: News Ltd, Newspix.

The changing face of Australian business

COMPANY	MARKET CAP ($M)
BHP	1,559
Conzinc Rio Tinto	827
MIM	643
Hamersley	568
Bank of New South Wales	404
CSR	379
Australian Guarantee	326
ANZ Banking Group	325
National Australia Bank	305
Coles Group	291

Source: InvestSMART. Data as of May 1978.

By the late 1970s, things are changing. Only four of the top ten companies are miners – though they are the top four. Banks and finance companies take four places. Many of these big companies have become smaller – reflecting stagflation and the end of the resources boom.

You can't choose the wind but you can set the sails

"One of the unpredictable attributes of markets is that no one rings a bell at the top of a euphoric market telling everyone to get out. It is only after the correction that you see and understand the importance of owning sound, quality companies. Those companies' shares will fall too, but it will be the investors that got carried away and compromised risk by chasing short-term returns that get hurt the most. Perversely it is usually these same investors that sell at the bottom of a collapse and they usually are indiscriminate in what they sell, thus providing an opportunity for smart investors to buy good companies at 'for sale' prices."

Peter Morgan Former Perpetual Head of Equities

Image: Construction of the Sydney Opera House. *Source: Fairfax Media.* Vinyl record collection. *Source: Shutterstock.*

Value then, value now

John Aitken joined Perpetual in 1973 and went on to manage the investment team and later become CEO. He was instrumental in professionalising investment management. "We standardised our research, concentrating on the value measures people still use today – sales growth, profit margin, tax expenses, earnings-per-share, dividend payout, cashflow, capex, gearing."

John also put a lot of emphasis on assessing management – and expecting it to deliver. "I remember one presentation where the MD went through the divisional results and then had the CFO ring up the next day to say the numbers for the two big segments were incorrect. We sold the company immediately – you need management to really know the business."

One of his investment lessons is about managing underperformers in a portfolio. "It's all well and good to have a company running along nicely, but when you've got something that's not working, you know, you should take your loss or be prepared to say, well this is a cyclical thing and will come good again. Either way, you have to make a decision."

The investment choices available to John and his team were very different to those today – at one point there were six major brewers and in the 1980s corporate raiders reshaped the market, with many major companies disappearing or taken over.

Other companies were 'stars' then and are still doing well today. "We were early buyers of plumbing supplies group Reece. It's got a long history of growth and strong financial performance because it likes to retain profits to reinvest in the business," says John. (The company had annual sales of $2 billion in FY2015).

His final thought: "There are always times when your approach becomes unpopular – there was the nickel boom when I started, the dot-com boom later. People will always ask why you don't own such and such – but they don't remember that conversation when those weak companies go up in smoke. I'm really rather pleased that Perpetual is still seen as a value investor, I know you're a lot bigger now but the philosophy isn't dramatically different."

Image: Australian beach culture. *Source: State Library of Western Australia.*

"I like the fact that people who've gone on to run the Perpetual Industrial Share Fund have come through the business, worked in the back office, done the books. They've had the grounding, stuck around, bought into a culture and process that is bigger than one person. That culture is hard to replicate but maybe that's why the Fund has been around for 50 years and has continued to deliver."

Grant Kennaway Global Practice Leader, Manager Research, Morningstar

Images from left: Holden Kingswood. *Source: State Library Victoria.*
Oil crisis. *Source: David Falconer, NARA, Wikimedia Commons.*

80s

1980 Robert Mugabe becomes Prime Minister of Zimbabwe. In 2008 the African country recorded an inflation rate of over 230%.

1981 Judy Davis wins a BAFTA for her role in the film version of *My Brilliant Career* (from the novel by Miles Franklin). The Guardian calls *My Brilliant Career*, 'the grandmother of feminist narratives.'

1983 America's Cup win. New Prime Minister Bob Hawke says any boss who sacks workers for not turning up is a 'bum'. "But they can work harder next day to make it up..."

1980 1981 1982 1983 1984

“Older and wiser, I look back and see opportunities missed – times when we should have raised capital rather than debt…”

Alan Bond Chairman, Bond Corporation Holdings

1985 The Commonwealth Government grants land rights over Uluru, or Ayers Rock, back to the Aboriginal people, under the condition that it will be leased back to the National Parks and Wildlife Service for 99 years.

1986 “That’s not a knife.” Paul Hogan delivers this iconic line in the worldwide box office smash *Crocodile Dundee*. The movie becomes the second highest grossing film of the year behind *Top Gun*.

1988 The Queen opens our new Parliament House. Prime Minister Hawke says “This building will become for our nation both the forum for our differences and the instrument of our unity…”

1985 1986 1987 1988 1989

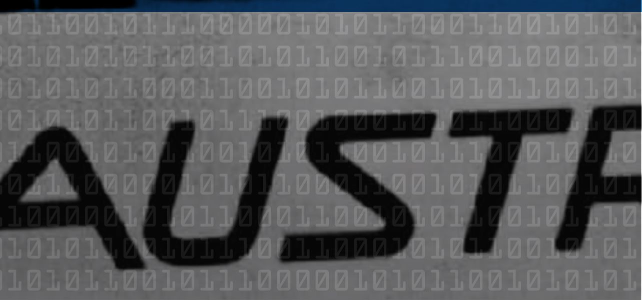


Image: Australia II wins the America’s Cup.
Source: News Ltd, Newspix.

1980s – Banana republicans?

The 1980s were a tumultuous time – featuring a long sharemarket boom and the clattering crash of 1987. It was a time of free Nelson Mandela, the Ashes lost to Gatting and Gower, Australia II, the Bicentenary and a new Parliament house.

We started the 1980s with a relatively closed and inflexible economy. One of the prices we paid for poor productivity and inflexible markets was the 1982-83 recession, which saw the longest dole queues since the Depression. Unemployment exceeded 10%.

The era of Bananarama and Banana drama

In the early 1980s our economy was insular – and insulted. We were the "Poor White Trash of Asia" (Lee Kuan Yew of Singapore) and verged on becoming a "Banana Republic" (our own Paul Keating).

Yet the nation responded to slights and crises with dramatic action, with the Hawke/Keating government, a coterie of excellent economic advisers and a constructive opposition ushering in reforms that transformed the country and underpin our economic performance today.

In 1983 the Accord with the union movement got to grips with wage costs, and over time pay decisions moved out of the "Industrial Relations Club" and to workers, unions and employers at the workplace. Technical but vital reforms at Treasury started to weaken entrenched inflation.

Tariffs and trade barriers were slashed, fostering competition and lowering prices. Key industries were deregulated, superannuation introduced, the government let go control over mortgage rates and the dollar was floated. In 2010, Reserve Bank Deputy Governor, Ric Battelino, called the float "amongst the most, if not the most important reforms of the past 30 years."

Image: Newcastle earthquake aftermath, 1989.
Source: Steven Siewert, Fairfax Media.

The changing face of Australian business

COMPANY	MARKET CAP ($M)
BHP	13,488
Westpac Banking	7,335
Alumina	4,885
Conzinc Rio Tinto	4,736
National Australia Bank	4,557
Elder Smith Goldsborough	4,516
ANZ Banking Group	3,903
Origin Energy (Ex Boral)	3,450
Coles Group	3,309
News Corp 'B' (Lon)	3,062

Source: InvestSMART. Data as of May 1988.

Near the end of the 1980s the market capitalisations of the top ten are dramatically higher. The top ten is also notably more diverse – with only three miners and a big media company joining the list.

Be prepared to stand out

Peter Morgan joined Perpetual in 1990. When he started, investors were still dealing with the aftermath of 1987.

"In 1987 it was a seller's market and lots of people fell for the stories – the FAIs, Ariadne, Bond Corp, Qintex – companies built on debt, with no real business model. But Perpetual's portfolio was real businesses – Wattyl, Brickworks, Soul Pattison, Allgas – household names with low debt, a track record of profitability, asset-rich companies. That's why Perpetual clients were better off."

When he became Head of Equities in the early 1990s, he made money for clients by riding the backlash.

"It was a buyer's market. High interest rates, post 1987 fear. We got to buy into lots of good companies at give-away prices – Siddons, Bundaberg Sugar. Companies selling for less than the value of the assets they owned."

Peter Morgan Former Perpetual Head of Equities

Images from left: Pat Cash wins Wimbledon. *Source: News Ltd, Newspix*. Greg Norman in action at the Australian Masters. *Source: The Age (Melbourne), Fairfax Media*.

Crash gives Perpetual some 'useful gains'

"Announcing an after-tax result of $4.82 million, group general manager Mr John Aitken said the company had experienced 'useful gains' as a result of the October market bloodbath, as many investors had 'sought to return to more stable, professional management.'

Perpetual's gain has been at the expense of the so-called former 'high-fliers', whose tarnished investment reputations during the past three months has helped draw business to groups perceived by investors, both private and corporate, as more conservative."

Catherine Armitage Sydney Morning Herald, 16 February 1988, EXCERPT

The payoff and the panic

The payoff for these reforms came quickly. Australia boomed, with GDP growing at over 4.5% for the seven years to 1990 and unemployment almost halving over that time. Our national productivity growth was amongst the highest in the world in the 1980s/1990s.

These good deeds did not go completely unpunished. When markets cracked in October 1987, ours fell around 40%. In retrospect (where all the best policy decisions are made) the opening of Australia to foreign banks in 1985 had fuelled a lending boom in an already booming economy. Some of that money was not used wisely.

Why? Former RBA Governor, Ian Macfarlane quoted one prominent banker who said he had "30 years' experience as a lending banker, but the first 29 were all the same". As financial journalist Trevor Sykes put it, "Never before in Australian history had so much money been channelled by so many people incompetent to lend it, into the hands of so many incompetent to manage it." A whole swathe of businesses, stars of the booming 1980s, later failed or were rescued. Some were the cashboxes of commanders in the White Shoe brigade – including "Last Resort Laurie" Connell's investment bank, Rothwells.

Yet despite 1987's Black Monday, Australia entered the 1990s in far better shape. It didn't look so at the time, but at the end of a decade where Michael Jackson and Madonna ruled the airwaves, Australia was poised to ascend to the peak of the world economy charts.

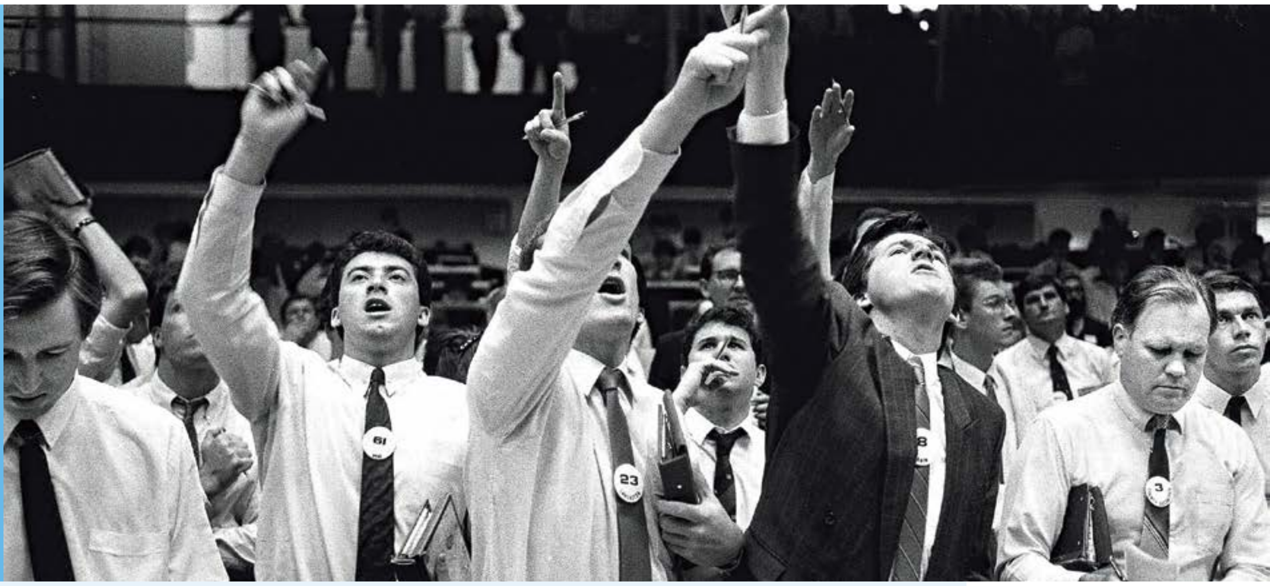
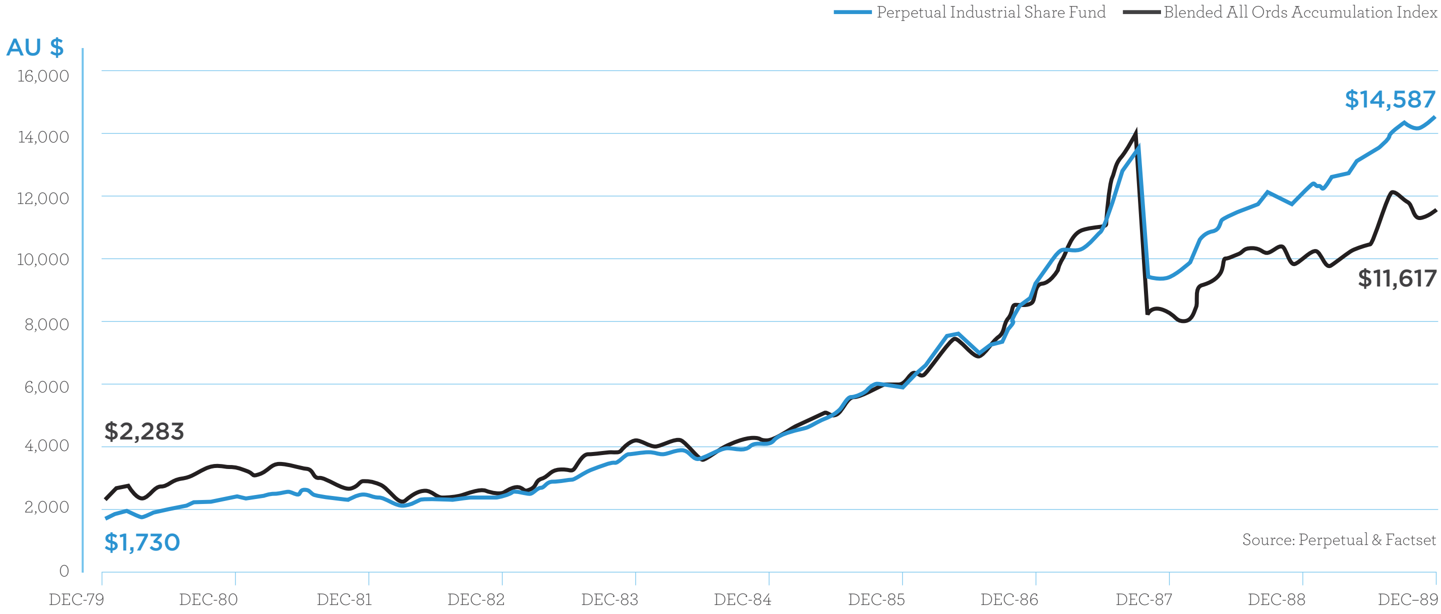


Image: Traders at the Australian Stock Exchange. *Source: Anton Cermak, Fairfax Media.*

At the end of the 1980s, $1,000 invested in the Perpetual Industrial Share Fund since December 1976 was worth $14,587.

Perpetual Industrial Share Fund vs Blended All Ords Accumulation Index

$1,000 invested since December 1976



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Perpetual expects to raise $50m

"Perpetual Trustees Australia is confident of raising $50 million over the next six months for investment in its new Industrial Share Fund. The fund already has $65 million under management from existing clients of the trustee company and has enjoyed a 28.8 per cent a year compound return over the past five years.

Fund manager, Mr Anton Tagliaferro, said the performance was attributable to the strict policy of only choosing quality industrial stocks. He said some of the best performing stocks included Rothmans Holdings Ltd, Wattyl Ltd, Burns Philp and George Weston.

Mr Tagliaferro said the basic philosophy of the fund was to buy value and examples of this were holdings in Brickworks Ltd, G.E.Crane Holdings Ltd and Washington H.Soul Pattinson Ltd. He said all of these stocks were trading at below net tangible asset backing."

Anthony Boyd Australian Financial Review, 7 September 1989, EXCERPT

90s

1990 Patrick White dies. In over 40 years of writing he won the Nobel Prize in Literature and the Miles Franklin Literary Award (twice).

1992 The landmark Mabo decision. The case took over ten years and was passed six to one by the High Court. It introduced the doctrine of Native Title into Australian law.

1990 1991 1992 1993 1994

"The first thing to say is, the accounts do show that Australia is in a recession. The most important thing about that is that this is a recession that Australia had to have."

Paul Keating Treasurer, November 1990

1996 John Howard's Coalition government elected. His landslide 40-seat majority win ended 13 years of Labor control of the Government benches. He remained in power for nearly 12 years.

1998 The 71st Sydney-to-Hobart yacht race starts in what one sailor calls 'champagne weather'. But a severe low pressure front hits, causing 70 knot winds, 20 metre waves and six deaths.

1999 'Do you approve an act to establish Australia as a republic with the Queen and Governor General replaced by a President appointed by a two-thirds majority of the members of the Commonwealth Parliament?' Australians vote 'No' at the referendum.

1995 1996 1997 1998 1999

Image: Prime Minister Paul Keating and his wife Annita.
Source: Fairfax Media.

1990s – The long boom begins

Most experts now agree that the excesses of the late 1980s could only be corrected by higher interest rates. More importantly, the Keating recession of the early 1990s – and good policy in its aftermath – effectively killed inflation, just as Fed Secretary Paul Volcker had done in the US in the early 1980s. For the first time in decades, our economy was free of the structural imbalances inflation creates.

During the 1990s, the Australian economy – and its financial markets – continued to change rapidly. Treasurer Costello gave the Reserve Bank independent control over monetary policy. Privatisation of government businesses created $70 billion worth of investment opportunities for share investors, including Telstra, QANTAS and Commonwealth Bank (CBA). The RBA says demutualisations (including, AMP, MLC and National Mutual) were worth another $21 billion. These new listings boosted share ownership – "In early 1998, the proportion of adults in Australia with direct or indirect ownership of shares was 40 per cent, double its level in 1991."

In the late 1990s, Australia reaped the rewards of reform. Our floating dollar helped us sail through the Asian crisis of 1997/98 and even to lend tide-over money to our growing trading partners in the region. We didn't boom in the tech boom, so we didn't crash when it cratered. Australia now had one of the world's strongest economies and would continue to play at that level for an unprecedented period.

Images from left: INXS. *Source: Lawren, CC BY 2.0.*
Kerry Packer. *Source: Peter Morris, Fairfax Media.*

The changing face of Australian business

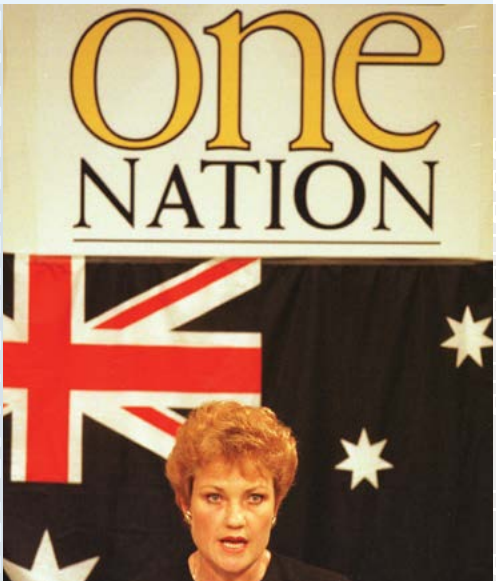
COMPANY	MARKET CAP ($M)
Telstra	48,378
National Australia Bank	32,056
BHP	28,218
Westpac Banking	20,306
ANZ Banking Group	17,457
CBA	17,346
Rio Tinto	12,363
Amatil	11,708
Lend Lease	8559
News Corp 'B' (Lon)	8,276

Source: InvestSMART. Data as of May 1998.

In May 1998 the privatised Telstra becomes the biggest company in Australia, the big four banks confirm their place at the top table and Lend Lease, a property/life company conglomerate, makes an appearance alongside a Coke bottler.

"Australia, in case you didn't know, is the miracle economy of the world financial crisis. Even though most of its exports go either to Japan or to the stricken tigers, Australia has managed to ride out the storm so far without even a serious slowdown. The key to this resilience has been a policy of benign neglect toward the exchange rate..."

Paul Krugman Nobel Prize-winning economist, 1998



Images from left: Pauline Hanson. *Source: The Age (Melbourne), Fairfax Media.* Supermodel Elle Macpherson prepares for a photo shoot. *Source: Iain Gillespie, Newspix.*

At the end of the 1990s, $1,000 invested in the Perpetual Industrial Share Fund since December 1976 was worth $57,289.

Perpetual Industrial Share Fund vs Blended All Ords Accumulation Index

$1,000 invested since December 1976

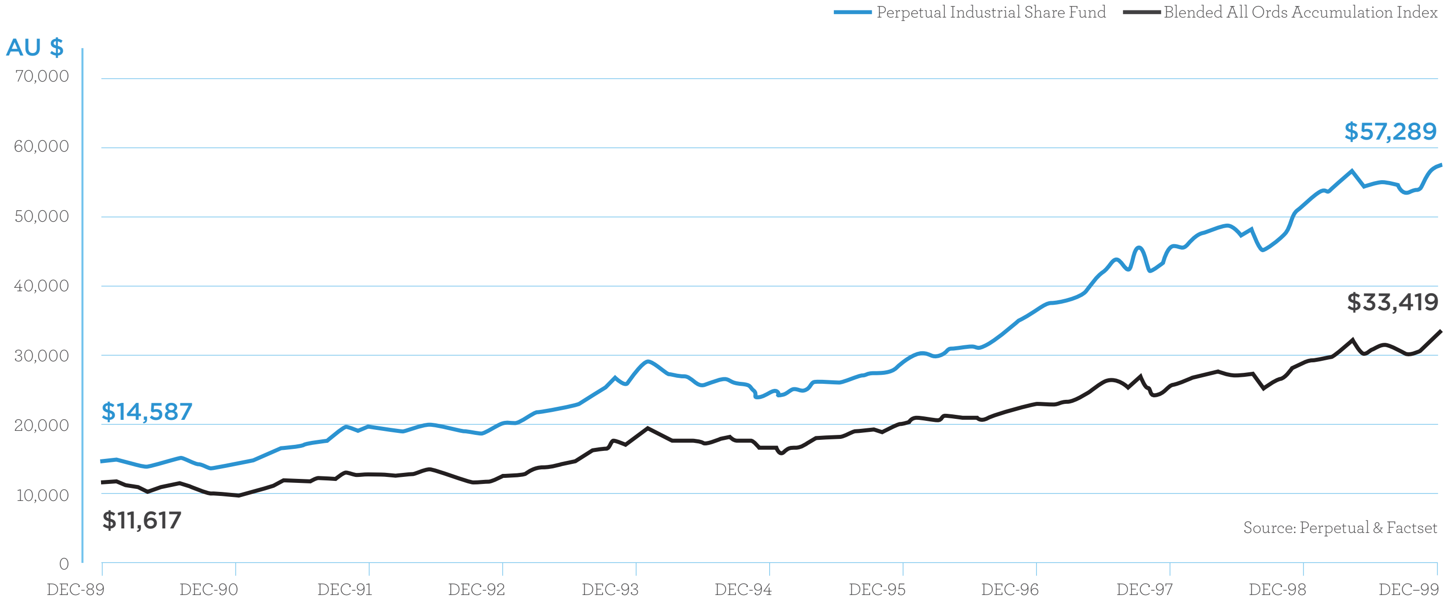


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Image: Tim Berners-Lee, inventor of the World Wide Web.
Source: CERN.

Malcolm Gladwell and the art of stock picking

"You've got to do the 10,000 hours, because investing is art as well as science. You've got to know the numbers, but it's time that teaches you what to look out for. Like when a company issues its first ever profit downgrade. Process tells you to put that into your model. Experience, art, tell you it probably won't be the last one."

Anthony Cay Portfolio Manager of the Perpetual Industrial Share Fund. He started at Perpetual in 1996

Patient clients

"With the Perpetual Industrial Share Fund, you know the clients are long term. It's the type of fund that a Portfolio Manager wants to be running because you can buy big stakes in excellent companies and have a mindset that you can own them for a long time."

Nathan Parkin Deputy Head of Equities, former Portfolio Manager, Perpetual Industrial Share Fund. Joined Perpetual 1997

Images clockwise from top: Telstra phone booth on a bush road. *Source: Glenn Campbell, Fairfax Media*. Priscilla Queen of the Desert film still. *Source: John Thomson*. Guns surrendered under the gun buy-back scheme. *Source: The Sydney Morning Herald, Fairfax Media.*

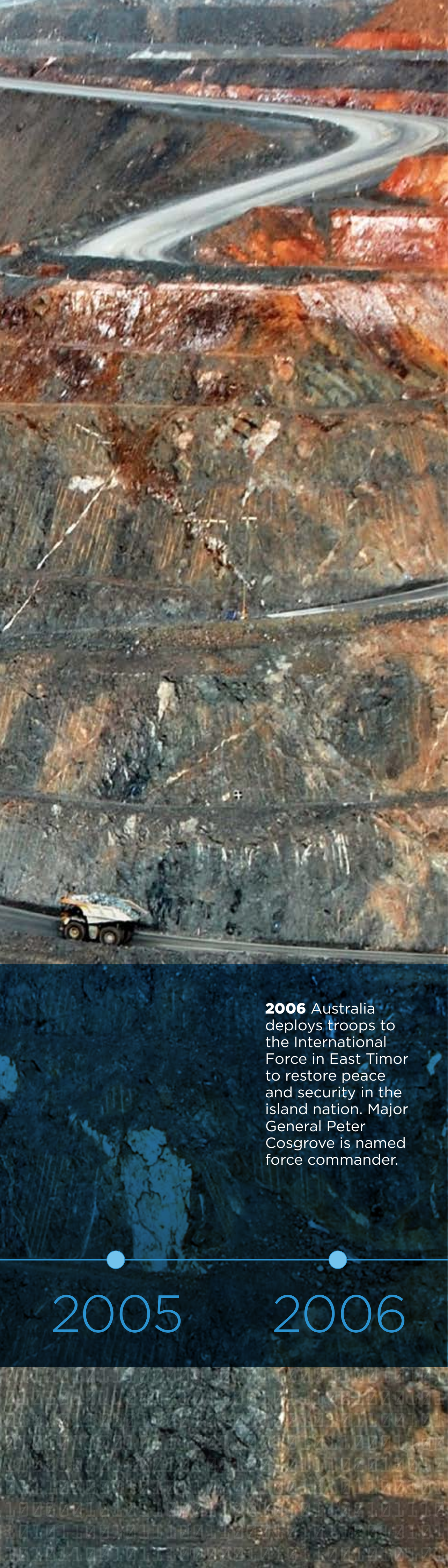
00s

2000 ‘The winner is Sy-de-ny, Australia’. Australia hosts the Olympics. More than 10,000 athletes compete – with 16,000 media to quiz them and record their feats.

2002 Two bombs rip through the Kuta area of the Indonesian tourist island of Bali, killing 202 people (including 88 Australians).

2004 An earthquake underneath the Indian Ocean triggers a tsunami that unleashes waves up to 30 metres high and kills over 200,000 people across 14 countries. It is the third largest earthquake ever recorded.

2000 2001 2002 2003 2004



> “Leverage buys you a glimpse of a prosperity you haven’t really earned.”
>
> **Michael Lewis** Boomerang, Travels in the New Third World

2006 Australia deploys troops to the International Force in East Timor to restore peace and security in the island nation. Major General Peter Cosgrove is named force commander.

2008 Lehman Brothers files for bankruptcy. US Treasury Secretary, Hank Paulson stitches together a crisis response on his Motorola Razor mobile phone – now in the National Museum of American History.

2005 2006 2007 2008 2009

Image: Mining in Australia. *Source: Alice Nerr, Shutterstock.*

2000s – A place of greater safety?

In the index of Timothy Geithner's *Stress Test, Reflections on Financial Crises*, the former US Treasury Secretary mentions Australia not once. His 560-page survey of various smaller financial crises and then of the 2007-09 Global Financial Crisis (GFC) has nothing to say about Australia – perhaps because we endured few of the massive dislocations that affected the US, UK and Europe.

The GFC was not a sharemarket crisis – born as it was of a boom and bust in the US subprime mortgage market, endemically poor risk-management at Lehman Brothers, AIG *et al* and a derivatives crisis eloquently explained in Michael Lewis' *The Big Short* (and by Margot Robbie in the movie version).

Fortified by a well-regulated, well-capitalised banking sector, a large government surplus, some adaptable policy making (rate cuts, bank guarantees, Ken Henry's "go early, go hard and go households" stimulus) and bolstered by Chinese demand for our ore, Australians, though not immune, suffered nothing like the eight million Americans who lost their jobs or the millions who lost their homes.

RBA Assistant Governor Malcolm Edey said, "Unlike the US, the UK and the Euro area, Australia didn't have a recession and we didn't have any bank failures." Though the Australian sharemarket (ASX 200 Accumulation) dropped 38% in 2008, it retraced almost all of that loss in 2009 and since mid-2009, Australian shares are up around 9% per year (to June 2016).

Is geography destiny?

With surprising modesty, many Australians credit the China-fuelled resources boom for our smooth sailing through the biggest economic shock since the Great Depression. It certainly helped. According to the Department of Industry and Science, between 2000 and mid-2011, copper prices increased by 342% and iron ore prices by 758%.

But good policy and the flexibility of management and workers also helped. Unlike many mining booms before it, the most recent one ended without a wages or inflation breakout. Former RBA official Stephen Grenville says: "Australia has operated successfully in this volatile world environment without a recession for a quarter century and is adapting without drama to the end of the globalisation-induced resources cycle."

Image: Cathy Freeman at the 2000 Sydney Olympics.
Source: Steve Christo, Fairfax Media.

"Though I wouldn't regard the last 25 years as a period of entirely uninterrupted expansion, the downturns that did occur were brief and shallow. Many Australians now in the workforce have never known anything other than relatively benign economic conditions."

Luci Ellis Head of Financial Stability Department, RBA, March 2016

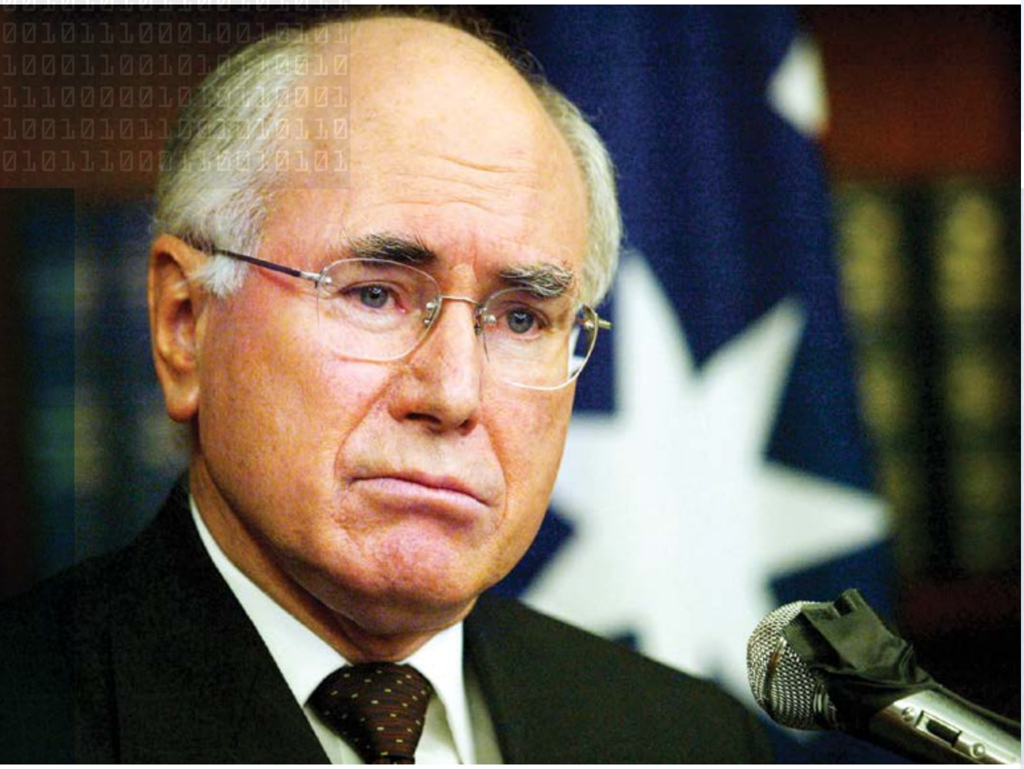


Image: Prime Minister John Howard. *Source: Andrew Meares, Fairfax Media.*

The changing face of Australian business

COMPANY	MARKET CAP ($M)
BHP Billiton	114,568
CBA	77,816
Westpac Banking Corp	63,004
ANZ Banking Group	55,005
National Australia Bank	52,490
Telstra Corp	40,689
Wesfarmers	35,669
Woolworths	31,566
Rio Tinto	27,523
Woodside Petroleum	25,483

Source: InvestSMART. Data as of December 2011.

In 2011, the resource booms swells the big miners/energy companies – there are three in the top ten. There are two big retailers (Woolworths and Wesfarmers) and four now global-sized banks – a relative position helped by significant shrinking in their overseas competitors.

Clicks, bricks and land value

In 2012, the buzz was all about online retailing – yet Perpetual ended up owning nearly 15% of traditional homeware and appliance retailer Harvey Norman.

Perpetual Industrial Share Fund Portfolio Manager, Vince Pezzullo says, "The rest of the market hated the stock. But we had done a lot of work on this company. We even paid an external consultant to research all the property they owned and it turned out that at about $1.80 a share we could buy the company for the value of the land it owned.

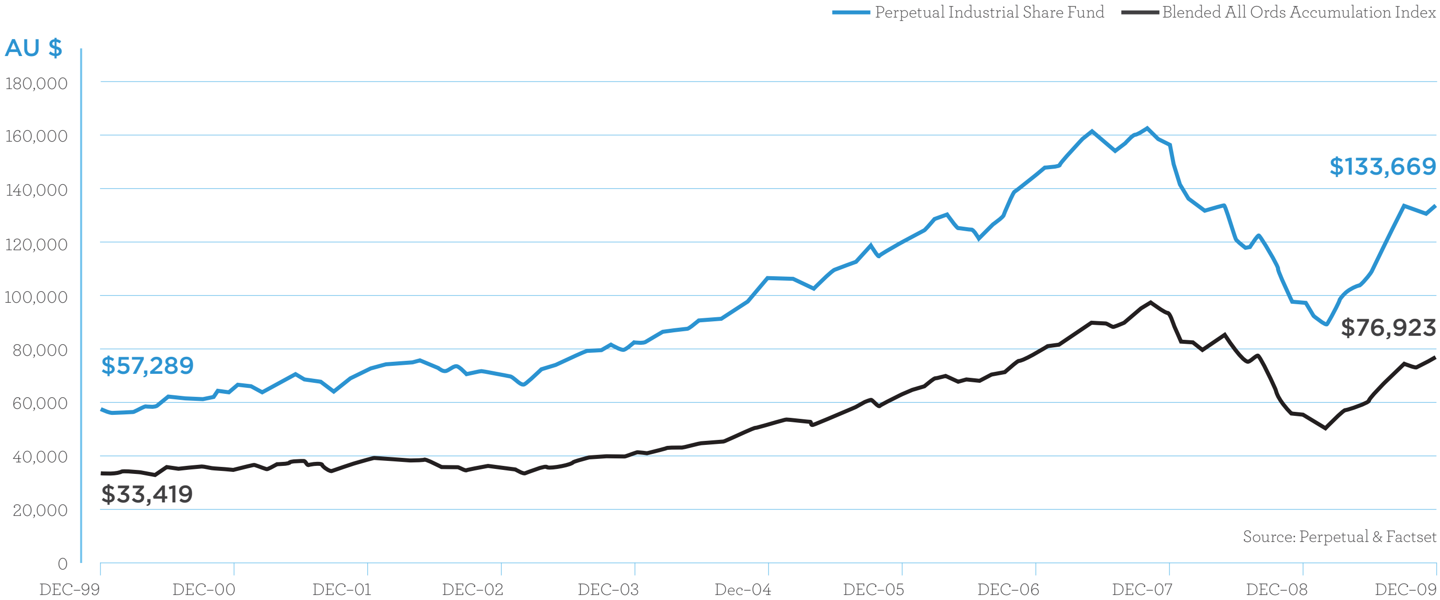
"We took a big position because we knew management were doing sensible things. In essence it's a housing-cycle stock and when that turned we knew it would pop – and it did. Housing went through the roof and because we got to buy at a big, unrealistic discount we made a lot of money for investors. Those opportunities are very rare but that's what we're always looking for – times when the market perceptions are so wrong, so backward looking."

Images from left: Australian Wallabies win the Bledisloe Cup. *Source: Jim Alcorn, Newspix.* Ansett Australia Boeing 747-412. *Source: Aero Icarus, CC BY-SA 2.0.*

At the end of the 2000s, $1,000 invested in the Perpetual Industrial Share Fund since December 1976 was worth $133,669.

Perpetual Industrial Share Fund vs Blended All Ords Accumulation Index

$1,000 invested since December 1976



Note: The current benchmark for the Perpetual Industrial Share Fund is the S&P/ASX 300 Industrials Accumulation Index. As the Industrials Index series is not available prior to 1979, the S&P/ASX All Ordinaries Accumulation Index has been used for reference purposes. Total return shown for the fund has been calculated using exit prices after taking into account all of Perpetual's ongoing fees and assuming reinvestment of distributions. No allowance has been made for contribution or withdrawal fees or taxation (except in the case of superannuation funds). Past performance is not indicative of future performance.

Image: Iraq War. *Source: Technical Sergeant John L. Houghton, Jr., United States Air Force, National Archives Catalog.*

10s

2010 In the Year of Women in Local Government, a Labor Party leadership ballot sees Julia Gillard replace Kevin Rudd and become the first female Prime Minister of Australia.

2011 Queensland is hit by a series of floods. Thirty five people are killed, over two hundred thousand people are affected, and damages total around $2.38 billion.

2012 'To a more open and connected world.' Facebook goes public, listing on the NASDAQ.

2014 A bad year for peace. Russia annexes the Crimea, a Malaysian Airlines 777 is shot down in the Ukraine and the Islamic State of Iraq and the Levant declares itself a caliphate.

2010 2011 2012 2013 2014

"People don't want to buy a quarter-inch drill. They want a quarter-inch hole."

Clayton M. Christensen The Innovator's Solution, Creating and Sustaining Successful Growth

2016 Australia notches up nearly 25 years – or 100 straight quarters – without a recession. That puts us within touching distance of the modern world's best growth record held by the Netherlands.

2015 2016 BEYOND

Image: Apple Store Sydney. *Source: Fairfax Media.*

2010 and beyond – The 3D years

The 2000s were the era of the binge and the hangover. In the 2010s the world economy wanted to throw a recovery party but couldn't get enough guests onto the dancefloor.

Perpetual's Matt Sherwood says the recovery from the GFC has been slowed by the three Ds – debt, disruptive technology and demography.

In Europe and Japan, debt – government and private – has held back recovery. Demography is destiny and too many countries, Japan – and again, much of Europe – have aging populations with limited spending power.

Digital disruption, while changing our daily lives for the better, has created uncertainty, inequality and unemployment for many. The three Ds have made it hard to fuel global economic growth as savings rates have gone up and wage and profit growth has declined as a result.

Don't assume

As it has been for five decades, successful investing today is about ignoring grand theories and short-term market sentiment and buying businesses that adapt to changing times. In the Perpetual Industrial Share Fund that has meant questioning well-entrenched views – for example, that bricks and mortar retailing is dead (Woolworths, Harvey Norman) and that competing with China is impossible (BlueScope).

It also meant changing the Fund to adapt to a world where Australia's best industrial companies sell to, buy from and compete with companies around the world. That's why the Perpetual Industrial Share Fund can now invest up to 10% of its capital outside Australia.

Image: Malcom Turnbull and Tony Abbott, Bondi Beach. *Source: Alex Ellinghausen, Fairfax Media.*

Digital disruption

Today, as it has for over a quarter of a century, the Australian economy looks in better shape than many others. At Perpetual, we believe what will keep it that way is a willingness to change, to let go approaches that worked in the past but aren't fit for the future.

It's the same with the companies we invest in for our clients. The fundamentals of quality and value remain unimpeachably relevant. Now more than ever, we're finding that the companies that pass those tests are the ones that think clearer and move faster.

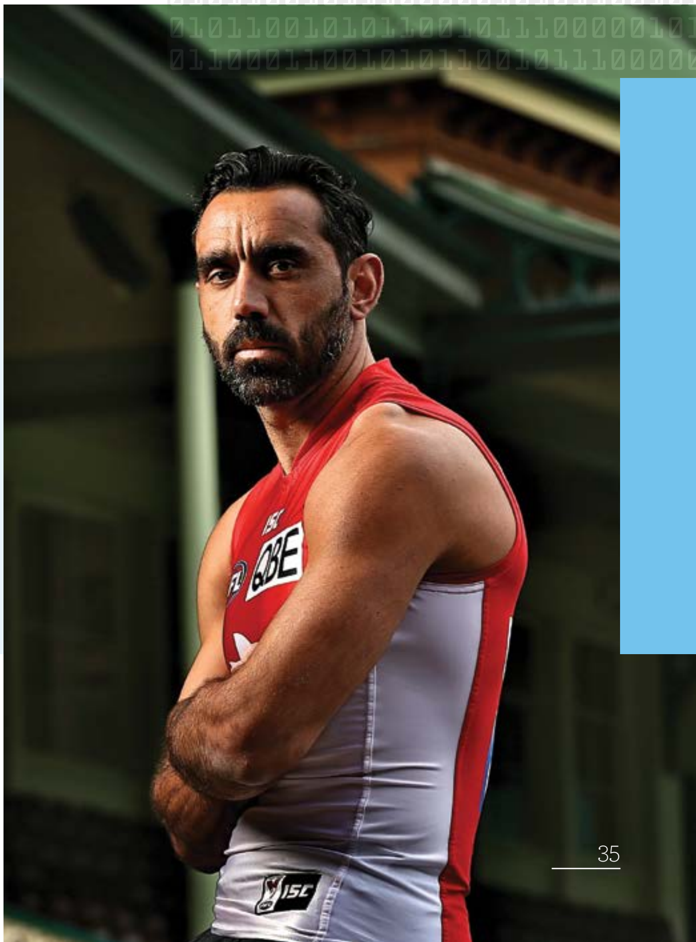
"Australia has a lot of very comfortable duopolies," says Nathan Parkin, "There are companies in retail, insurance and telecommunications ripe for disruption. We're looking at the disruptors. But also at those established businesses to see if they're ready to do what it takes to win out – to get their cost base down, to get new products to market quicker, to discount if they have to."

The changed face of Australian business

COMPANY	MARKET CAP ($M)
CBA	128,927,000
Westpac	99,572,900
ANZ	71,392,700
NAB	68,061,800
Telstra	65,957,400
BHP	60,508,300
CSL	49,911,900
Wesfarmers	45,642,100
Woolworths	26,892,300
Macquarie Group	25,964,400

Source: ASX200 (22 June 2016).

In mid-2016, the Australian market capitalisation top ten is all about the consumer. It includes just one miner and nine industrial companies – two retailers, a telco, a healthcare company and five banks.



Images from left: Prime Minister Julia Gillard and Kevin Rudd. *Source: Andrew Meares, Fairfax Media.* Adam Goodes, 2014 Australian of the Year. *Source: Brendan Esposito, Fairfax Media.*

Stockland – “If you sell a single share you have to answer to me.”

After the GFC, property trusts struggled, Stockland – a Real Estate Investment Trust (REIT) with a residential focus had downgraded its earnings prospects repeatedly. Anthony Cay had long exposure to the stock via his time as a property analyst.

“So it was 2013 – most of the market wouldn’t even touch Stockland. And I said to our analysts and Portfolio Managers, “I’ve been following this stock for nearly 15 years. And this stock is cheap.”

Anthony’s view was that residential property would come back. Stockland’s residential assets had been written off to the tune of a billion dollars – in his opinion, to a value worth dramatically less than they would be when the residential market recovered. “I gave it a strong recommendation, we put it into the Perpetual Industrial Share Fund and other Perpetual share funds and we bought a lot of the stock – we ended up owning 8.5% of the company at around $3.20 a share.”

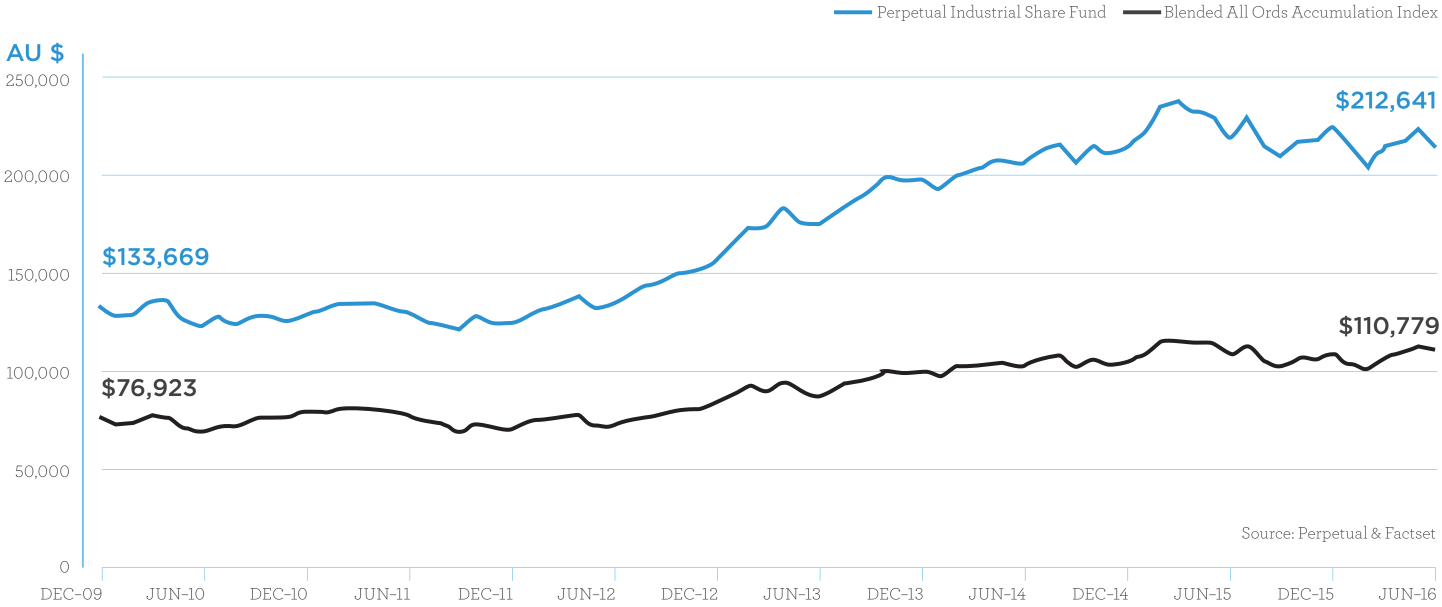
The residential market did recover, so did Stockland, and investors in the Perpetual Industrial Share Fund reaped the rewards – the Stockland share price moved towards $4. The final twist in the tale included various takeover bids for the residential property developer, Australand Group. Stockland was one of the bidders for Australand and owned 10%. When a major international player launched a surprise premium bid for Australand, Anthony was on his way to the Snowy Mountains.

“So I’m driving to the snow with my wife and kid when I hear the news. Now I know this company like the back of my hand. On the six-hour drive I composed the report in my head and wrote it at the lodge. I went through all the reasons why Stockland’s share price was going to go up and laid out ten reasons why the market was wrong. ‘If any Portfolio Manager sells a single share they have to answer to me’ (with a very large exclamation mark.) A couple of months later, we got an extra 10% in the Stockland share price for Perpetual investors.”

At June 2016, $1,000 invested in the Perpetual Industrial Share Fund since December 1976 was worth $212,641

Perpetual Industrial Share Fund vs Blended All Ords Accumulation Index

$1,000 invested since December 1976



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Images from left: Lindt Café floral tributes. *Source: Sardaka, CC BY 3.0.* David Bowie exhibition at Australian Centre for the Moving Image. *Source: Joe Armao, Fairfax Media.*

Other voices

We asked some advisers, clients and industry experts for their views on the Perpetual Industrial Share Fund's 50-year history and what it tells us about Australian investors.

"The Perpetual Industrial Share Fund has always been one of the Australian share funds we recommend to clients. We like the fact it's been around 50 years and we like the consistency in the returns and the size of the Fund and the Perpetual process. We're a great fan of the Fund. And so are our clients.

We have one client, we started her out in the Perpetual Industrial Share Fund in 1997. In the 19 years since then, she's moved money between the Perpetual Industrial Share Fund and the Perpetual Concentrated Equity Fund. She's made moves in and out but on our calculations she's put about $2 million into the funds – and taken out $2.2 million. But the performance was so good her fund balance is still over $2 million. It's really performed for her and a lot of our clients."

Tony Gilham Founding Partner, GFM Wealth Advisory, Financial planners/SMSF specialists, Melbourne

"I was a financial adviser for many years. I probably first started using the Fund in 1987.

I would use the Perpetual Industrial Share Fund for my clients because it had a good long-term story about investing in businesses – banks, retailers, etc – that people could relate to. I think its provenance, how it started life as a trustee fund, made it appealing too.

The income it generated – plus dividend imputation – was very attractive and the clients I put into the Fund were those who could look past short-term volatility and were reassured by how many market cycles it had already ridden through.

I have been an investor in the Perpetual Industrial Share Fund on my own account and my husband and son both still have investments."

Sylvia Dickson Financial adviser and investor, Melbourne

“I worked at Perpetual when the Perpetual Industrial Share Fund “went public” and changed from a common fund to a publicly available fund. It was my job to wear out some shoe leather and market it.

In the early 90s, the 1987 crash was still on people's minds and if people did want to invest, they tended to flock to deposits offering very high interest rates or the next big thing in resources. But the Fund had a rock solid history and a coherent investment philosophy – strictly industrial stocks.

I put those things together, talked about the power of compounding, dividend income and imputation (which I still talk about today) and the Fund really took off.”

Peter Thornhill Investment educator, worked at Perpetual in the early 1990s

$5bn

As at June 2016, the Perpetual Industrial Share Fund invests more than five billion in client funds.

“You think about Perpetual and you think about the quality of people. Some great Portfolio Managers have come and gone but the Fund's delivered excellent long-term performance and downside protection when it was needed – it's a testament to the process and culture at Perpetual.

Simple things stand the test of time – and I think the Perpetual Industrial Share Fund is doing that – it's about value, quality and dividends and as more and more people look for retirement income it's just going to be more relevant.”

Grant Kennaway Global Practice Leader, Manager Research, Morningstar

Lessons for investors from 50 years of share investing

1. "Chaos isn't the pit, chaos is the ladder"

As the charts throughout this book highlight, there's no such thing as a boring decade (we start after the 50s, so maybe that explains it). Each decade has its share of chaos – wars and revolutions, economic crises, world-changing innovations and epochal elections.

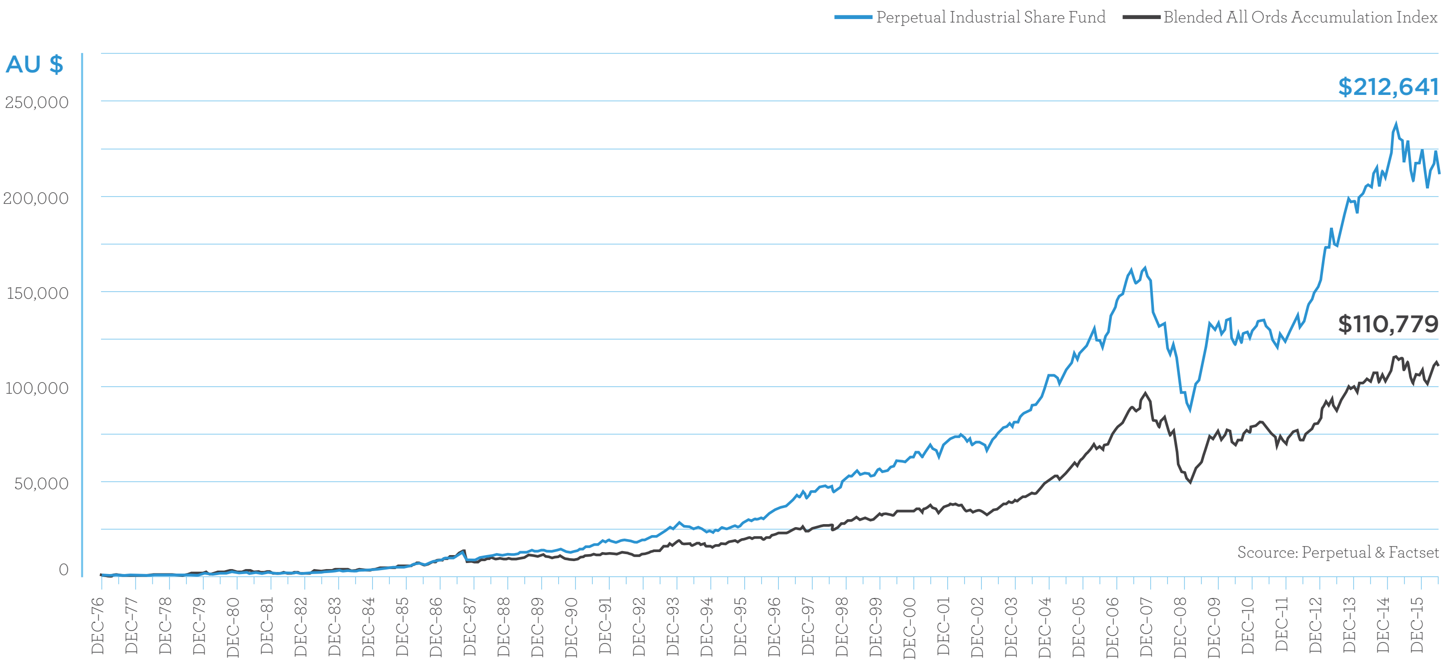
But the charts also highlight that industrial shares have defied short-term shocks and marched ever-higher to the drum of human progress. Just $1,000 invested in the Perpetual Industrial Share Fund in 1976, is today worth over $212,000 – despite all the events that have changed the world in that time.

Perpetual Industrial Share Fund Portfolio Manager, Vince Pezzullo says, "People become irrationally negative just as they become irrationally euphoric. If you take a long-term view when others are panicking, you can buy a dividend stream and a business which is selling for well below its fundamental value. When everyone's overly discounting what something's really worth, that's when you've got to have the discipline and go bang – to buy in big."

$1,000 invested in the Perpetual Industrial Share Fund since December 1976 was worth over $212,000 by June 2016.

Perpetual Industrial Share Fund vs Blended All Ords Accumulation Index

$1,000 invested since December 1976



Note: The current benchmark for the Perpetual Industrial Share Fund is the S&P/ASX 300 Industrials Accumulation Index. As the Industrials Index series is not available prior to 1979, the S&P/ASX All Ordinaries Accumulation Index has been used for reference purposes. Total return shown for the fund has been calculated using exit prices after taking into account all of Perpetual's ongoing fees and assuming reinvestment of distributions. No allowance has been made for contribution or withdrawal fees or taxation (except in the case of superannuation funds). Past performance is not indicative of future performance.

Image: *Source: nostal6ie, Shutterstock.*

2. Be active

"When my information changes, I alter my conclusions." John Maynard Keynes.

The Australian sharemarket has changed significantly over the past 50 years. Companies that dominated in one decade later vanished from the boards. Companies that teetered on the edge re-emerged to become global leaders (News Corp and BlueScope are just two examples).

The returns the Perpetual Industrial Share Fund has generated for its investors over 50 years have been built on the premise that when markets, companies and the world change, portfolios need to change too. Our active investment approach is underpinned by deep analysis and research. It means constantly seeking companies that are better at meeting or anticipating the needs of their customers – and adapting to the challenge of their times.

Former Industrial Share Fund Portfolio Manager Nathan Parkin has one big example. "At the peak of the dot.com boom, News Corp was something like 20% of the market – but we wanted to hold as little of it as we could. It was inflated beyond reason by the dot.com mania.

Today we're big holders – we own nearly 15% of the voting stock. It's got money in the bank, it's extremely undervalued in our view and highly defensive. It's got a US online real estate business that could be huge but we're not relying on that to justify our position – we're happy to own it because of the earnings power of businesses like Fox Sports, Foxtel, Barrons, the Wall Street Journal. It's a completely different business to the one people loved in the 2000s – it's a much better business now."

3. Bank on the balance sheet, not the banks

"The balance sheet is the thing that stands between you and disaster," says Nathan Parkin. "When times are good, markets throw caution to the wind and chase companies that have a lot of debt and so a lot of risk. We don't want to be in those companies. You're better off future proofing your portfolio by buying companies with a good balance sheet.

You want to be holding businesses that have cash on their books and aren't dependent on the banks when things turn ugly. Banks are great at lending you an umbrella when it's dry. As soon as it starts raining they want it back again."

Image: *Source: Swinner, Shutterstock.*

4. There's more than one kind of disruption

Understanding the essence of a business – not just its numbers – is a key to successful long-term investing. Perpetual Industrial Share Fund Portfolio Manager, Vince Pezzullo says, "There are businesses that underperform because the cycle moves against them. When the cycle moves back, the earnings come back. What we want to understand is anything that fundamentally disrupts a company – it can be technology but it can also be regulation, social change or competition. When you get change to the business dynamics – something that causes a fundamental rerating – you don't get that money back and that's why we're extra cautious."

5. Don't fall in love

You could argue that the Perpetual Industrial Share Fund has lasted as long as it has because of what it didn't do – what it didn't buy. Portfolio Manager, Anthony Cay says, "The way markets work, you're going to have decent periods of time when the stocks you own run up and you make healthy returns. If you can compound those returns over the long-term, you'll do well for clients – and much better than most other investments. The key is cutting risk and reducing any capital loss when the market turns against you – which it occasionally will. We call it being 'actively cautious'.

Just as importantly, you've got to avoid the rubbish stocks that everyone falls in love with but that end up crashing – Babcock and Brown, Centro, ABC Learning, etc. Avoid those big mistakes, protect investors' capital, and they've got a bigger base to compound on when markets are rising again."

6. Don't pour your money into holes in the ground

Australia boasts some world-class mining companies (albeit they make up a lot less of our sharemarket than they used to). Nine of our top ten companies are now industrials. And over the long-term, industrial shares have been much better performers than miners.

As you can see from the chart on page 43, Australian industrial shares have outperformed resource shares – and the Perpetual Industrial Share Fund has outperformed both indices over the same period.

Perpetual Industrial Share Fund Portfolio Manager, Vince Pezzullo, says, "Resource cycles are very short. Companies and investors get euphoric when prices start to run, and they'll justify any valuation based on spot prices. But supply and demand is a law, not a theory. You push the price up enough and someone will open a new mine and push the price down."

"Australia is often described as 'The Lucky Country' with reference to its natural resources, weather, and distance from problems elsewhere in the world. But maybe Australians make their own luck."

Credit Suisse Global Investment Returns Yearbook 2016

Images: *Source: Maralova, Shutterstock; Guryanov Andrey, Shutterstock.*

7. Don't forget lessons 1 and 2

Paul Skamvougeras, Head of Equities, says, "For me, the big lessons are – one, the quality and credibility of the management team. Even a good business can be ruined by bad management.

The other is leverage – a geared balance sheet can be good when things are going well, but when they're going bad, it really limits a company's flexibility and their options. They're the two key lessons – great management and a good clean balance sheet.

Sometimes you forget those lessons – and the market has a way of teaching you that you shouldn't."

8. Be born in, or move to, Australia

Warren Buffett famously said two of the big reasons for his success were compound returns and being born in the US. You can make the same argument for Australia.

Australia has been a great place to buy shares – and not just for the 50-year life of the Perpetual Industrial Share Fund. Credit Suisse's Global Investment Yearbook tracks sharemarket performance as far back as 1900. According to their research, Australia has been the world's second best source of real sharemarket returns – generating an average, after-inflation return of 6.7% a year over 116 years.

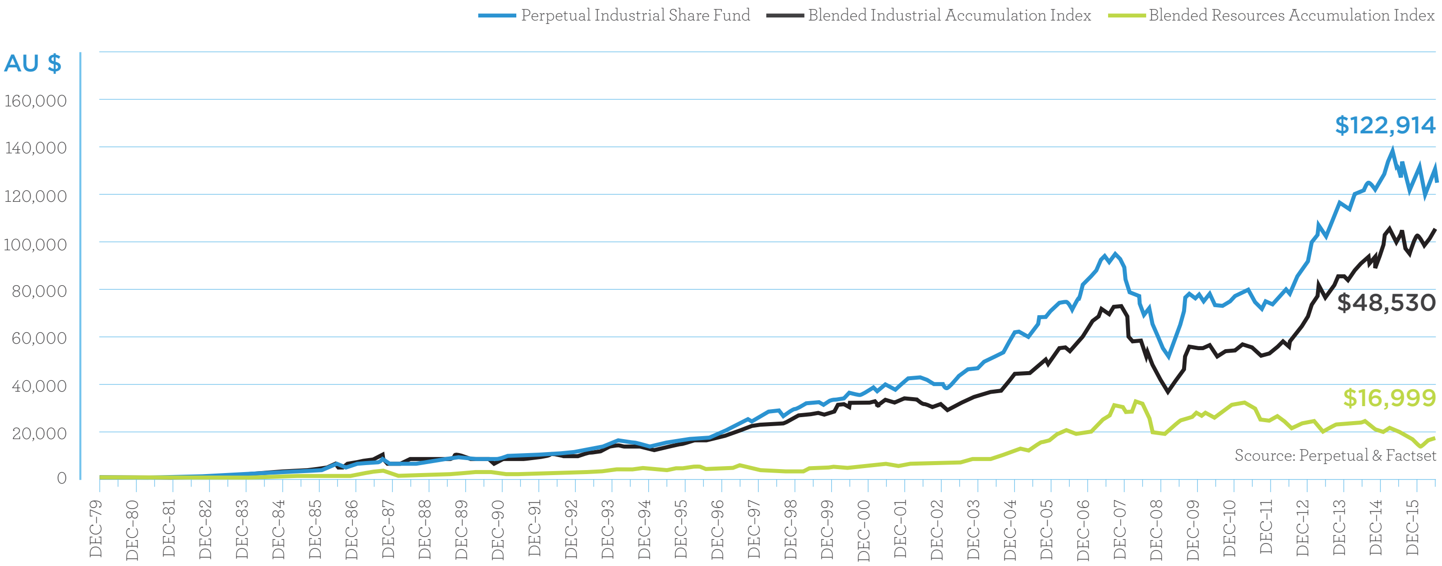
At Perpetual we believe it's still a great place to buy shares – we have a proven regulatory structure and an economy that still has sound fundamentals – especially by global standards. Our tax system, with dividend imputation and favourable capital gains treatment, is a positive for share investors – especially in industrial shares where dividend imputation levels are usually higher than for resources.

As investors in the Perpetual Industrial Share Fund over the past 50 years have found, industrial companies have a proven ability to generate growth and income.

The Perpetual Industrial Share Fund has outperformed both the Industrials and Resources indices since December 1979 (Blended, Accumulation).

Perpetual Industrial Share Fund vs Resources

$1,000 invested since 31 December 1979



Note: The chart above shows returns for the Perpetual Industrial Share Fund, the S&P/ASX 300 Industrials Accumulation Index and the S&P/ASX All Resources Accumulation Index. Total returns shown for the Perpetual Industrial Share Fund have been calculated using exit prices after taking into account all of Perpetual's ongoing fees and assuming reinvestment of distributions. No allowance has been made for contribution or withdrawal fees or taxation (except in the case of superannuation funds). The indices shown prior to April 2000 were known as the ASX 300 Industrials Accumulation Index and the ASX All Resources Accumulation Index. Past performance is not indicative of future performance.

More Lessons?

If you'd like more information about the Perpetual Industrial Share Fund and how it would fit into your portfolio – whether as an investing, super, SMSF or retirement option, speak to your financial adviser.

You can find more information about the Perpetual Industrial Share Fund – including the latest performance and how to invest, at **www.perpetual.com.au**

If you're an existing Perpetual Industrial Share Fund investor and would like to make additional investments or reinvest your distributions, you can do this by logging into your account at **Secure.Perpetual.com.au**

Please contact a Client Service Representative on **1800 011 022** if you need to set up online account access or are unable to login.

Like to see more of *Decimal to Digital* – including new investing insights and Portfolio Manager interviews? Visit our *Decimal to Digital* hub at **www.perpetual.com.au/decimaltodigital**

Follow Perpetual on **Twitter** and **LinkedIn**.

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