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# Same equity risk, twice the franking

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A retirement portfolio is about half growth assets and half defensive. That is roughly where Australia's large funds put a 65-year-old, and it is what the Vanguard Balanced Index Fund — a reasonable proxy for the shape — targets exactly.

Inside the growth half, one slice does something none of the others can. Australian shares pay franking credits, and for a retiree in pension phase those credits come back as cash.

## Why this matters more after retirement than before it

Franking credits are refundable. A superannuation fund in pension phase pays no tax, so every credit it receives is paid out to it in full. The foreign tax withheld inside an international equity fund is not refundable: the offset can reduce an Australian tax bill to zero, but it cannot create a refund, and any excess is simply lost.

So for the investor this article is about, the Australian slice of the growth half earns something the rest of the portfolio cannot. The rest quietly pays tax it will never see again.

## Collecting franking on more than you own

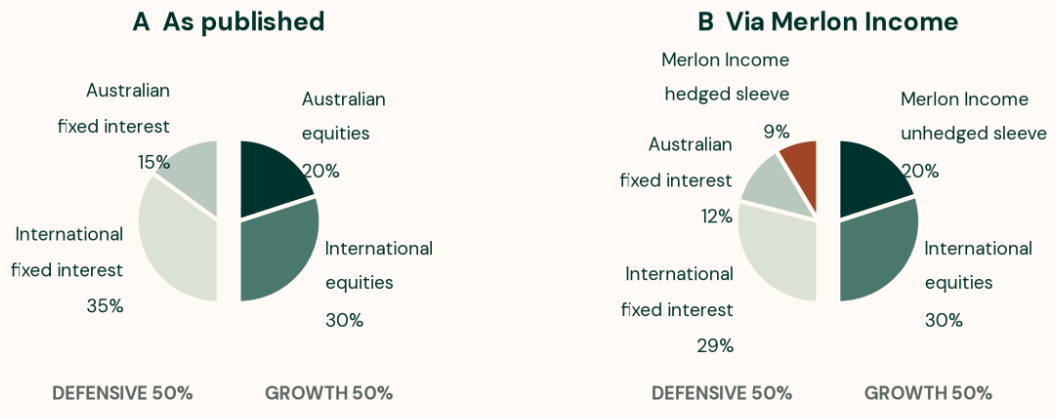
Here is the part that is not obvious. A fund that hedges part of its equity exposure still owns the shares underneath the hedge — and those shares still pay dividends, and those dividends still carry credits.

Our own Australian Share Income Fund typically runs 60–80% net long, hedging the rest with options. At 70%, holding 28.6% of a portfolio in it gives 20% look-through Australian equity — exactly what the Balanced fund holds — plus an 8.6% sleeve that behaves like cash. Because that sleeve is cash-like, it is funded from the defensive side rather than the growth side.

The result is a portfolio with identical growth exposure that collects franking on 29% of itself rather than 20%.

### The same 50% growth exposure, held differently

Both portfolios split exactly half and half. In B the Merlon Income Fund is one holding of 29%, split across the two halves: its net-long 20% counts as growth, and its hedged 9% sits on the defensive side, funded pro-rata from fixed interest — so the two pale wedges shrink by exactly that much.



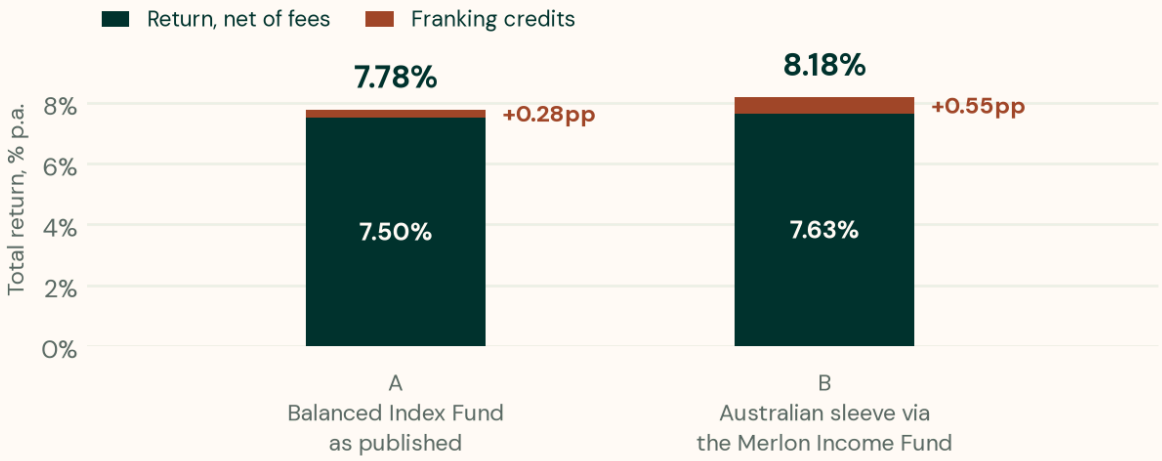

Source: Merlon; Vanguard wholesale fund total return indices via Bloomberg; fund administrator data. 15 years to 30 September 2026.

## What that was worth, over fifteen years

Change nothing else — same international equities, same fixed interest, rebalanced monthly.

### Same equity risk, nearly twice the franking

Both portfolios hold 50% look-through growth assets. The only difference is how the Australian equity sleeve is held. Franking is the structural part of the gap; the 0.13pp of return is not, and it shrinks as the window lengthens.




Source: Merlon; Vanguard wholesale fund total return indices via Bloomberg; fund administrator data. 15 years to 30 September 2026.

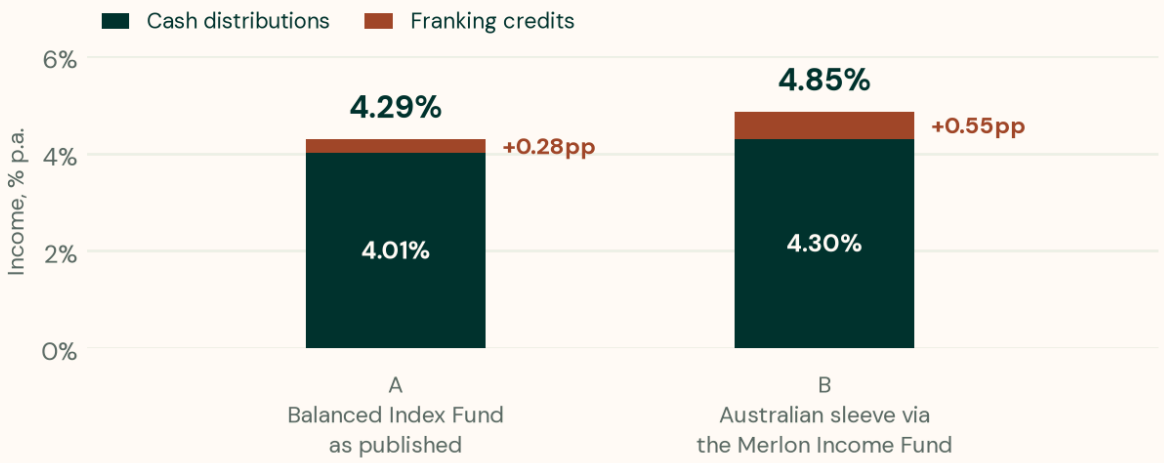
Portfolio A is the Vanguard Balanced Index Fund's target allocation, built from its seven underlying wholesale sector funds and rebalanced monthly; the build reproduces the fund's own published return over fifteen years. Portfolio B changes one thing: the Australian equity sleeve is held through the Merlon Australian Share Income Fund. That fund is typically 60–80% net long equities (70% assumed here), so 28.6% of it gives the same 20% look-through Australian equity plus an 8.6% hedged sleeve, which is funded from the defensive allocation. Look-through growth is 50% in both.

Merlon returns are net of fees. Franking on the Australian index sleeve is the S&P/ASX 200's own, 1.39% p.a. over fifteen years. Past performance is not a reliable indicator of future performance. The inception date for the Fund is 30 September 2005.

Franking roughly doubles, from 0.28 to 0.55 percentage points a year, on identical equity exposure. The income the portfolio pays out rises too — from 4.29% to 4.85% grossed up, which on a $500,000 balance is about $2,800 a year more to actually spend.

## What a retiree can actually draw

Income the portfolio pays out, grossed up for franking credits. A pension-phase retiree receives those credits as cash; the foreign tax paid inside the international sleeves is not refundable and never arrives.




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### The fifteen years were not a neutral test

This is the part that matters more than the result, so we would rather put it plainly than bury it.

International equities returned **13.9% a year** over this period against Australian equities' **9.6%**. That is an extraordinary gap, driven largely by a handful of very large US companies, and it is a headwind to anything tilted towards Australia. Our comparison survives it because it does not tilt — both portfolios hold the same 20% — but a reader should know which way the wind was blowing.

And bonds did badly, which is the opposite of what most people assume. The Australian 10-year yield *rose* from 4.22% to 5.12% across the window. Fixed interest returned about half what it now yields; so did cash.

| 15 years to 30 September 2026 | Returned | Yields today |
|---|---|---|
| Australian fixed interest | 2.9% | 5.4% |
| International fixed interest (hedged) | 2.3% | 6.0% |
| Cash | 2.3% | 4.9% |
| Australian equities | 9.6% | — |
| International equities | 13.9% | — |

Source: Merlon; Vanguard wholesale fund total return indices via Bloomberg; fund administrator data. 15 years to 30 September 2026.

## Nobody knows the next fifteen. But the arithmetic is suggestive

We are not forecasting. What we can do is apply the *same* assumption to both equity markets and see what falls out.

Give Australian and international equities an identical risk premium over their own bond markets. The gap between them is then just the gap between those bond markets — **0.6 percentage points**, against the 4.3 points international actually delivered. That conclusion holds whatever premium you choose, because it is the same number added to both. Franking adds 1.4 points to the Australian line for an investor who can use it, which more than covers the 0.6.

Two things follow, and neither depends on us being right about markets. If bonds return closer to their yields, the defensive half does better in both portfolios — and the hedged sleeve, being cash-like, does better alongside them. And if international returns land closer to Australian ones, the cost of holding Australian equities falls while the franking they pay does not.

In other words, the case for the hedged sleeve, and for an Australian tilt more broadly, looks better in a normal world than it did in this one.

## What this does not mean

**Our fund trailed the index.** Over the same fifteen years the Income fund returned 7.96% a year net of fees against the Australian index fund's 9.62%. The portfolio still comes out ahead because of franking and because the hedged sleeve displaced bonds that returned almost nothing — not because of stock selection.

**And the Australian index is concentrated**, which is a reason to think about *how* an Australian tilt is held, not only how large it is. Merlon's portfolios are built without reference to index weights; that is a separate argument for another piece.

**For the record, and because a five-year figure is the one that should be quoted:** the Merlon Australian Share Income Fund returned 10.55% a year over the five years to 30 September 2026, and 8.98% a year excluding franking credits. **Past performance is not a reliable indicator of future performance.**

## The lesson, which is not about us

Most of the attention in a retirement portfolio goes to how much sits in growth assets. The more useful question, once that is settled, is what the growth half is made of — because one part of it pays a credit that comes back as cash, and the rest pays tax that never does.

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