ZANACORP

Investment Insight

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The digital revolution is the wonder of our age. It has miraculously changed and improved daily life, much like electricity lit up the night. The internet transformed business efficiency, keeps us closer to family, friends and our interests and allows any voice to instantly echo around the world. Sadly, it has also evolved in a more visible and vocal expression of "tribal" interests and many insane ideas, increasing social division and unrest, dissolving commonly held values and civil discourse in its wake. Misinformation and fake news is real. This is 21st century life, warts and all. Digital devices are the new battleground for the perennial struggles between old and young, the haves and have nots, climate change and the polarising politics of the left and right. Each tribe sees the world quite differently and wants only its way and now. When warring politicians representing warring people are unable to agree on a common problem, a common solution seems unlikely, only chaos. Meanwhile, there has been a world-wide assault on households from ever rising interest and rental costs, energy and food costs, education and health costs. This is the scourge of inflation. Good politics and sound economics have been hijacked by social media and instant news feeds and an ongoing series of poor and spineless economic choices. Genuinely resolving the global financial mess necessitates financial pain. As we are collectively unable to agree on who should pay, how and when, the quagmire simply gets deeper. Though sharing the burden broadly may seem fair, it is political suicide, a pifall of democracy. Our adversaries have no such concerns. Needless to say we continue to advise investors to be cautious. The risk of a serious financial mishap from high(ish) interest rates remains elevated. Winter is coming.

To Everything Turn, Turn, Turn, There Is A Season

Nothing Is More Predictable Than Change

Turn, Turn, Turn was a folk song popularised in the mid 1960s by The Byrds. Not commonly known, the lyric is drawn from the Bible, Ecclesiastes 3:1-8, an Old Testament book, written over 2000 years ago for uneducated people.

The verses tell simple truths, understood by all people of that time and most since, until recently, before we became less resilient and less patient.

"A time to plant, a time to reap...
A time to break down, and a time to build up...
A time to gain that which is to get, and a time to lose...
A time to keep and a time to cast away..."

To Jews and Christians these themes underly beliefs, yet to everyone, the words state plainly what they mean: there is a time and a place for everything and **change is constant**. A prolonged period of Western affluence has led many today to expect good times to last forever. **They don't and won't.**

Although the table is not a predictor of the next asset class winner, we can deduce that none remains permanently in favour, or out. For good reason. Over time, rising assets become popular to own attracting increasing capital, until becoming expensive and poor value. Unloved growth assets become under-owned and cheap. To make money, one must **buy low sell high.**

Zanacorp clients will be quite familiar with our ongoing Tactical Asset Allocation (TAA) strategy where we periodically shift a portion of funds from a strongly performing asset class into what may appear to be a poorer one.

This is not a precise science, nor does it imply relative performance will immediately reverse. It more reflects our long held value based belief that taking profits from winners and buying assets well and with patience, reduces downside investment risk enhancing returns over the longer term.

We hope this reinforces your understanding of our switching process.

Annual Asset Class Returns - Calendar Year

MORNINGSTAR™

2003	2004	2005	2006	2007	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022
32.3%	32.2%	22.8%	34.2%	17.1%	14.9%	57.4%	13.1%	11.4%	32.8%	48.0%	26.8%	14.4%	13.2%	20.0%	4.5%	28.0%	9.2%	29.6%	1.6%
14.6%	28.0%	19.6%	34.1%	16.1%	9.2%	37.0%	9.3%	10.5%	20.3%	20.2%	15.0%	11.8%	13.2%	13.4%	3.3%	23.4%	5.7%	27.0%	-1.1%
8.8%	26.6%	16.8%	24.2%	6.7%	7.0%	9.6%	6.0%	4.8%	14.1%	7.3%	10.4%	10.2%	11.8%	11.8%	1.9%	21.4%	5.1%	17.2%	-9.7%
6.6%	9.9%	12.7%	11.5%	6.6%	-24.9%	8.0%	4.7%	-1.6%	9.7%	2.8%	9.8%	3.3%	7.9%	6.4%	1.6%	19.6%	4.5%	16.9%	-12.3%
4.9%	8.9%	5.8%	6.0%	3.5%	-38.4%	3.4%	1.6%	-5.3%	7.7%	2.3%	5.6%	2.6%	5.2%	3.7%	1.5%	7.3%	1.4%	0.0%	-12.5%
3.0%	7.0%	5.6%	5.4%	-2.6%	-53.2%	1.7%	-0.7%	-10.5%	6.6%	2.0%	2.7%	2.6%	2.9%	3.7%	-2.8%	7.2%	0.3%	-1.5%	-18.4%
-0.8%	5.5%	3.8%	3.1%	-8.4%	-55.3%	-0.3%	-2.0%	-21.4%	3.7%	-0.8%	-3.8%	2.3%	2.0%	1.7%	-8.7%	1.3%	-4.0%	-2.9%	-20.1%
2003	2004	2005	2006	2007	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022

Cash | Australian Fixed Interest | Int' Fixed Interest (Hedged) | Australian Listed Property | Australian Equity | Small Caps | International Equity

Asset Value Trends Looking Up?

We refer paying clients to our January 2023 Zanacorp Bulletin updating our then thoughts and strategy supported by a detailed assessment long term trend data.

In 3 short months, we have witnessed the 2nd biggest US bank failure in history, **Silicon Valley Bank** (SVB) as well as the collapse of **Credit Suisse**, a global prime bank and Switzerland's 2nd biggest bank where **CoCo (Hybrid) bond holders lost 100% of their capital.**

Do not ignore these signs. They are markers alerting all to the underlying vulnerability of financial entities to rising rates and falling bond prices. They led the **US Treasury / FED to release US$500bn in liquidity in March 2023 alone**. To put this in context, the US response to **the GFC was US$800bn** over 2 full years.

Despite this, we remain buoyed by the strength of global job markets, resilient consumer spending and falling inflation prints, each easing the pressure on most central banks to raise interest rates. Markets have responded in kind, firming across the board including crypto. **Liquidity is a powerful stimulant**, even if administered to avert a significant system failure.

Above is a 20 year performance table of the major asset classes. It may appear complex, but its value lies in its simplicity and we urge to readers to invest some time to learn from it. Knowing the path, helps to walk the path.

Ranked from best performer at the top to worst at the bottom, we suggest you choose one asset class at a time and follow its performance over the 20 year time line. Start with your favourite. You may notice **cash achieved top place only once** and small caps captured top and bottom place 12 times.

The 2003 –2012 decade saw **Australian Equity** 1st or 2nd **six times** but only twice since. Contrast this with **International Equity** unplaced to 2012 but featuring for **seven years of the last 10** after a decade of US market outperformance and technology and software sector dominance. **Most investors chase last year's winners, successful investors look for next year's.**

In Australia, high property prices are more critical to household confidence than any other measure. CoreLogic have heroically called February as the bottom of the property market, whilst Westpac recently revised their forecast for Melbourne house prices from a 2023 decline of 10% to only 1%. Only time will tell if these calls are well founded or false dawns.

If we are in a traditional bear market, **which no one can know**, the current liquidity driven recovery precisely mirrors the 1st upward wave of an historically established downward cycle pattern as last occurred in 2010. It would be consistent with this pattern, that positive momentum lifts prices even higher in the next 3 months as hope seeks to trump a more dim reality.

We remind all readers that **we do NOT see markets dramatically crashing**. However, we do see most of the challenges facing economies unresolved.

The Long And Variable Lag - How 2022 Impacts 2024

We are all subject to information overload. To manage this most people focus on headlines, a sound bite or a "short version" of a news item or topic. Even cricket has become a 3 hour "big bash". Few of us make time to read a book or delve deeply into a complex issue. Governments and regulators act the same way. To resolve issues **they often apply a quick fix** hoping problems will resolve themselves, with increased spending and debt. To deal with **INFLATION** they have rapidly HIKED INTEREST RATES, erroneously assuming **doubling the dose of medicine, halves the time of recovery.**

So far, the swift and steep interest rate rises across the globe have done little to dampen demand, consumption or employment much to the chagrin of central bankers. **Investors are not worried either. They should be.** Markets assume a pause in rate rises, then a drop and we are off to the races again with shares, house prices and debt resuming to their "normal" upward trajectory. Problem solved, no recession, pain over. Really?

Readers uncertain as to why Porter Davis and many other home builders are collapsing, need look no further than ScoMo's 2020 well intentioned but poorly executed **HomeBuilder** scheme. To support housing construction, $25,000 was offered to (mainly) 1st home buyers to sign a building contract and start within 18 months. Most buyers chose **fixed price contracts** (or they could not get a loan). Those builders tied to a fixed price then saw materials and labour costs explode and **profits became losses. The end.** To be fair, at the time, no one saw the massive cost increases coming, or the overwhelming worldwide demand to borrow cheap money and buy, renovate or build houses ALL AT THE SAME TIME. Maybe they should have as the convergence of events was akin to the IT spending wave in the lead up to Y2K and the subsequent dot.com bust that destroyed IT companies and in their ashes the US borrowing binge that led to the GFC.

Notice the pattern of events. A change in conditions/needs, the overreaction of markets/people, the response of regulators and then the lag in time, before the predictable economic/market outcome. This lag repeatedly results in policy error, often turning booms into busts. Look around, who wants to be in debt in 2023? In 2021 people were "all in'.

It is only 13 months since March 2022 when RBA first increased interest rates taking them from 0.1% to 3.6% . **Little has really happened to change lives**. House prices are now even ticking up. Australia has had the **smallest** rate rises in the western world as we have the biggest household debt and a mortgage cliff ahead. The calm before the storm? **NZ ,UK and Canada** are further down their "inflation busting" track. Having moved earlier and harder, each is struggling with no solutions in sight. Is that our destiny too?

In our view, it appears a near certainty that the lagging impact of a year of rising interest rates and "sticky" inflation will be a significant economic slow-down and widespread pain. The **only uncertainty is when and how** it manifests itself in Australia. Each country is different. As always, some people will be seriously impacted and others not so much. We feel fixed income people (retirees) and those who carry high debt burdens will be hardest hit as they have fewer options. We expect **company profits to fall** later this year, putting downward pressure on share prices, reducing confidence, spending and employment. Perversely, we imagine this will come as a surprise and most markets will be impacted AT THE SAME TIME. Déjà vu?

In Australia, rising interest rates will eventually crush household spending over the next 9 – 12 months. The Australian **Mortgage Cliff**, is here.

Figure 6: End of fixed-rate mortgages periods, Four majors, 2023 – 2024, N

Source: Four majors; ABA

Look at this chart. **Over the next 9 months 614,272 homes shift from 2% loans to 5.5%.**

Many borrowers are not ready for this severe cash flow hit, but will be OK for a while. Do not be surprised by what follows, in **2024.**

TECTONIC SHIFTS BEFORE OUR EYES

In future issues we hope to expand on our ongoing observations of **Fourth Turning** global events, including Artificial Intelligence (AI) that seem likely to reset the next decade. For now, with the theme of change, we will simply introduce the thought that the post-Cold War economic benefits of peace, free trade, globalisation, energy efficiency and global co-operation are over.

In 2020, the world had its eyes opened to its vulnerability to Chinese controlled supply chains. In 2022, responding to the Russian attack of Ukraine and domestic inflation concerns, the world witnessed the US weaponise and abuse its Reserve Currency status. De-globalisation and **de-dollarisation** will reframe the world order, global trade, energy supplies and peace. Cloning the path of every century that preceded this one, in a world of competing interests, **there are no "good guys" or "bad guys", only allies and enemies**.

Demographics Is Destiny

We are zealous believers that over time, shares, property, bonds and infrastructure assets generate far superior investment returns than cash and term deposits (though we don't ignore "Turn, Turn, Turn"). **We also challenge** the simplistic notion put to investors by lazy experts and advisers that **"time in the market, is more important than timing the market".**

Although hypothetically correct, **people are just not wired that way**. Under the stress of prolonged loss, few investors can stay the course, when the recent past and foreseeable future look grim. Crazy as it seems, over time, they generally lose confidence and usually end up **selling** near the bottom. Defying logic, this investment behaviour is observable over and over again.

People are social and emotional creatures, influenced by many factors. Our friends, FOMO, greed, fear, impulse, anxiety, age, pride and biases all come into the investment purview for each of us. Even your writer. Being aware of, and managing emotions, is an important part of managing money. It is part of the mentoring role of any financial adviser. By tactically managing asset exposures, Zanacorp strategies reduce volatility and investor anxiety, assisting clients to **make reasoned decisions** and **avoid emotional ones**.

When investment conditions are favourable, most people are calm and rational, at ease going up the risk curve to squeeze out a higher return. It seems to come naturally. However, when markets are falling, especially over a protracted period, those same people express quite different thought processes and behaviours, notably panic, then denial then regret.

As people across the planet age, the need for investors' risk tolerance to align with their life stage becomes increasingly vital, as time becomes scarce and the ability to recover from investment losses more difficult.

We have briefly outlined our thoughts on the investment conditions that lie ahead. Not of a collapse in markets, but rather **a longer and possibly more painful gradual decline** where the masters of the universe that got us here, struggle to find a pathway out. Debt does not disappear, it is either repaid or diluted away by inflation, neither of which is good for investors. No economic downturn is all bad, there will periods of time, possibly long ones where markets will recover sharply finding "green shoots" of hope.

Most of today's retirees were working during the GFC with only a blurred memory of the massive 5 year decline in markets. Their **wages paid the bills** and each day was filled by the worries of work, family and life. **Today, those people have no employer or income, only their capital.** As a cohort, they have a lot to lose and with the "benefit" of the internet, they now worry about their health, retirement and financial well-being (**money**). As do we.

Demographics is destiny. Globally, past savers (Boomers) will be the future sellers of assets, for income. Many debt laden Gen Xers accessing cheap money, may also be sellers, as rising interest costs bite. Millennials should note, seasons change & time is your friend.

Meanwhile, as we enjoy the final stages of this boom, expect markets to be range - bound, flirting with emotions up and down, but grinding painfully lower. The world has travelled this road before. **Turn, Turn, Turn.**