ZANACORP

Investment Insight

June 2021

History never looks like history as we live through it. The events of the present when compiled in the future, remind us all of the forgotten lessons of the past. This is the human life cycle. How will our future selves record the early 2020's? Will it be a narrative of medical and economic triumph over the global scourge of COVID-19? Or will it be viewed as the last gasp of an aged and failing Judeo Christian system, both social and economic, whose time has now passed, no longer serving today's societal norms? Well intentioned governments have abandoned fiscal responsibility and basic economic principles to maintain the status quo. Recognising the many positives from the 2020 global stimulus measures, lacking nuance, one cannot ignore that financial outcomes for some people have been great and for others diabolical. Clinging to past failed economic policies is leading us all to an unimaginably dark future. Let's call it out. EVERYONE KNOWS MANY THINGS ARE SERIOUSLY WRONG WITH THE WORLD. An increasingly hostile China, trade imbalances, social unrest, spiralling asset prices, ultra low interest rates, high debt levels, job insecurity and the ever widening gap between rich and poor. Somehow we just hope the collective "brains trust" of the world will work it out, without disrupting our little lives. Yet that hope seems increasingly naïve. Wanting to be wrong, we believe the current "everything bubble" may end badly just as every other one has. Winter is coming.

Back To The Future

Falling Feels Like Flying, For A Little While

Have you ever met a person who has had their life so ruined by borrowing money, that they wanted to end it? It is seriously disturbing.

That was the baptism of fire your writer experienced more than once in the late 1980's. A young(ish) Chartered Accountant, being asked to pick up the pieces of shattered dreams and correct the wrongs of so called "investment advisers", property spruikers and inexperienced investors and bankers, in the brave new world of deregulated financial markets.

Financial Planning was a non existent profession then. It looked more like the American wild west, with gun slingers reeling in the pots of money held by unsuspecting investors unhappy with safe 6%-8% money market returns when shares and property were rising 14% -18% year after year. It was a time when **greed was good.**

Many **borrowed too aggressively** and were taught harsh lessons by the 1990's recession - **falling asset markets hurt borrowers most** of all.

As much as we think the 1980's world has changed, it really hasn't. Like the subsequent dot.com bust and GFC, it's just the same old plot with a new cast.

It is timely to recall Warren Buffett's advice—**"Be fearful when others are greedy, and greedy when others are fearful"**. Buffett is currently very cashed up, waiting as he does, for imminent opportunity.

In March, we suggested 2021 will be a boom year. We retain that view. The people who were scared as hell 15 months ago, today are raging bulls. That is greed and fear in play. In 2021, **greed is good, again**.

Few economists anticipated the miraculous rebound from the March 2020 meltdown. Most governments have also been surprised by the speed of the economic recovery, in spite of multiple lockdowns. Why?

An obvious explanation contributing to this outcome is the "sugar hit" from extraordinary government stimulus measures putting money directly into consumers' bank accounts. This is the untested MMT being used as a front line economic vaccine. Add to this the immediate global reduction in interest rates to near 0% along with rent and mortgage holidays. **We created the first ever recession where consumers had a RISE in disposable income.** This anomaly was all government funded.

Therein lies the danger of this response. Having absolutely saved many people in their hour of need, it also ensured they learned nothing from their near-death financial experience. In 2020, **every investor, every borrower, every business, every employee, every retiree and every welfare recipient has been led to believe if markets fall or the economy fails, GOVERNMENTS WILL BAIL THEM OUT.** So governments are now in economic peril, not private citizens. Who will save them?

Under this new economic paradigm, spending and borrowing levels worldwide have simply exploded. This has ignited GDP growth and business profitability and made investors rich (on paper at least). Better still, with no net migration, unemployment levels have been slashed. **Young workers can now find a job.** Travel restrictions meant money otherwise spent on overseas holidays became local holidays, cars, home improvements, restaurants etc. Global protectionism has an upside, who knew?

In Australia, 2021 housing debt (ex re-fi) has gone to the moon, lifting house prices and widening the inequality gap despite COVID lockdowns and **no net migration.**

Still, **1.2m houses remain empty.** This aberration is the result of decades of tax and monetary policy mismanagement. Today more than ever, the Bank of Mum & Dad is used to assist younger Australians to enter this white hot market and become the new modern slaves to a mortgage. Should hard times come within the next 5 years, **do you think mum and dad will ever get that money back**?

The worldwide sea-change/tree-change response to government lock downs and travel restrictions, has led to massive demand for regional property outside every urban city in the world. Inadequate housing supply has seen prices in these regions rise by 30% -50%, yet another bubble?

The impulsive global desire for big ticket lifestyle investments using cheap money is a perfect set up for an almighty global bomb to be triggered.

Investors are experiencing the euphoric sensation and apparent freedom from all the economic laws of gravity. It feels exhilarating. But be careful. **The investment world is not soaring, investors are simply falling into debt.** For now, assets are melting up, mirroring bitcoin earlier this year propelled by momentum, over-confidence and FOMO. It is so 1980's. **DO NOT BORROW MORE THAN YOU CAN REPAY. Greed is not good.**

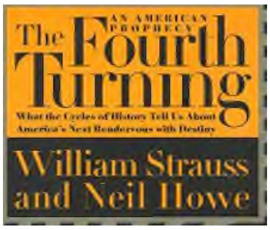
In 1997, Alan Greenspan famously uttered the words **"irrational exuberance"** when speaking of then buoyant markets. Although the FED Chairman, world markets considered him an old man so "what would he know" and kept rising until the infamous Y2K bust in 2000 and then 9/11.

Greenspan's monetary response to these events was to reduce interest rates. These rate declines triggered a massive borrowing binge ending in the 2008 Global Financial Crisis (GFC). In the 13 years since, to keep economies afloat, interest rates were lowered, time and time again to induce more spending and borrowing. There has been no opportunity to **normalise** rates, as to do so would destroy asset prices and the global economy.

The implausible events culminating with COVID-19 have resulted in a global borrowing mania and a total exodus from cash. All Zanacorp client portfolios are enjoying strong returns and will continue to do so, yet they retain underlying capital protection **should the irrational gulf between economic reality and inflated asset prices correct unexpectedly**.

Our July, 2007 newsletter alerted clients to the then ending investment party. **We were 9 months early, before the GFC hit**. Much of what we saw in 2007 still applies. New today, self-serving governments around the world will use and then abuse their freshmoney printing licences until that last fanciful trick also fails. Then the world as we know it, will change forever. We hope not to see **a new generation of debt destroyed lives?**

The Fourth Turning



The generation gap popularised by the media in the 1960's was hailed as something new. It wasn't. It has been the natural order of things dating back to Aristotle and the philosophically "natural" domination of elders over youth in ancient society.

Have you ever noticed that most of **recorded history is written by people 40 years old** or above? Given much shorter life expectancy in earlier centuries, this suggests the historical record, is a slanted perspective of life written through the lens of older generations. **Imagine if the 10 or 20 year olds of yester-year were to record their observations and life experience.** It would provide a quite different insight of the same times but reflecting quite different experiences and thoughts.

The Fourth Turning, a 1997 tome written by demographers William Strauss and Neil Howe provides a most fascinating theory filling in the gaps of the various generations that have co-existed in Anglo American history, dating as far back as the 15th century.

Like the natural changing of the 4 seasons, the reference describes a compellingly cyclical pattern of inter-generational archetypes, that tends to repeat itself every 4 generations (roughly 90 years). Although American based, the generational cycles are recognisable world wide. The book describes how **the experiences of each generation when they are young shapes the way they govern in later life,** framing the lives of that of those who follow them. The twist it portrays is that by the time the 4th generation, born after a crisis period reaches a position of power, few of the 1st generation who lived through the last crisis remain living and much of what they know is lost, resulting in a new beginning.

Each cycle of 4 periods is known as a saeculum based on the lifespan of a human life. Each period is comprised of roughly a generation and its descriptor is not of events but rather a series of events over the cycle. The world is currently in the Fourth Turning, the crisis period, believed to have commenced in 2006 and due to conclude in the late 2020's.

Despite its many inherent limitations and generalisations the relevance of this work is that the world is currently poised to pass through a redefining stage of history.

Having already discussed the prevailing economic madness, the stage seems set. Will the fierce battle between China and the West be the final act or will the West have already determined its own demise?

The Silent Generation (1925-42) represent the First Turning (A High). Born after The Great War they are characterised by an era when institutions are strong and individualism is weak. They came of age after the Depression and WWII experiencing great challenges and framed a society that knows where it wants to go. Defined as Artists, they are generally silent and obedient, community minded and good leaders. As children they learned thrift, trust and respect. In power they built welfare systems and collective bargaining for workers, protecting the many

The Boomer Generation (1943-60) represent the Second Turning (An Awakening). Born after WWII and defined as Prophets, untouched by childhood crisis or wartime danger, this generation is more individualistic attacking institutions in the name of personal and spiritual autonomy, breaking the shackles of conformity. Boomers came of age and shaped the cultural revolution spanning 1965-1999 breaking many racial, religious and social norms. Boomers tend to be driven idealists having ushered in a fairer society than the one they were born into. Paradoxically, boomers commandeered the "me" in their affluence .

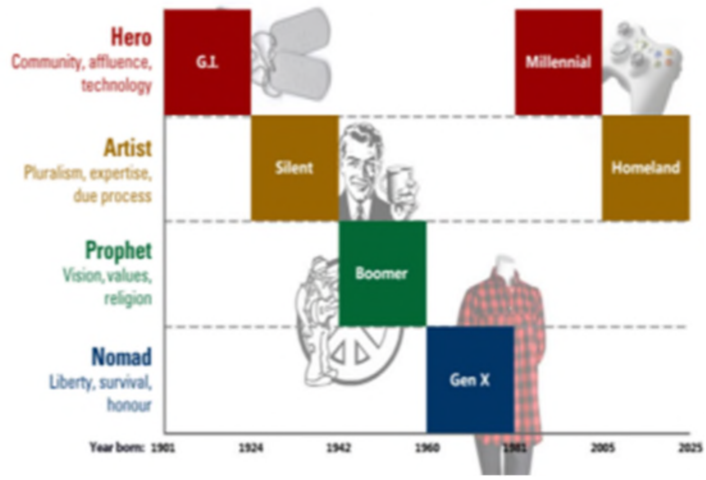
Gen X (1961-1981) make up the Third Turning (An Unravelling). The latchkey generation born into a household of 2 working parents and the first product of modern society often raised in broken homes. With a more balanced work/life mix they are less reformist and more self taught and self determined, coming of age in the digital world. Cynical and distrusting of institutions and leaders, this generation is classified as Nomads. Nomads consolidate prior change rather than create it.

Having a decidedly edgy cultural streak, now ruling Gen Xers split consensus views into competing and adversarial camps. The rise of woke culture, identity politics, BLM, disdain for democracy and Marxist views propagated via the world's universities, epitomise this cohort and crisis.

Millenials (1982-2005) represent the The Fourth Turning (A Crisis). The most educated generation in history born in the digital age, this high tech generation will be burdened with managing the next crisis as institutions are torn down and rebuilt, finding community purpose and redefining lost national identity. Generally risk averse and seeking order, they will re-engineer society from decades of "me" to a wider vision of "we" as evidenced by their championing of climate change/global inequality.

Nurtured in the dot.com, 9/11, GFC and now COVID-19 crises, this generation is affluent, now dominating the workplace and soon the polling booth. They have seen the failings of their predecessors but are not yet ready for the task ahead. Sheltered by boomer parents, they are a pragmatic group and will forge a different world in the 2030's. We expect big government will play a major role in future, just as it did in the 1930's.

Howe/Strauss Generational Archetypes and Generations



The chart above maps both the archetype, timeline and modern labels assigned to the currently living generations. Consider the general values ascribed to your cohort and its outlook to draw your own conclusions.

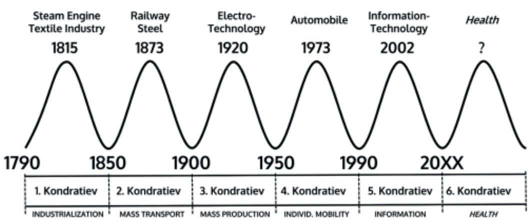
What Do We Learn From Demographic and Generational Change?

Recognising generations as cyclical, reinforces economics as cyclical. Although no two cycles are alike, we know that peaks follow troughs and vice versa. The purging of poor practices makes room for better ones, just as forest fires clear the dead wood making way for new growth.

A defining characteristic of the 21st century has been that most financial policies have attempted to smooth out the economic cycle, defying the natural order of things. Like trying to correct a bubble in a balloon, pressing on the spot merely shifts the bubble to another spot.

By attempting to suppress natural cycles, we have inadvertently transformed a balloon into a bubble. The bubble will burst, but not just yet.

Readers with an economic bent will be familiar with Kondratieff wave theory. This economic theory developed in 1925 points to the very same outcome as The Fourth Turning during the 2020's.



Extrapolating this cycle suggests a date around 2030 as the bottom of the next global decline. Notice the shortening cycles?

Alternative theories pointing to an imminent socio-economic climax are just that—theories. They are not prescriptive predictions. Nevertheless, readers should keep their wits about them. The widespread consumption **"madness"** evident in many debt-ridden and decadent societies seems unlikely to be permanent. Preparing for change appears prudent.

Brain Teaser

Continuing our generational theme, can you solve this riddle?

A boy and a doctor are fishing. The boy is the doctor's son. However, the doctor is not the boy's father.

Who is the Doctor? *(Solution at foot of page 4)*

2021 Superannuation Amendments – All Good Ones

2021 Indexed Super Contributions / Income Stream Caps

Over the last 30 years we have found super to be the best way for people to tax effectively accelerate savings, optimize wealth and generate tax free retirement income for life. Australia's retirement savings system is regarded amongst the best in the world. With design features, options and structures which can be tailored to suit every adult, we have been pleased to provide solutions to clients along their unique pathway to financial independence. That the government needed to put caps on accumulations, is a testament to the generosity of the system. Many cynical investors see the light too late in life, try not to be one of them.

From 1 July 2021, the concessional and non-concessional contribution caps are set to be indexed for the first time since 1 July 2017.

	Existing Cap	New Cap
Concessional (Tax Deductible) Contributions	$ 25,000	**$ 27,500**
Non Concessional Contributions (under 67)	$100,000	**$110,000**
Transfer Balance Cap - Income Streams	$ 1.6 mil	**$ 1.7 mil**

From **1st July, 2022** the work test will be removed for people aged 67-74 enabling Australians to access all super tax concessions. **Downsizer contribution concessions** will also be made available to those over 60 (currently 65) to free up family homes sooner and top up super.

Income Stream Payments 50% Concession—Extended

Over 60s and retired clients holding tax free Account Based Pensions and not needing the minimum annual age based pension will be relieved that the 2021 50% reduction in compulsory pension payments will be extended to 30th June, 2022. This enables retirees to continue to build their pension account balances without obligatory cash drawdowns.

Employer Super Guarantee Scheme—10%

From 1st July, 2021 employers will be required to contribute 10% of employee Average Weekly Ordinary Time Earnings (AWOTE) to super. It is expected this amount will increase by 0.5% p.a. from 1st July, 2022 until it reaches 12% from 1st July, 2025, boosting the savings of all.

SPACS, Reddit, Robinhood & GameStop- Canaries In The Coal Mine?

In the early days of under ground mining, coal miners used to bring canaries with them into the mines. If the canary died, the miners knew there were dangerous gases present and would leave the mine.

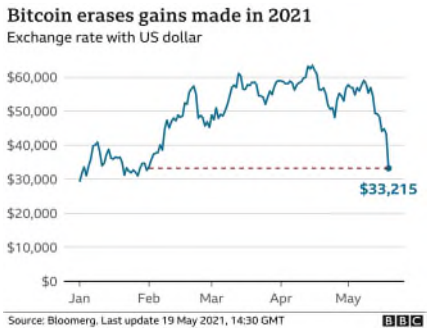
Many readers may be unfamiliar with the stories behind the above title names. Most under 35 year olds wouldn't. The 2021 share market frenzy is identified by investors with **little experience, but too much time, money and access to global markets, FOMO and credit .** COVID accelerated it. The conspicuous presence of this new breed of investor is akin to that of a canary and danger in the investment air, replacing the old taxi driver.

Special Purpose Acquisition Companies (SPACS), were known as "cashbox" companies in years past, are strange vehicles because they take investors' money, **before** they own any business. If that sounds stupid, it is. They came and went bust in the 1980's. Yet, here they are again raking in billions. **Reddit** is a social news platform garnering younger investors to "beat the big guys" on the sharemarket. It adopts the law of large numbers to disrupt prices and markets using **Robinhood,** a commission "free" share trading platform. No Sheriff of Nottingham here. This online service is offered apparently for free, because **the young users are the product being sold**. It is an insidious identity breach—but it works. **GameStop** is a small US retailer whose price in 2021 rose from $18 to $483 in 2 months, before falling again to $50. Showing contempt for market rules, this online manipulation made and lost people billions.

Cryptocurrencies—A Fad or The Future

If anything characterises the gulf between current generations, it is the appearance of cryptocurrencies as an investment asset. Polarising views, at one end, it is considered to be either a mindless speculation on an intangible digital construct, that will end in tears. At the other end, it represents the future of global exchange, trade and finance with its decentralised peer to peer block chain base, providing the ultimate security of ownership. The new gold. Predictably, the answer lies in between.

Presently, crypto is the realm of younger people and most **early adopters are treating it like a casino**. For the many mobile phone based holders, after a couple of clicks they have opened an account and they are on their way, slavishly tracking the price of their coin of choice and so happy if it is heading up. **What's so hard about this?** Few have any plans or exit strategies, it really is just like a simple game, except with real money. Everyone they know is playing. Still think we are in normal times?



Although just one of hundreds, **Bitcoin is the poster child** of the crypto world. Have a look at the price over the last 6 months. **Up 100% then back to where it started**. This is the "new gold"?

Most crypto prices collapsed in March 2020 before a parabolic rise, suggesting a post COVID mania, on steroids.

Digital transactions have been part of everyday life for decades and few of us have been concerned. When was the last time you used a debit or credit card? We trust the banking system to debit/credit our accounts when we tap and go, without a second thought, leaving a permanent digital trail of our lives while fattening bank profits. Retailers know the days of cash trading are long gone with COVID-19 all but ending them.

So why do many have a problem with crypto? We suspect the answer lies in the discomfort of not knowing where money is located, who controls it and the risk holdings may be fraudulently accessed or stolen. As owner/custodian of an unregulated asset, there is no "help line" to ring if something goes badly wrong. That **security is what we pay a bank for**.

At an institutional level and country level, crypto is starting to find traction. This is where the long term future of the coins will be determined. El Salvador recently made Bitcoin legal tender in a bid to be a global leader whilst China, home to the largest Bitcoin miners, banned its mining. Is Bitcoin an environmental disaster? That's a story for another day.

With the asset class in its infancy, it remains too early to draw definitive conclusions in relation to its "true" value and role in society. Crypto today is where the dot.com boom was 21 years ago. It will be part of our future without a doubt, but which currency will win the race? With no industry standard, so many variants and limited utility, it is a speculation.

We expect to provide many more articles on this topic in the years ahead. We will end this introduction with a thought provoking anecdote.

Picture a geeky Australian millennial working at Adobe, conjuring up a practical joke. Let's just say it was a notional cypto coin. He joined with a US IBM software engineer to make it real. They named it **Dogecoin** a meme of a Japanese Shiba Inu dog and created 100 billion coins which **you "dig", because dogs don't "mine" coins.** They then let "doge" loose on the real world with a shiny gold icon, to see what would happen.

Bang! **$US 32bn is what you get.** That is the value ascribed by crypto buyers to this joke. Adding credibility to Dogecoin is none other than the world's richest man "rocket to Mars" Elon Musk. Well, he's got plenty of money to burn. So there you have a real life 2021 Tulip Bulb bubble and billionaires made overnight.

We will discuss the inflation/deflation debate in a future issue. For now, if SPACS, Reddit, cryptocurrency speculation and Japanese dogs still have you thinking there is nothing wrong with the world, turn the page now.

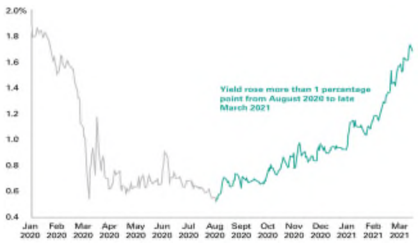
The Importance Of 10 Year Yields

Unlike short term interest rates which are controlled by central banks, long term interest rates over 10, 20 and 30 years are determined by the bond market, the world's largest securities market at **$US 119 trillion dollars** (100 times Australia's GDP) and includes all central banks.

The benchmark (lowest) rate is determined by **loans to government** (known as **bonds**). They are considered **risk free.** The yield (interest) reflects the cost of money, inversely determining the relative price of all other assets from property and shares to infrastructure assets, mining projects and manufacturing plants. Asset prices rise as interest rates fall.

For over 35 years bond yields have fallen from 13% to 0% in 2020. Over this time investors were rewarded for taking risk. Asset prices progressively increased while debt costs progressively decreased. Rising asset prices have led to increased risk taking at ever lower income levels, reducing fear of borrowing. We've enjoyed **a truly golden age of debt.**

This cycle has left all assets at nose bleed levels along with debt levels so we no longer take debt or rate rises seriously. Now remember where we are, interest rates are at their lowest and debt at its highest. **Think like an adult**, what are the options from here? What are the risks? The emergency COVID-19 interest rates are still with us. After 20% asset rises in 12 months, **are we still in an emergency?** The bond market suggests not, as illustrated in the chart below. The interest rate cycle has turned.



While retail borrowers have been asleep, 10 year bond rates have risen 1% over the last 12 months.

ScoMo and Josh have a problem as Australia's $A 1tr debt racks up a $A 16 bn p.a. interest bill. More money printing?

If you are a speculator we think you still have time to make a final killing in the next 6 –12 months, then get out. If you are a long term investor, think long term. Consider the bigger picture 3 to 5 years out in a higher interest rate world. All markets are likely to fall in that time. We have positioned our client portfolios for both growth and protection. We prefer to hold insurance before a house may catch fire. What do you do?

The Reserve Bank is now cornered, debt has increased while rates were decreased, borrowers have become extremely vulnerable to even the smallest interest rate hike, which could tip over the house of cards.

A genuine threat of global inflation has returned, 1940's style. With free money all around the world, commodity prices, construction, shipping and input costs are ballooning out of control. We are told not to be concerned as these issues are **transitory** but are they?

Meanwhile, back on the yellow brick road, Australian consumers doing their retail therapy using credit cards think **the "bad times" are over.** In record numbers!

None of us can see the future. It is possible the post COVID world will sort itself out painlessly. Then again, when it looks like a duck, walks like a duck and sounds like a duck, it is probably a duck. Are we in a bubble and just can't see it? That is how they form, we will know in a year (or two).

Market Round Up

Overseas Shares

A glimpse at the Market Facts table shows stunning returns in 2021.The US is the standout rising 34%, Japan 29% and Germany 26%. Each nation is driven by different factors but the underlying propellant for each has been government stimulus. Our preferred international asset manager generated returns of that order for all our clients, though like us, they remain cautious. From here, world markets are likely to diverge with US market leadership breaking down. We see the next 10 years quite differently from the last as the **impact of higher taxes** takes its toll on profits.

We expect 2021 to remain strong reflecting the Northern Hemisphere summer spending recovery, vaccination relief and elevated base effect GDP growth. 2022 conditions remain opaque and will more likely expose the chasm between post COVID sustainable and failed business models.

Australian Shares

The All Ords matched world markets rising 26%. Australian **"Risk on"** saw our heavyweight stocks rise strongly, especially **banks and retailers** (for mums and dads) as well as huge gains from speculative bio-tech, fin-tech and mining microcaps for our newest young DIY punters. The best returns in decades replenished the portfolio values of all investors. This welcome relief offers the opportunity for each investor to review how well they coped with 2020 and a chance to take some profits off the table. Muddying the risk/reward decision is the real **prospect that juicy dividends** will be paid over the next 12 months after the COVID dividend drought. Risking loss of capital for a little income is a tough call.

Residential Property

There is no doubt Australia's property market remains the focus of nearly every financial discussion we have with clients. Why shouldn't it? It is demonstrably the only asset class that matters to Australia's well being and everyone lives in a house. The sombre tone of this entire newsletter has been to identify manic investor behavior, avoid debt, and prepare for change. Based on these criteria, no asset class would be more vulnerable than residential property. Yet **the graveyard of soiled reputations is full of experts suggesting our property market will fall.** In recent years, we have failed to read this market well. It is not our area of expertise.

The pictured CBA Home Buying intentions chart summarises the current tale. Our best recollection of every market that reaches a **parabolic climax is that it ends abruptly and harshly.** What more can we say? There are empty houses and apartments everywhere, migration has stopped indefinitely, construction has exploded, and prices reach all time highs. Let's let history write the ending to this story, as we certainly cannot.

Interest Rates

The key to the destiny of every market lies in the future trajectory of interest rates. The bankers say they will remain low, the bond market is suggesting otherwise. Price pressures are everywhere. **Heads or tails?**

We have amended our Market Facts table to incorporate the $US spot gold price. We will reference this sought after metal in future editions.

Brain Teaser Solution: The boy's mother. Hopefully it was obvious.

MARKET FACTS	June 2021	June 2020	June 2019	5 Years Ago 2016	7 Years Ago 2014	10 Years Ago 2011	15 Years Ago 2006	20 Years Ago 2001
Australian All Ordinaries	7,585	6,001	6,699	5,310	5,382	4,660	5,034	3,425
Dow Jones (US)	34,502	25,812	26,600	17,930	16,826	12,414	11,150	10,502
FTSE 100 (UK)	7,037	6,169	7,425	6,504	6,743	5,945	5,833	5,642
Nikkei (Japan)	28,791	22,288	21,276	15,576	15,162	9,816	15,505	12,969
Hang Seng (Hong Kong)	28,905	24,427	28,542	20,727	23,191	22,398	16,627	13,043
Dax (Germany)	15,531	12,311	12,398	9,680	9,833	7,376	5,683	6,058
Gold - Spot US$	$ 1,762	$ 1,776	$ 1,413	$ 1,315	$ 1,316	$ 1,510	$ 611	$ 271