ZANACORP

Investment Insight

October 2020

When the future is uncertain we naturally look to the past for guidance. Reviewing history and with benefit of hindsight, we all understand the timing of events, mattered. Institutions, beliefs, values and motivations, mattered. Science, geography and climate, mattered. The people in power and leadership, mattered. In 2020, exposed by COVID-19, much of what mattered has been lost to consumerism, affluence, self direction and self interest. Despite science and medicine having overcome most of life's past threats, in many ways people have never been more fragile or vulnerable. The many once strong pillars of coherent society have been eroded. The world has no leaders in whom the people can place their trust or their confidence. Although imperfect, there are no current day Lincoln's, Churchill's, JFK's or Martin Luther King's to inspire nations or people to rise up to new challenges or make the most of their skills. Politicians have lost their integrity. Instead, enter big government. Not quite like Orwell's 1984, COVID-19 has seen government impose itself on every aspect of life apparently saving lives, saving jobs, saving businesses and saving the value of your investment capital. Although immediate action was needed, we caution readers not to be naïve or deceived. The pre COVID-19 global economy was not in good health, dependant on debt, ultra low interest rates and inflated asset prices for its "normal" functioning. Having "saved" us, what have governments fundamentally changed to make the economy more resilient in the future? NOT MUCH.

Active Inertia and COVID-19 - The Problem Not The Solution

We're All In This Together - In One Way or Another

Before we commence this newsletter we wish to extend our appreciation to clients for their patience and understanding since Lockdown 2 began in early August. Zanacorp was not designated as an essential service business and like many others has operated under compromised conditions.

Although many professional tasks can be executed remotely from home, our proudly high standard of end to end services is delivered by our staff working together sharing specialist skills from our professional services and advice teams, to data entry/management and document quality control, compilation and distribution. To deliver these services, we are at times dependant on access to some purpose built technologies physically located in our office. As such processing delays have been unavoidable.

I also wish to take this opportunity to formally thank each Zanacorp staff member for their efforts during this period. Many clients were unaware of our challenges reflecting a seamless level of client service from home going above and beyond the call of duty ensuring client needs come first.

Prepare For a Marathon Not A Sprint

In this edition of Investment Insight we briefly explore the early response to COVID-19 particularly by Australia and the impact this may have on longer term investors. At the time of writing, Melbourne remains in Stage 4 lockdown. COVID-19 has been with us for only 8 months. A US election looms and Europeans are experiencing a much anticipated 2nd wave of infections, with lockdown wearied people confronting a new winter.

With no certainty that this virus will be controlled any time soon, opinion is polarised as to how society should best deal with a protracted crisis. With more data now available the WHO is now advising AGAINST lockdowns reversing prior guidance. The jury is still out. As in most wars, hope for an early end usually dims and the fallout is far worse than most imagine. It is possible COVID-19 could be like that. The profound disruption to the way people live, work and play cannot be overstated, nor the human and economic cost. We are comforted that the Zanacorp Capital Protection Strategies we have rolled out for all clients, are built around resilience, using time as a lever of gains not losses. We are prepared for a long battle though not wanting one.

Je Suis Perdu

Picture if you will, an English speaking person lost in the middle of Paris and seeking directions from a local to find their hotel. Now imagine the Parisian either does not understand English, or pretends not to understand (perpetuating a French stereotype of refusing to speak English).

Let's listen in…. "**Can you tell me how to get to the Shangri-La Hotel?**" says the tourist. Politely, the Frenchman, raises both shoulders and shakes his head, indicating he does not understand the question.

The tourist, sensing the communication problem repeats the question. The Frenchman repeats his expression. Frustrated, the tourist repeats the question again, only **this time he speaks much SLOWER and much LOUDER**. Now the Parisian begins to get annoyed. He is not deaf or stupid, he simply does not speak English! After a brief silence, both parties go their own way mumbling discontent. The tourist of course, remains lost and no wiser.

The light hearted scene we have described, was a fairly common one (pre Google Maps) which would occur every day in every major city of the world. The situation illustrates one manifestation of a behavioural response known as **ACTIVE INERTIA.** In simple terms, the behaviour recognises that if one's current actions are not achieving the desired result, then one must do something different. Sounds pretty obvious you might think and it is. Changing the approach is the "active" part of the behaviour.

A problem arises in that although we think we are *doing something different* (talking slower and louder in this case) we are merely ***doing the same thing differently***. That is the "inertia" part of the behaviour. Hence our tourist can speak English any way he likes, but he is unlikely to get any help from a non-English speaking person. Why is this important?

The GFC and COVID-19 Economic Response

It should alarm us all that the economists, bankers and bureaucrats who framed the ill fated direction of policy post GFC are still calling the shots in the post COVID-19 world. To solve the debt induced GFC crisis, bankers lent more money, to more people, at cheaper rates since governments would not seriously address their structural problems. In our post COVID-19 world monetary policy is exhausted, having reached the zero bound of interest rates (and beyond). Punishing savers, rewarding spenders and inflating assets was not sound economics, but bankers only have one tool. Besides it averted a recession, proving the idiom **"if you have a hammer everything looks like a nail"**. What bankers can no longer do is now being reinvented by free spending fiscal (government) policy "helicopter money".

Let's look at this.... "**How about we give money to failing businesses to keep people in failed jobs so that they can keep on spending money they don't really have and pay loans they can't really afford to keep asset prices high and prevent the banks from another GFC, because they lent too much to borrowers with no real income. If they can't meet their existing loan commitments with the support we provided, let's legislate for a 6, 9 or 12 month mortgage "holiday" until the global economy bounces back to normal, COVID-19 is cured and we can all get on with living again".**

Although we are being facetious with this simplistic analysis, do not too readily dismiss the underlying issues we have joined together. **This is a very big deal and it is real.** What's worse is that it is thought to be a solution.

Governments throughout the world believe they saved the system by handing out free money and suspending the fundamental rules of a market based economy. Having done this once, they can do it again for almost any reason they choose. With that power, they are issuing money and encouraging people to spend and borrow despite knowing job security is compromised for many borrowers. How is this any different from the bankers?

We hope you can now see the seriousness of the analogy between our English tourist and our collective economic brains trust. Although well intentioned, **fiscal policy is following monetary policy down the same rabbit hole,** but in different way. A form of active inertia. Government is using its unlimited balance sheet to create money and stimulus measures giving the illusion of control when in fact they know **the system is broken**.

The long and painful structural reforms needed post GFC were deferred in favour of bail outs and "soft touch" financial reforms. We seem destined to repeat that formula again hoping for a different result. Recessions are healthy ways of punishing excess debt and reminding others that borrowing comes at a price. By averting the deep purging needed during the GFC **bankers granted immunity to borrowers** by reducing interest rates enticing everyone else to doubled down. They kicked the can down the road.

The Government Investment Hazard Three Years From Now

Like it or loathe it, big government is now entangled in the private sector and having paid the price of admission, is here to stay and really muddies the water. It matters not whether it is Liberal or Labor, Republican or Democrat, the involuntary leap towards global socialism has been made. Governments have loosely developed policy "on the fly" in the midst of a crisis to famously do **"whatever it takes"** to save the system (not fix it).

History is littered with examples of failed socialist systems. Each incarnation claiming to be different from the last. Yet, it is rare to find any free society prosper when the aspirations and efforts of the individual are directed by the collective objectives of the state. The US is well down the socialist path. Unconventional tools like QE, ZIRP and MMT have been normalised and the US corporate bond market and RMBS compromised by FED intervention. For investors, **safe pathways to wealth creation have become hazardous and faster roads may now lead to dead ends.**

Please do not see this as a philosophical rant. We are alerting readers to the extreme measures currently sustaining the prices of all assets classes. Excess liquidity and unconventional policy will absolutely drive asset prices higher in the short term. **Expect greed to trump fear**. Markets love free money. However, 1,2 or 3 years out, when this ends badly, look here.

The Australian Response

The October 2020 Budget papers forecast a 2020/21 Deficit of $213bn and 2021/22 of $112bn after recording a 2019/20 deficit of $83bn totalling $408bn over just 30 months. It serves no purpose to be critical of the Federal Government's COVID-19 response. Swift and significant action was demanded and taken. Nevertheless, ignoring the heroic budget assumptions, what do we get for ransoming the future of our children?

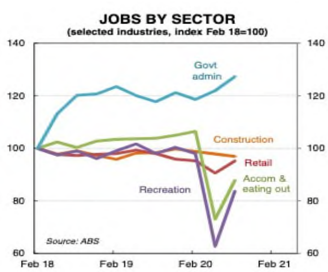
Well, we get more essential infrastructure. Tick. We get personal tax cuts. Fine. We encourage business investment with tax breaks. Sure. We retain **JobKeeper** & **JobSeeker** for longer. Yeah. We give business **JobTrainer** assistance to take on apprentices and **JobMaker** hiring credits to employ new people. Good. We invent **HomeBuilder** to give money to people to renovate homes and borrow/build new homes in outer suburbs. What!

Where is the long term vision and investment to create a competitive Australia? To motivate young people still at school into new future facing industries and technologies? Fix the social housing crisis? What about Bob Hawke's idea of a "smart Australia"? Nup. Nothing there. It is the same old, same old, with a new paint job. Lets dig up some dirt, sell it and build more houses and focus on the next election. Active inertia at its best.

With all that money, what did we do to assist the many industries directly impacted by COVID-19 such as **tourism, hospitality, education, recreation** and allied services? They need help now.

This chart illustrates the impact of COVID-19 on some major industries.

Public servants are doing nicely thank you. No pain and no job losses.



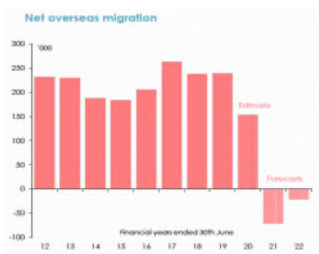
Construction has been resilient so far and retail industries are bouncing back in states outside of Victoria. JobKeeper/JobSeeker spending has INCREASED average household income by 16%, strongly underpinning retail spending.

The real damage and hurt lies in recreation, dining and accommodation. Many businesses and jobs have been lost through no fault of the operators.

So what could we have done to help those in need? Aside from industry specific targeted assistance, the smartest jurisdictions around the world introduced many forms of goods and services vouchers to ensure their local businesses impacted by COVID-19 were supported. China, Taiwan, Singapore and India issued domestic **spending coupons and vouchers** to support businesses. You would expect creative thinking in those countries. Now think closer to home. Have you heard about Tasmania's $550 **"Make Yourself At Home"** vouchers or the NT's $200 **"Territory Tourism Voucher"**? These cost effective schemes offering a "use it or lose it" benefit for local residents to spend on local tourism/hospitality businesses demonstrates some nimble thinking by Australians. Well done! Hey Josh, Dan can you stop arguing and start thinking. Tassie and the NT might just be onto something?

Businesses are overwhelmingly responsible, aiming to keep themselves and their customers safe. They don't need governments to tell them to do this. Many in travel need borders restrictions to be safely relaxed. Yet even in a small country like Australia, governments have seen fit to ring fence their own, locking out "pariahs". It is popular at the polls. So under duress, an inconvenient yet divisive truth is revealed. **Australia is not a nation. It is a collection of 6 independent states and 2 territories demonstrably pursuing self-interest ahead of national interest.** The same can be said of the EU nations and the 50 divided US states. Clearly it's "everyman for himself".

Wake up people. Look behind the rhetoric. Most countries have now seen their dependence and vulnerability to China's workshop. De-globalisation, relocating supply chains, bringing jobs home, replacing **just in time by just in case** and **reduced migration** is just part of what a changed future will look like. COVID-19 has put every country on notice to look after itself. This will affect China, it will affect Australia, it will affect our trade and our prosperity.



For decades, Australia has relied on migration to grow and side step GDP declines. Look at what COVID-19 is expected to do. Instead of over 400,000 net arrivals over 2021-2022 we expect to lose over 60,000, the biggest percentage decline since WW1.

It is debatable how accurate these forecasts may to prove be. Nevertheless, it would be unwise to ignore the significant impact this migration shock will have on rents and housing demand.

Investors need to make personal choices to protect themselves. Do not rely on government bailouts or worry about "the other guy" making or losing money. He/she won't help you in a crisis. Have a plan, shun investment debt, live within your means, avoid FOMO, be patient. Seek paid advice if unsure of what to do. In times of uncertainty this is simple common sense.

Final Stage of Hayne Reforms - OnePath & Perpetual

In a perfect storm for Victorian advisers, there has been no relief granted to extend the deadline for transitioning clients to the Adviser Service Fee remuneration model to comply with Hayne Royal Commission guidelines.

As a result, although we would have preferred to see clients in person, time constraints make this impractical. Having substantially completed this task, we have a small number of clients with investments in either OnePath or Perpetual where we need to update our remuneration/fee arrangements. We intend to forward relevant documents shortly by mail. This is important to us. We reiterate our undertaking that **no client will incur additional costs.**

We remain humbled by the unanimous support we have had from existing upgraded clients, who have expressed their appreciation and valued our investment advice. This support invigorates our desire to maintain the highest standard of advice best serving our clients' needs. A ZFG non-negotiable.