ZANACORP

Investment Insight

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As if lifted from science fiction, every person living on planet earth in 2020, the most connected human society ever, has been socially distanced to live in physical isolation. It is a cruel irony, yet here we all are. Worldwide, young and old, rich and poor, each seemingly at peril to an invisible health threat the broad toxicity of which remains blurred. A virus whose origin we are not permitted to investigate. Facing a moral dilemma, governments have seen fit to impose restrictions not even undertaken in wartime, to crush the global economy and destroy the livelihood and savings of billions to save the lives of a few. It is not an easy call. History will one day record whether the "cure" was worse than the disease, especially when contrasted against Sweden's moderate approach of allowing infections to develop some herd immunity. These times have revealed both the best in people such as our tireless health and emergency services workers as well as exposed the worst in people, the selfish supermarket hoarders and the financial scavengers scooping up money designated to assist victims. Like COVID-19 itself, some countries, businesses, workers and investors are likely to be more vulnerable than others. Virgin Australia may be just the first of many icons to fall under the weight its of debt. From here, each person's financial fate will be unique.

When Global Health Collides With Global Wealth

Obey The Signal

Imagine you are in a competitive road race where the first to reach their destination collects a life changing prize. You are anxious and excited to win. You are driving at night and at speed, in an unfamiliar area with no street lights or road markings. You have just passed a serious multi-vehicle collision, with fatalities likely. You approach the next major intersection, with the lights of other cars visible, travelling in all directions. Traffic lights ahead of you display glowing red, yellow and green signals. What do you do? **Stop, slow down or go**.

Welcome to the 2020 investors' dilemma.

Following a tumultuous March, investors mesmerised by COVID-19 induced voluntary civil lockdowns, economic hibernation and corporate stress saw investment markets tumble by as much as 34% from their peak just a month earlier. April 2020 appears to have provided respite from the horror. **Is the economic and investment shock behind us and a recovery of prices in sight, or is the road ahead more hazardous than the one we have just travelled? Should we buy, sell or hold?**

We believe we are approaching the premature denouement of the 21st century global economic experiment, arguably first triggered by the 9/11 terrorist attacks. We may elaborate the sequence of events at another time. For now, all that needs to be said is that the increasing intervention of central banks to control the business cycle, to moderate booms and busts using quantitative easing ever lower interest rates, ever higher debt and ever increasing asset prices may be coming to its inevitable end. **Liquidity raised the water level, but insolvency will sink the ships.**

The final act, opening with the suicidal economic response to COVID-19 has hastened the development of the plot. We find it unimaginable that in November 2019 just 5 short months ago, we introduced our clients to the radical untested concept of Modern Monetary Theory (government money printing). Over that time it has become mainstream economic policy with Canberra now employing over 5 million Aussie workers. **In recent weeks**, **governments across the globe have unleashed an unfunded spending cyclone to combat the recession they themselves created.** In Australia, the relatively modest Federal Government initial economic stimulus measures were upscaled within weeks to gold plated JobKeeper/Jobseeker and free childcare programs. State Governments later joined the rescue party with their own measures. **Spending $214 bn on top of losing $4bn a week,** short term benefits come at a high price.

We accept the view that confronted with a crisis one must do whatever it takes and worry about the consequences later. Well, later is now. **In 6 weeks our governments have borrowed more than the last 60 years COMBINED.** We expect when final tally is determined, the financial cost of fighting COVID-19 is likely to exceed the costs of all military wars. **The only question that remains, is how on earth do we now pay for it?**

Developing Investment Strategies

We want all Zanacorp Financial Group investment clients to be aware that we are presently developing cohesive time based strategies to deal with the current crisis and protect client capital. Naturally, retirees are not in the same position as accumulators so our strategies are being structured to meet the differing needs of our various groups of clients.

As the current correction is relatively youthful, we are using the ongoing unravelling of events to our advantage before contacting clients.

A Heavy Burden Passed On To Younger People

I often consider how different life is for Millennials today from that of older people. Forget the travelling, phones, coffees and smashed whatevers, they are superficial symptoms of our free spending times. Thinking a little deeper, the psyche of younger adults has been framed with the backdrop of the dramatic dot.com share bust, terrorism of all kinds up close and personal, the GFC and now COVID-19. Understandably these profound events entered our homes over the last 20 years and have moulded the outlook of those growing up. Unlike Boomers and Gen X'ers, they live life more in the moment than for the future, they accumulate much less "stuff" and **they are demonstrably more conservative investors than their parents**.

If I were a banker, I would be worried since these smarter kids are not so easily drawn to buying overpriced homes and being enslaved to bank debt.

In the decades ahead, one way or another, Millennials will be required to pay back the cost of the free spending frenzied responses to COVID-19. To them, it will not go unnoticed how today's government interventionist approach differs from the individual accountability that applied to previous pandemics. The now well known 1918 Spanish Flu killed 20-50 million people. The lesser known 1957-58 Asian Flu and 1968-69 Hong Kong Flu each killed 1-4 million people. Devastating as the events were, individuals did what they needed to do to best protect themselves without coercion.

Interestingly, in times when there were less medicines and no ventilators, transmission reducing measures such as quarantining, social distancing, restrictions in group gatherings and personal hygiene were effective. Throughout these equally challenging times in the 1950s and 60s **there were no country lockdowns, no school closures, no government payroll explosion AND no residual debt passed on. All Boomers got a free ride**.

We are not epidemiologists and we absolutely believe COVID-19 and its containment demands serious social behavioural change. However, island Australia (like NZ) is geographically ideally located to restrict its entry and transmission. It is arguable nuanced policies designed to protect and insulate high risk people could have been employed with younger people less restricted and the economy left to operate. It is regrettable that outright panic and fear was generated in the minds of everyone. Across the world, many people have died from preventable illness during the lock down by not having treatment available to them. Many have taken their own lives.

What has happened cannot be undone. Sadly, the heavy yoke will be borne by our youngest workers confronted by a now decimated job market.

Black Swan or Inevitable Fate?

Stein's Law: If something cannot go on forever, it will stop.

Most people correctly perceive COVID-19 as a "Black Swan" event that could not have been foreseen, but one that stopped the world in its tracks. Although partly true, **our new economic reality, triggered by the coronavirus, would have happened anyway** albeit a little later and less spectacularly. Having often discussed the extreme post GFC economic policy measures were doomed to fail, Stein's Law has finally prevailed.

Now For Some Economic Reality

The next 3 to 6 months will be full of global and Australian economic data on matters such as GDP, unemployment, credit formation, exports, imports, consumption and government debt and deficits. In terms of investment markets, share prices and property prices, this data is irrelevant.

We believe that in a financial sense, there will be no return to life as we knew it before COVID-19. **The social, economic and globalised foundations of the world have permanently changed**, with every layer of the global economy weakened and exposed, akin to a second 9/11 shock.

Assuming we do not get an unexpected 2nd wave of COVID-19 later this year, which is by no means certain, social discontent, currency wars, international trade disputes, national debt management concerns, manufacturing disputes and corporate collapses are all imminent. It may take time for governments, economists, businesses and investors to arrive at this new reality, but they will get there. **2020 is Year 1 of the new global economic order** with new rules and new national self-sufficiency objectives. It will be the year the Chinese Communist Party (CCP) lost control of the 21st Century. The year of conceiving **land tax on all Australian homes.**

"Winter Is Coming"

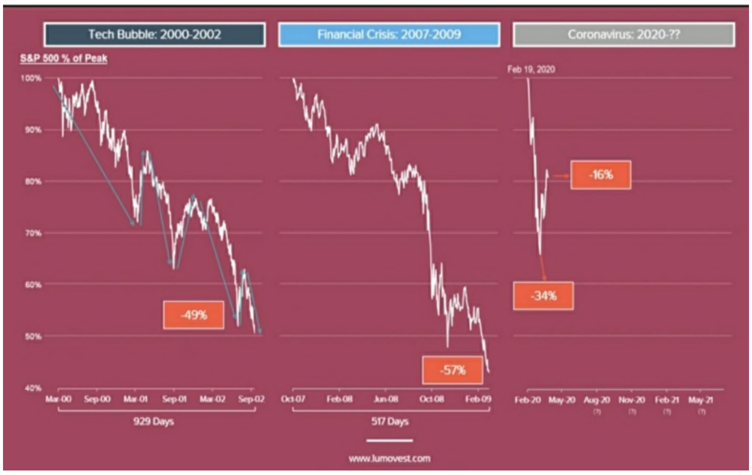
Game of Thrones viewers will be familiar with the above catch cry. It was Season 1 Episode 1 when doomed hero Ned Stark, King of the North, tried to galvanise his people to prepare for the leaner times he saw ahead.

We envisage the next 2-4 years to be a psychological and economic struggle for all as we transition from the world as we knew it, to the world we will learn to live in. The transition will be characterised by periods of optimism, followed by unexpected setbacks and **policy developed on the run**. The coming global economic recession will be long, painful and deep.

Uncertainty, the enemy of markets, will rein throughout this period of adjustment. So too will the prospects of great opportunity and renewal.

Please be prepared for disappointment, frustration and unfulfilled expectations. The last 6 weeks have upended nearly every facet of economic life and no one truly knows what lies ahead. Although simplistic and imprecise, in Shakespeare's The Tempest (1610) "what's past is prologue" was an instructive truism meaning that history sets the context for the present. A sort of look to the past to see the future.

Observe the chart below noting the regular cyclical rises/falls over time:



Being sufficiently weathered by time, your writer has lived or studied the 5 major investment bear markets over the last 50 or so years. Although each was different and a product of its time, they remain similar and instructive.

Now peruse the chart again. It illustrates the course of the dot.com bust, the GFC and COVID-19 so far. We are compelled to draw your attention to detail showing the Tech Bubble lasted 929 days for a loss of 49%, the GFC had a duration of 517 days for a loss of 57%. Notice how during the course of each, markets rallied many times before falling to new lows.

Bear market rallies thrive on the impulse that lower prices must be "cheap" luring investors to buy. In reality they are false dawns and after a short period of recovery, the gains evaporate, destroying confidence and capital. There were 6 rallies in each of the 21st century market routs. Expect them again in the next couple of years. Coronavirus is less than 70 days old and Australian prices have declined by just over 25%. Attractive as this may sound to opportunists, the world is still in lockdown! Who in their right mind can believe we are anywhere near the end of this?

Do NOT expect a sustained "V" shaped recovery in markets or economies or that once over COVID-19, we are back to the races. We believe we are currently in a market correction NOT a bear market. The general media is signalling messages of hope and recovery, leading way too many investors to be confident markets will simply bounce back and willing to invest capital. These are atypical of any bear market. The truer signals we look for are that after an extended period of frustration, the MAJORITY of people are genuinely uncomfortable with risk assets and prepared to earn nothing from cash. They are also reluctant to invest in markets at any price having lost belief in a market rebound. These signs appear very distant from today.

COVID-19 Future Recurrence?

We are not qualified to offer any advice on the future course of COVID-19. That said, we are concerned that messages of reducing daily reported cases claim victory over the virus. Victoria's dogmatic and economically expensive school/business lockdown response presumes we can manage a recurrence of exposure or transmission once the lock down is lifted. This appears genuinely naïve, particularly if we ever aim to open our borders to overseas visitors and workers before a vaccine is developed. It takes very few people to arrive in Australia carrying the virus to potentially spark another panic.

In a democracy, balancing public safety and economic cost is divisive. **One can never know the outcome of the path not taken**, only the one that was. For the 99.99% of people likely to survive COVID-19, life will be more anxious and less plentiful demanding resilience of a different kind from now on.

We believe the world needs to get more information on when and how the virus originated and its anti-body immunity characteristics. The CCP has resisted investigation and appears less than transparent in its reporting. **We are not mushrooms**. It remains undeniable that having locked down its internal borders in January 2020, China knowingly permitted residents to travel abroad potentially releasing asymptomatic carriers around the planet.

The Value of Advice - Adviser Service Fee Documents

We have dedicated the last 6 weeks to support, assist and advise all clients on how to best navigate the current financial malaise as a matter of priority. We had been planning on continuing to meet clients to implement the significant task of adopting the Adviser Service Fee remuneration model required for compliance with the Hayne Royal Commission.

As a result of the State's social distancing measures we have been unable to effectively advance our expected rollout of Adviser Service Fee discussions and documents. We advise that for many clients holding assets via the Colonial First State platform, we intend to forward relevant documents shortly by mail. This is important to us. We reiterate our prior undertaking that **no client will incur any additional costs** from the new arrangements.

Now more than ever, clients have seen the value of our personal advice drawn from a high level of investment experience and knowledge. Our industry low fee rates are a component of our compelling value proposition. We trust all clients know their best interests are our primary concern.