OUR ECONOMIC & FINANCIAL MARKET OUTLOOK as at 15/3/21

Australia and the world are trying to recover from the health and economic effects of the Coronavirus Pandemic. Lockdowns and consequent large falls in economic activity resulted in unemployment and underemployment rates skyrocketing. Governments and Central Banks (*RBA in Australia*) responded with:

- massive increases in Government spending (*Fiscal policy*); and
- reductions to official interest rates and various forms of Quantitative Easing (*money printing of a sorts*) to try and stimulate borrowing and spending.

These efforts have been successful in achieving their objectives (*to a degree*) at least in the short term and, together with the arrival of various vaccines and treatments, give us hope for the future. The jury is still out on what impact the massive increase in Government debt and the ultra-low interest rates will have on our longer-term futures.

Some Numbers to Help Put Things in Perspective

AUSTRALIA

Unemployment	February 2020	5.1%	
	July 2020	7.5%	
	January 2021	5.8%	
Real GDP Growth per ¼	December 2019	0.4%	
	March 2020	-0.3%	
	June 2020	-7.0%	
	September 2020	3.4%	
	December 2020	3.1%	
Inflation per ¼	March 2020	0.26%	
	June 2020	-2.30%	
	September 2020	1.83%	
	December 2020	1.03%	
	Annual Rate	0.77%	p.a.

Interest Rates

The current RBA (*Reserve Bank of Australia*) target interest rates for cash and 3 year Australian Government Bonds is 0.1% p.a. As of the 15/3/21 the pricing of Government Bonds on the fixed interest markets results in yields (*interest*) of:

90 day	0.07%	p.a.
3 year	0.29%	p.a.
10 year	1.83%	p.a.

The RBA are currently actively buying 90 day and 3 year bonds on market (*via their Quantitative Easing (QE) program*) to try and push prices up and ensure rates stay close to their low targets. They are also buying other Government Bonds such as 10 year bonds to try and counteract selling by other market participants who predict inflation may become a problem thereby forcing interest rates up. The market interest rate for Australian 10 year Government Bonds as recently as October 2020 was only 0.73% p.a. and as low as 0.6% p.a. in March 2020.

Why do the RBA want interest rates to be so low:

- To stimulate the economy by making borrowing cheaper
- To bail the Government out in a sense, because the large increase in Government spending has been financed by massively increasing their borrowings which will be easier to repay if rates are lower.
- Other countries are keeping their interest rates very low e.g. 10 year Government Bonds in Japan are 0.11% p.a., Germany – 0.33% p.a., UK 0.82% p.a., USA 1.6% p.a. which helps to stop their currencies from appreciating. If Australia had higher interest rates people from other countries would be buying our Bonds forcing the value of the $A up and making our exporters and import replacement industries less competitive versus our overseas counterparts.

Unintended consequences of the RBA's low interest rate policy and QE programs appear to have resulted in a lot of the extra money being created finding its way into "speculation" rather than being used to buy goods and services and increase the nations productivity. The same can be said with respect to other countries' Central Bank programs and in particular the US Federal Reserve (the Fed). Examples of speculation can be seen in things like Bitcoin, Tesla's share price and in Australia the share price of a few flavour of the moment stocks like Afterpay. Furthermore, in Australia over the last few months, a lot of the extra money created appears to be finding its way into residential property, pushing prices up to unjustifiable levels, it seems particularly more so in some of the regional areas. Low interest rates are also feeding this. I wonder what will happen at the end of March when the Australian Government ends its JobKeeper program and various other excess Government spending is ceased?

<u>So how does this all translate into the outlook for investments:</u>

- Shares (*both Australian and Overseas*) appear to me to be expensive on average, but not so much when compared to current interest rates available. But when you drill down into the components of that average what you find is there are still plenty of shares whose prices are reasonable to good value, but the average is dragged up by others that are expensive and, in some cases, ridiculously expensive. If share markets suffer a correction most prices will fall but invariably the more reasonably priced ones will recover more quickly, and the really expensive stocks will suffer much larger falls. The message here is to be selective in which shares you invest in or choose fund managers who do this and avoid those really expensive stocks.
- Fixed interest investments at current interest rates look distinctly unattractive so any exposure to this sector in my opinion should only be with active managers who can manipulate their holdings to take advantage of subtle changes in the relativities of various subsectors of fixed interest markets and avoid problems arising in other subsectors.
- Selected high quality direct and listed commercial property investments look to me to be reasonable value at the moment, particularly with interest rates as low as they are.
- Private equity investing (*unlisted businesses*) are less liquid than other alternatives, but for a small part of a portfolio (*say 5% to 10%)* the better funds offer potentially good returns over the medium and long terms. They also have the advantage of mostly being uncorrelated to other investment sectors meaning they can perform well when other things may be struggling.

AS ALWAYS, THE BEST WAY TO CONTROL INVESTMENT RISK IS TO REMAIN GENUINELY DIVERSIFIED IN THE INVESTMENTS YOU SELECT.