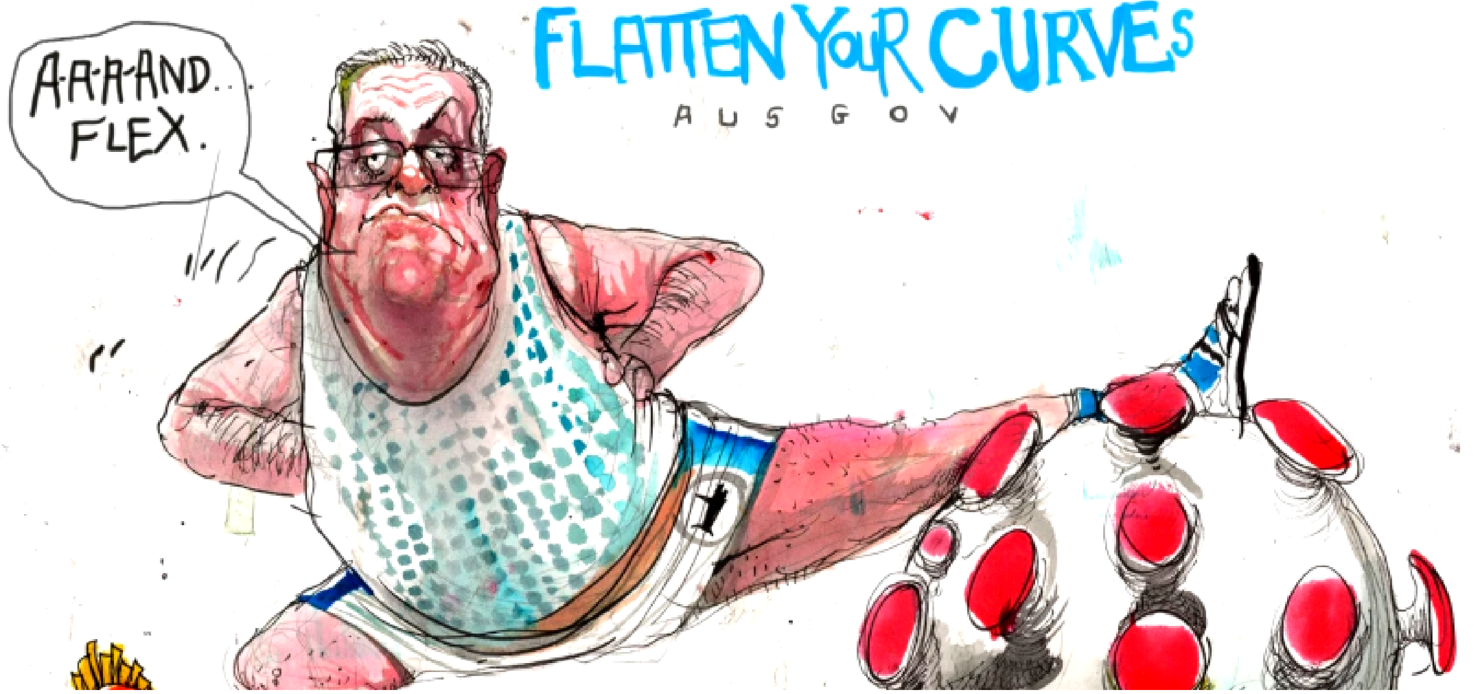



# Is there an Endgame to COVID-19 in sight?

By Paul Miron
Managing Director of Msquared Capital

Are we still in the eye of the COVID-19 storm?

As the rest of Australia watches the current situation in Melbourne, we should remember that such drastic actions, have been effective and necessary in flattening the curve and controlling the spread of the virus.

Despite this, the past week has provided some positive information that will enable us to see through the fog of uncertainty created by a war against an invisible pathogen.

Although I find it difficult to say that life might never be the same again at least from a social perspective, we have indeed entered into a new era of economic management.

This past week Josh Frydenberg delivered a mini-budget. We have been told JobKeeper and JobSeeker will be extended to March of next year. As a result, we are on track for government debt ballooning beyond $850b[1], albeit still relatively low compared to the rest of the world.

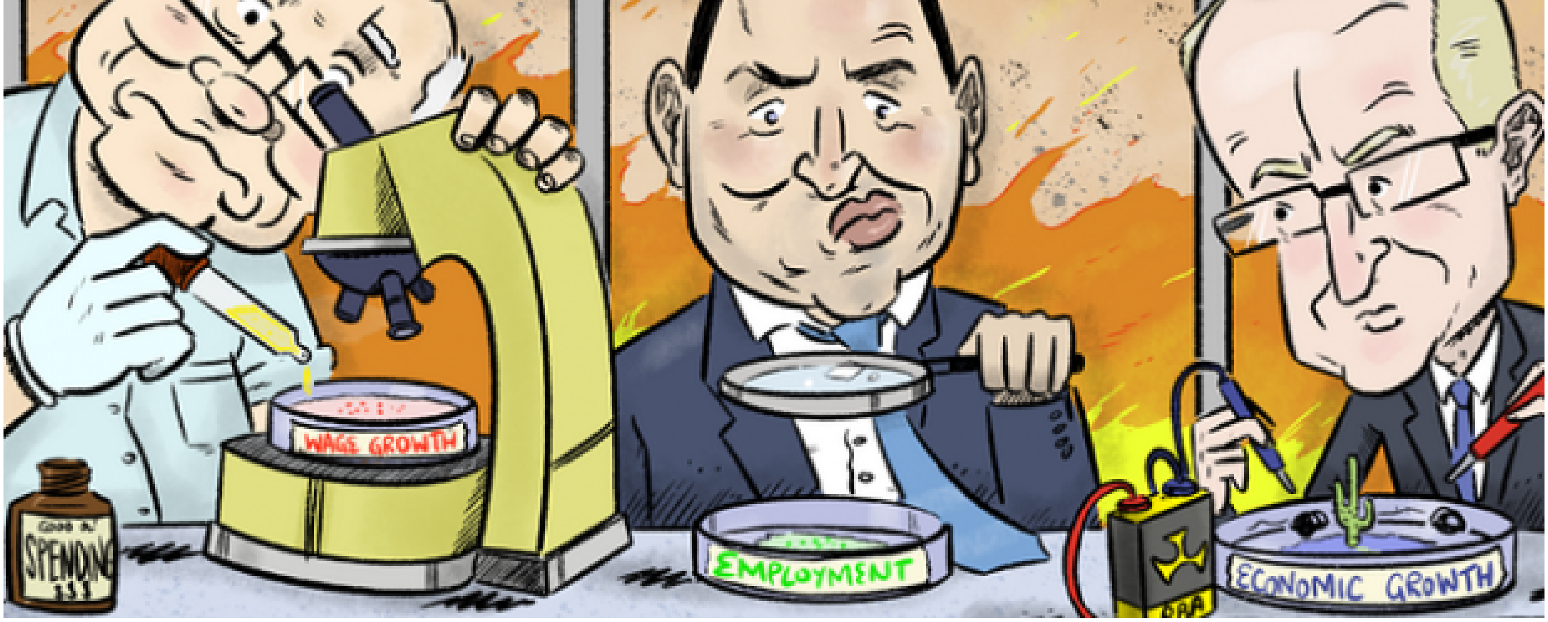
In summary, we have both the capacity and balance sheet to enact the most generous COVID-19 rescue package on the planet and our Government is not shy to use it in sparing us from the full brunt of the financial calamity resulting from the spread of the virus.

The application of the Governments stimulus package to our economy could be likened to how a surgeon would use anesthetic during an operation.

The difference being that most countries are not in a position to afford the anesthetic - Australia is truly the lucky country.

**We have to ask ourselves, does this come at a cost? Should we be worried about the enormity of debt?**

Globally we are printing money at the highest rate on record, this has not been through the traditional credit creation methods[2]but rather through Government spending via COVID-19 stimulus packages and the issuances of bonds.




As a result, there is a transition in the burden of debt from households to the public sector, the consequence being that this debt will need to be paid down over the next few decades. The Government's belief is that as long as our GDP Growth is higher than the cost of debt, our economy will recover.

Many governments, through the use of Central Banks (such as the RBA in Australia) have successfully steered their economies by using interest rate levers where available.

In Australia we have managed to use these levers to achieve growth whilst keeping inflation within a range of 2.00-3.00%pa. Going forward, changes to interest rates will be less desirable and met with resistance as the government is now a substantial borrower itself. Considering the scale of this international economic event, rates are set to remain low for an extremely long time, the prospect of increasing interest rates will be an option of last resort.

We should expect that alternative measures will be applied to drive the economy via policy reforms and regulations demonstrating a proactive government.

We believe that high on the agenda will be the abolishment of payroll tax, stamp duty reform and IR reform to stimulate markets and encourage investment and market efficiency,

We should also be prepared for APRA interventions to influence property demand as was the case in 2014, which in refelction seems like a long time ago[3].

The government was able to curb investment property demand by restricting credit with multiple measures implemented such as capping the amount of interest only loans that lenders could offer, making investment loans more expensive by offsetting higher capital adequacy measures imposed to the banks and APRA launching investigations into the servicablity requirements of borrowers which eventually instigated the Royal Commission.

The other government assumptions which will set the scene for a Covid recovery:

1. Continuing effective containment of the virus, through maintaining social distancing and contact tracing;
2. Current economic momentum is set to continue post-lockdown(s). There are 3.5 million people who are presently on JobKeeper and JobSeeker with this number expected to diminish to 1 million[4].
3. A vaccine to be approved and available by the end of the year; and
4. International travel to recommence by the end of the year.

If these assumptions materialise it is anticipated that GDP would contract 2.50% for the next financial year which is a far cry from the 4.80% predicted by the IMF[5].

This is exceptionally promising as the economic engine remains intact with the government's actions providing the necessary oil (cash) to the economy aiming to save as many businesses and jobs as possible. Therefore, once the health threat subsides, we will be able to bounce back relatively quickly and have a clear path to a COVID-19 recovery. Despite the current woes of Melbournians, we hope the current stage 4 restrictions will place them back on the trajectory of flattening the curve.

Several countries have made steps to secure supply chains of large pharma companies who are leading the COVID-19 vaccine research and are on track for the deployment of a successful vaccine in significant quantities by the end of the year. On the back of this we have seen a range of positive medical vaccine updates last week. The US has spent $13.6 billion USD[6] with pharma alone,  I am sure that Trump is praying that he can get a return on his investment in November prior to the election.

The above assumptions eventuating would support a continuing resilience in the property market, defying property doomsayers and sceptics.

The trajectory of prices in the immediate term is certainly downward as investment property cashflow is constrained effecting a modest contraction of values of circa 5.00% over the next 6 months. We anticipate that once the endgame to Covid is more clearly identified, whilst cushioning is provided from government interventions, values will naturally plateau out and consumer confidence will come back with exuberance as life returns somewhat to normality.

The resumption of international travel will provide a floor to negative growth and effect an under-supply of property overnight, with short term stay, hotels and apartments being once again occupied and taken off the permanent rental market and breaking the current rental glut.

Investors should always consider worst-case scenarios, despite everyones assumptions asset preservation with a reliable and stable income is the key to successful investing through uncertain times. Msquared Capital offers investors returns starting from 6.50%pa distributed monthly, whilst giving the flexibility and choice on specific investments that they elect to participate in. We are specifically sourcing opportunities with lower loan-to-value ratio to act as a buffer through the current environment.

If you would like to see live opportunities please feel free to get in contact with us a **info@msqcapital.com.au**

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[1] Maiden, Samantha. 2020. Australia's biggest deficit since World War II revealed. 23 July. <https://www.news.com.au/finance/economy/australian-economy/scott-morrison-to-reveal-australias-biggest-deficit-since-world-war-ii/news-story/b3f7ad725a879f62354db37e179c86b3>.

[2] Werner, Richard A. 2014. “Can banks individually create money out of nothing? — The theories and the empirical evidence.” International Review of Financial Analysis 1-19.

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[6] The Economist <https://www.economist.com/leaders/2020/07/23/governments-must-beware-the-lure-of-free-money>

Images

Image 1 - https://www.afr.com/policy/david-rowe-cartoons-20191104-h1jd8q

Image 2 - https://insideretail.com.au/news/2020-survey-no-lift-in-wage-growth-no-lift-in-economic-growth-and-no-progress-on-unemployment-in-year-of-low-expectations-202001

Image 3 - https://www.investigate-europe.eu/en/2020/vaccines/