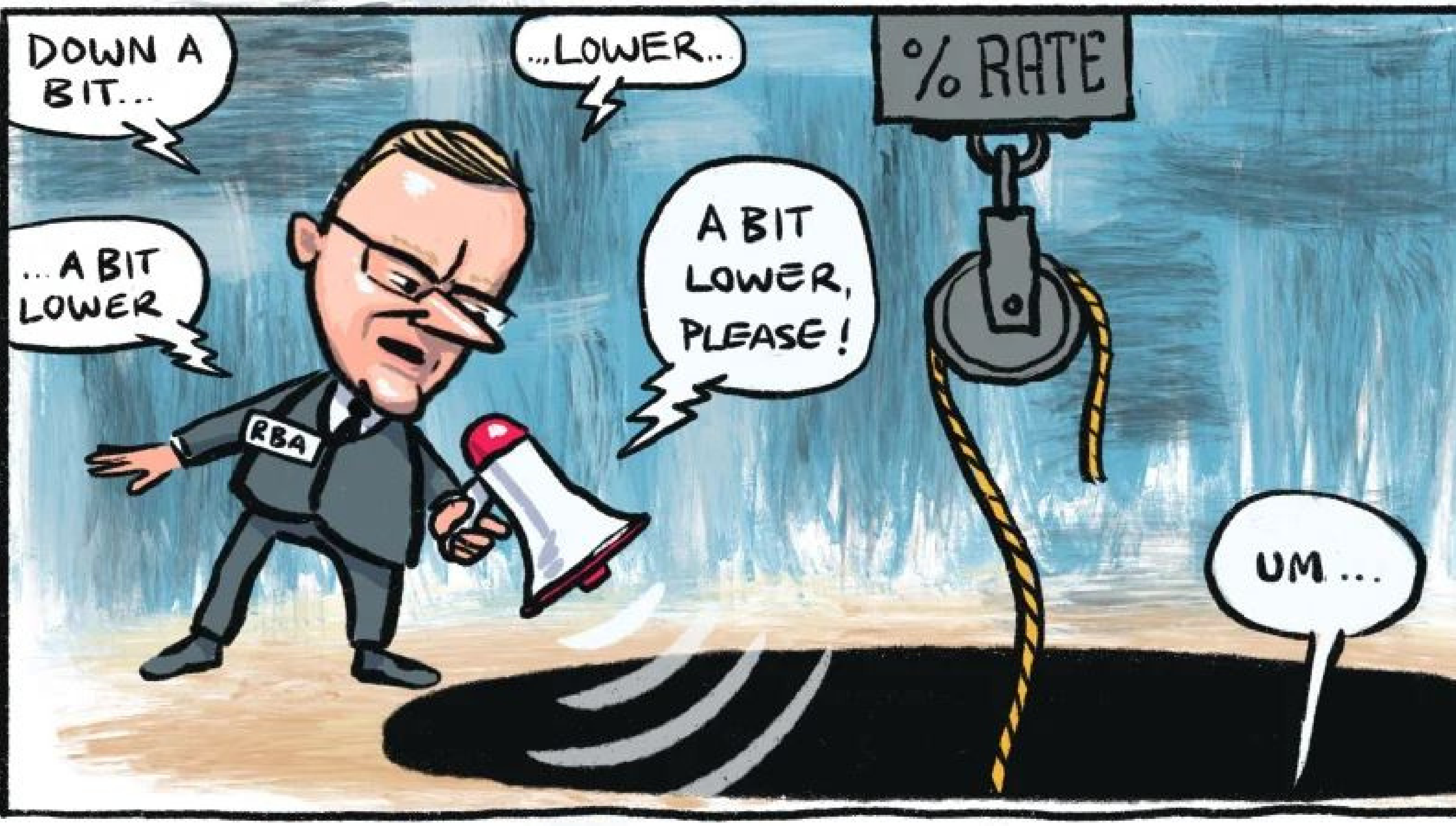

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How Lowe can you go?

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By Paul Miron
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This week marked one of the most controversial Australian Economic events, officially entering into the Quantitative Easing (QE) club.

The first week of November commences with the Melbourne Cup and it traditionally marks the start of the silly season, with the realisation that Christmas is only a few weeks away and mild panic sets in, trying to finalise semi completed projects and important decisions before year's end.

How our world has changed this year, we are at War - deep in the trenches, fighting an invisible pathogenic enemy with social distancing, mask wearing and keeping our hands clean as our front-line defence. Our economic defence measures are loan deferrals, job seeker, job keeper, and aggressive monetary and fiscal policy.

COVID-19 has turned everything upside down. The biological difference that sets humans apart from animals is our cognitive ability to rationalise events logically into a story, justifying actions. However, no matter how much one beats their chest with confidence, we are diverging massively from traditional economic management and classical economic theory.

This week, the economic heavy-weights of the past and present have erupted into public debate on eminent actions of RBA cutting interest rates to 0.10%pa and officially entering into Quantitative Easing and joining the international club of other nations printing money at a record rate. There is still great uncertainty despite the RBA calling an end to the technical recession that in the true essence of the word we never really had in the first place (see my article 'Are we really in a recession?').

That leads me to the namesake of this article, how Lowe can you go?

So what does this all mean?

QE is essentially an aggressive monetary policy of buying government bonds in order to push down the cost of borrowing and increase the amount of capital available to the banks.

Despite RBA Governor Philip Lowe stating last year that he saw little benefit in entering QE, he has succumbed to those arguing for it, in order to try to achieve two main goals:

1) To lower our 10 year bond from circa 1.0% (now 0.79%), as it is an attractive investment internationally, which in turn, keeps our Australian dollar artificially high.

Personally, my belief is that under normal circumstances this should have not presented as such an issue.

However, with our current trade tensions with China worsening, it is critical for our diplomats to try to mend both current geopolitical and trade relationships, work through differences, obtain certainty on trade swiftly, whilst also finding new alternative markets for our lobsters, cotton, meat to name a few. For this reason, we need to be competitive and a lower Australian dollar will be essential for our export products to be attractive.

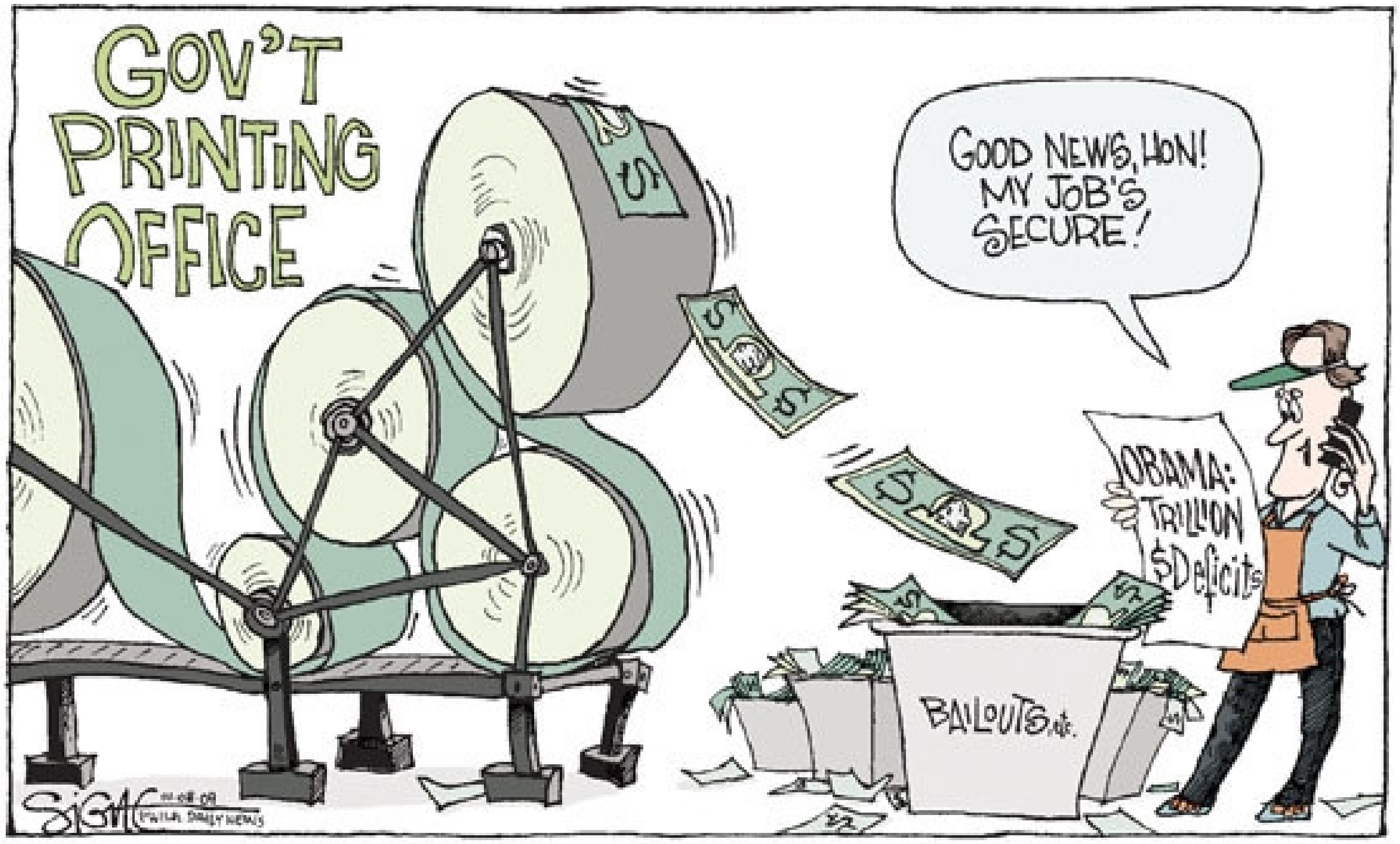
2) To invest and increase consumption through lower interest rates, thereby increasing the velocity of money[1] and enabling the economy to repair and essentially grow.

What we can be certain of, is that with QE, official interest rates will remain low for many years, perhaps decades to come. Returns from traditional asset classes such as shares, bonds, cash and commercial property are now readjusting, specifically the risk and reward balance of traditional investing.

A main public opponent to QE is the ANZ CEO, Shane Elliot, who argued this action will have little impact on borrower demand and will negatively impact retirees who are seeking returns.

There is now excess liquidity of cheap money with little demand, which will also result in lower margins and profits for the banks. This is a double whammy for retirees and those seeking returns from bank dividends as an option. Recently, both ANZ and Westpac profit announcements have seen a shocking decline of 42% and 62% respectively, which should also be a warning to those looking at shares without considering whether the

[1] https://www.investopedia.com/terms/v/velocity.asp



business will, and can, remain profitable, so that they can continue to pay healthy dividend cheques.

QE policy is a gamble, and we do not have to look too far to see that, with Japan having the highest recorded debt in the world by sadly achieving 30 years of stagflation[2].

The other consequences we are presently experiencing is the flight of capital from Cash styled products being bank fixed interest or term deposits (risk free rate). The attractiveness of holding most cash style products is now effectively losing capital against inflation.

This outcome is the true reason why asset prices of most investment classes are going up, despite the underlying investment not generating any additional income and pushing the returns down. Despite this bull run, you should ask yourself about the fundamentals - is the cash flow that underpins the investment safe, secure and reliable? Be careful not be lured to think that low returns reflect low risk, this concept has been traditionally relied upon and is presently being challenged for many years to come and will be due to low rates.

QE and Property

Let's look at property as an example, a tale of two stories. Despite Corelogic data this month's confirming on aggregate that property prices are on the way up, be mindful it is not across all sectors and markets.

If you are buying an investment apartment in the inner city, the rental return's are continuing to fall, with some properties attracting up to 30% less rent prior to COVID-19, with the vacancy rate increasing we still have no idea when immigration will return to normal.

[2] https://www.investopedia.com/terms/s/stagnation.asp

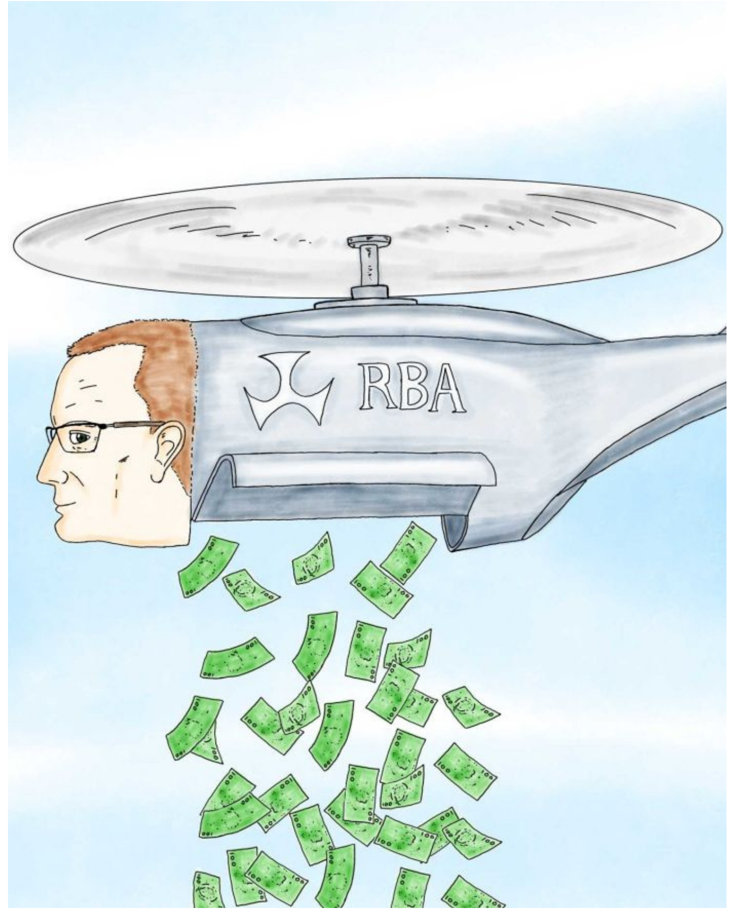
From an owner occupier market view - this is a complete contrast. A traditional working family with both spouses employed are now saving 20% of their income, a feat only repeated post WW2. With spending options such as overseas holidays, restaurants and other social activity reduced, they are turning to their "castle" whether upgrading or renovating the family home, this segment of the market is booming.

Investors are turning to geared investment strategies to buy property, a word of warning, this is not suitable to everybody as they are not considering the risk and headache of maintenance, defects and other expected items in managing direct property, especially with the uncertainty of investing during COVID-19.

As a consequence, the demand for alternative asset classes has never been higher to bridge the gap for a reliable fixed income. It is important for investor's to be diligent and wary; they need to understand the investment, research and understand the cash flow that is being generated and the structure of the investment.

In current volatile times having an investment which is secured over property (Sydney property for the most part) not only enhances the investor yield but has the positive characteristics of maintaining its value as property has traditionally done.

Private credit funds such as Msquared is one such alternative investment opportunity, and most importantly we are a secured lender.



ABC News/ Alistair Kroie

Msquared typically lends up to 65% of the security value. We do not lend against specialised securities such as pubs, clubs, farms or petrol stations. This philosophy enables the investment to be resilient against market volatility and has asset preservation characteristic that so many investor are seeking.

It is our belief that investors who consider investing in mortgages should be given both the tools and platform so that they can comfortably choose each individual mortgage investment (ie the property), as vary in return and vary in characteristics. It is important for the investors to be in the drivers seat whilst having the peace of mind that their hard earned money is backed by quality security on the eastern seaboard Capitals of Australia.

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