NEWSLETTER

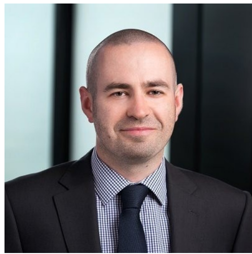
May 2020

Introduction

Welcome to our newsletter for May. Another newsletter for extraordinary times.

In this edition of our newsletter, we review all of the commonwealth stimulus that has been announced so far. We also take a look at both the share and the residential property markets. Both of these markets rose in the month of April. However, almost certainly April will prove to have been an aberration.

As always, we hope that you and your loved ones stay safe and well in these unprecedented times.



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The Stimulus Summary

The Coronavirus has kept our Federal Government very busy.

The Coronavirus has led to an unprecedented response from the Commonwealth Government in the form of stimulus. In the section below on the sharemarket, we discuss the historical basis for government stimulus at times of economic downturn. In this section, we thought we should start this month's newsletter with a recap of Commonwealth Government stimulus payments (yes, they are technically known as stimuli).

The Commonwealth breaks its stimulus spending down into three types: households, business and supporting credit. Let's look at each in turn. If you are not sure whether you would qualify for one or more of the stimuli, perhaps give us a ring and we can talk things through with you.

Households

Households is the catch all term for private individuals. The following payments are available to individuals:

- Jobkeeper – this is a payment of $1,500 per fortnight, paid to employees but received through employers. The employer needs to prove their eligibility – basically by showing that their revenue has dropped during the time of the Coronavirus.
- Coronavirus Supplement – this is a payment of $550 per fortnight. It is made to people who are eligible for particular social security payments (unemployment benefits, youth allowance, parenting payments, Austudy and Abstudy and farm allowances). It is received in addition to these payments. Eligibility rules for unemployment benefits have also been relaxed.
- Household support payment - these are two separate $750 payments to social security, veteran and other income support recipients. The first payment was for people who were eligible for these supports between March 12 and April 12, 2020. The second payment will be available to people who are eligible on July 10, 2020.
- Temporary early release of superannuation - people who have been negatively affected financially by the Coronavirus are allowed to withdraw up to $10,000 from their superannuation fund in the current financial year and up to another $10,000 from their fund between 1 July and September. The money is withdrawn tax-free.
- Temporary reduction in minimum superannuation drawdown rates - various types of superannuation pension require the recipient to withdraw a minimum amount from their superannuation fund each year. These amounts have been reduced by 50% for this and the next financial year.

Support for Businesses

The following support is available for businesses affected by the Coronavirus restrictions:

- Jobkeeper Payment - as outlined above, the Jobkeeper payment is being provided to workers via their employer. The idea is to make it easier for employers to retain staff. In cases where staff cannot be retained, the idea is to keep a linkage between the employer and the employee in preparation for what is hoped will be a general return to business once the social restrictions have eased, at which point people can get their jobs back.
- Cash flow support - eligible business will receive a cash flow boost of between $20,000 and $100,000. These boosts are received in two phases. The first is the current financial year and the second is early in the coming financial year. Businesses must have an aggregated turnover of less

than $50 million. To qualify, businesses need to have made eligible payments such as salary, wages or the payment of director fees. The idea seems to be to support predominantly those businesses with employees.

- Increasing the instant asset write-off - previously, businesses could write off the full value of assets purchased up to an amount of $30,000. Put simply, previously if your business purchased an asset worth $30,000 or less, the whole expense could be written off in the year of purchase. The threshold has been increased to $150,000. In addition, qualification for this relief has been expanded. Companies with turnover up to $500 million are now eligible. Further, assets that do not qualify for the instant asset write-off can be depreciated at a faster rate.
- Wage subsidies for apprentices and trainees - eligible businesses can apply for a wage subsidy of 50% of the apprentice or trainee wages paid between January 1 and September 30, 2020. The maximum subsidy is $7,000 per quarter, $21,000 in total. The subsidy can be accessed by a business that takes on an apprentice who has lost his or her job with a previous employer.
- Regional relief - while the details are not yet fully fleshed out, the government has set aside $1 billion to provide specific relief to regions of Australia that have been particularly adversely affected. Presumably, these regions will be those in which tourism plays a substantial part in the local economy.
- Sole Traders - sole traders may also be eligible for the Jobkeeper payment, described above. The rules here are a little tricky, so we recommend you get in touch so we can talk you through them.
- Temporary relief for financially distressed businesses - essentially, the rules around insolvency and debt recovery have been relaxed. The rules here are quite complex and the issues very serious. If you think that this issue affects you, we recommend you get legal advice.

Supporting Credit

- Guarantees for SMEs - small to medium enterprises that need to take on a new unsecured loan to provide working capital can have up to 50% of that loan guaranteed by the Commonwealth. A small to medium enterprise is defined as business with turnover of up to $50 million. The maximum loan is $250,000 for a period of no more than three years. It is expected that lenders will still perform the usual credit checks before providing a loan. That said, existing small business customers can generally access new loans without needing to comply with all of the normal responsible lending obligations that typically apply.
- In addition, while it is not really an action of the Commonwealth Government, the Reserve Bank of Australia (which is an independent body) has acted so that interest rates are about as low as they can possibly be. We discuss this in the section below on property.

The Share Market

The share market really defied all logic in April 2020. The ASX 200 index closed at 5,076 points on March 31. By the close on April 30, the index had reached 5,522. That is a rise of 8.7% - the largest single calendar month rise since 1988. No one saw that coming!

Of course, calling the April results a 'monthly record' underscores the arbitrariness of point in time comparisons. Prices had fallen by 21% in the calendar month of March. And prices at the end of April were still 22.6% lower than their recent highpoint of 7,139 points on February 20. The record gains in April simply reduced the recent losses for everyone who did not buy their shares for the first time on April 1.

With apologies to animal lovers, most pundits see the performance in April as a form of 'dead cat bounce.' A dead cat bounce is used to describe temporary rises in share prices during a longer period of falls. The idea (look away now if you would rather not hear more about cats) is that even something as inanimate as a dead cat will bounce if it is dropped from high enough. Shares go high, the price falls, then bounces up a little, before falling back again.

Dead cat bounces are a relatively common phenomenon within larger falls in share market prices. In 1929, having reached a high of 5,187 points at the end of July 1929, the US Dow Jones Index fell to just 813 points at the end of June 1932. That is a fall of more than 80% across the three years. However, between the end of December 1929 and the end of April 1930, the market rose from 3,728 points to 4,239 points – a rise of 13.7%. Between the end of December 1930 and the end of February 1931, the market rose 18.2% from 2,638 points to 3,118 points. That's two dead cat bounces, eight months apart. (We will come back to the 1930s experience in a little bit).

Similar bounces were seen during the 'tech-wreck' crisis around the turn of the century. Again, using US data, the Dow Jones fell from a high of 17,636 points at the end of December 1999 to a low of 10,826 points at the end of September 2002. That is a 38.6% fall across the 33-month period. Within that, however, there was a bounce of 14.5% between the end of September 2001 and the end of February 2002.

It is numbers like these that lead us to usually caution that one of the major risks of share market investing is timing risk. Timing risk is the risk of buying your shares only to see prices fall and/or selling your shares just in time to watch prices rise. (Technically, the definition is a little more complex than that, but the risk of losing money is what it really means). Unless you are a full time professional watching the market all day every day, the best way to manage timing risk is to try to 'block out' what has just happened in the market and keep your eyes on the longer term. Buy over time and, when the time comes, sell over time as well. As we say pretty much each month, what has just happened is not a good indicator of what is about to happen.

Consider the 2001/2002 US experience. In February 2002, investors had just watched the market rise by 14.5% in the previous five months. The 'tech wreck' seemed to be over. Almost certainly, some of the buoyancy in recent prices was caused by what we now call 'FOMO' – the fear of missing out. As people watched the market rising, they bought back into it, helping prices rise further. Unfortunately, the 'tech-wreck' was not quite finished. Between February and September 2002, the market fell back by 26.2%.

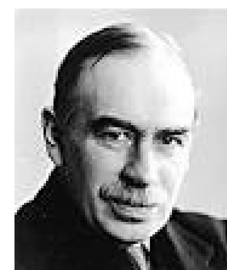
FOMO is a real threat at the moment. Anyone looking at the market performance in April could be easily forgiven for becoming anxious that they are missing out on a market recovery. Perhaps fortunately, between the Australian market's open at 10am on Friday May 1 and 11am on Monday May 4, the ASX 200 had fallen by 5.9%. This might temper the sense that the market has bottomed out.

So, the key for share market investors (including people simply investing via their super funds) is to be patient. This is not a market that can be 'timed' for maximum benefit. It has already fallen substantially and no one really knows whether the market has reached the bottom or whether there is further to go. So, don't try to time the market. Keep playing the long game.

Lessons of the Great Depression

One of the best things about living in Australia is that the very brightest of our economists tend to get jobs working with agencies like the Reserve Bank or the Commonwealth Treasury. This has helped us greatly over the years – most recently, during the GFC when Australia technically avoided even going into recession. We wrote about this particular piece of good management last month.

Many of the lessons that are being applied in Australia in the 21st century spring from the experiences of world economies during the Great Depression described above. Perhaps the most vital set of learnings from the Great Depression came from the mind of John Maynard Keynes, a British economist. Using the knowledge that there are two broad sectors within a capitalist economy – the public sector (that is, Government) and the private sector (that is, everything except the Government), Keynes identified that there are periods within the economic cycle when the Government sector needs to take the lead. These periods were times of relatively low private sector activity, which were typically times when the economy as a whole was either slowing down or contracting. During these times, the profit-seeking private sector could not really be expected to increase investment and employment – two things that need to happen for an economy to recover and growth to recommence.



John Maynard Keynes

At times of lower or negative economic growth, Keynes identified that the public sector needed to increase its relative influence in the economy by making new investments and therefore creating new employment. This would reduce unemployment immediately through the people employed. Even better, the increased spending by newly-employed government workers would provide a fillip for the private sector, and would therefore also lead to increased employment within that sector. Growth would start in the public sector and then spread to the private sector.

Probably the most famous example of public sector boosting of an economy came in the US through what was known as the 'New Deal.' It was led by President Roosevelt, who took office in 1933 and immediately sought to stimulate the US economy through massive employment schemes. Much of this was through 'public works,' such as the building of new hospitals, dams and the like. Unfortunately, here in Australia there was no real parallel to the new deal. In fact, Australia implemented what became known as the 'Premiers' Plan,' which actually saw Government spending shrink (in direct contrast to what Keynes had advocated). Some historians argue that it was because of the responses like this that the Great Depression continued in Australia right up until the start of the Second World War in 1939. Unemployment, for example, remained over 11% until the War effort kicked in.

Happily, Australia has learned its lesson and no longer relies solely on the private sector to boost the economy at times of downturn. We use what is now known as a ‘Keynesian approach’ to boost Government spending. We also target the spending so that it puts money in the hands of people most likely to spend it, such as people who are already receiving social security benefits or people who have lost work or business due to the Coronavirus. Over the last two months, we have watched the Federal Government roll out a series of payments collectively referred to as stimulus (see previous article). Uniquely (in historic terms), the increase in Government spending has been particularly targeted so that much of it is delivered through employers. This is a very intelligent design feature as it means that people remain connected to their employer when, as it is hoped, social restrictions can be eased and economic activity is again made possible.

They say that people who ignore history are doomed to repeat it. Happily, economic history is very well-known within the walls of Australia’s economic institutions. Our response to this virus has been very different to the response of Australia’s Commonwealth and State Governments back in the 1930s. We have learned our lessons well.

(PS: if you would like to know more about this fascinating period in Australian history, Wikipedia is a good place to start – you can then use the references section to dive deeper into the online archive).

The Residential Property Market

The residential property market is still a difficult thing to write about. Put simply, the current environment is so unusual that the medium to long-term impact on the property market cannot yet be estimated.

According to data released by SQM research, there has been a substantial fall in the number of properties offered for sale (with the exception of a small rise in Canberra). In the month of April, nationally listings fell by 4.9% compared to March. Compared to April 2019, listings are down 11.9% across the country. By capital city, here is what has happened to the number of properties being offered for sale in April:

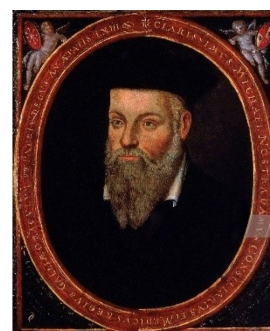
City	Change in listings during April 2020 (compared to March 2020)
Perth	-8.4%
Sydney	-7.2%
Adelaide	-6.0%
Brisbane	-5.6%
Melbourne	-4.7%
Hobart	-4.3%
Canberra	+0.4%

Unsurprisingly, properties are also taking longer to sell. In Sydney, for example, the number of properties for sale more than 30 days after they were listed increased from 4,000 in March to 7,100 in April. For Melbourne, the figure rose from 5,280 in March to 8,000 in April.

Somewhat counterintuitively, however, house prices in capital cities rose by an average of 0.7% during April. Sheesh!

This is the real crux of the property market at the moment. The number of houses for sale has fallen, it is taking much longer for properties to sell, but prices do not yet appear to have been negatively affected. Whether they will is very hard to tell. Clearly, any fall in demand during April 2020 was offset by the reduction in supply. But future demand and supply is a very difficult thing to predict at present.

There is little doubt that the Australian economy is in recession. The length and severity of that recession will greatly influence the extent to which the residential property market is affected. However, the effect of the recession will be mitigated by things like historically low interest rates, which should reduce the number of people who feel compelled to sell a mortgaged property.



Not even Nostradamus could predict what will happen next!

The length and severity of our recession also largely depends on how long we need to maintain social restrictions and then the speed with which our economy can 'bounce back' once restrictions are eased.

That is, how badly the recession affects us is almost impossible to predict. Where is Nostradamus when you need him!

Interest Rates

Earlier this week, the Reserve Bank of Australia's Board met again and decided to keep interest rates at their current historically low levels. Almost certainly, interest rates will remain low for the foreseeable future. As always with this kind of thing, there are people who benefit and people who suffer as a result of these low interest rates.

Basically, people who are holding cash and relying on interest earned on that cash are doing it tough at the moment. For example, the Commonwealth Bank of Australia is currently offering 1% per annum on term deposits of up to 5 years duration. Their best offer is 1.3% on term deposits of 12 months. The rate for most periods is less than 1%.

Unfortunately, people relying on interest payments may also be experiencing a 'double whammy' via the sharemarket. As we will write about in coming weeks, dividends are being reduced for almost all types of shareholding. People who are self-funded via investment, therefore, will be experiencing less income being generated from those investments than has previously been the case.

While people with cash investments are worse off, people who have borrowed or need to borrow money are of course better off when interest rates are lower. Residential property loan rates offered by banks such as the CBA are generally less than 3% of the moment. For people who have lost income, the fact that their interest payments have reduced is undoubtedly good news (as is the fact that most major lenders are allowing people to have repayment 'holidays' for a period of time. Please note this does not mean they are forgiving the debt: the loans still need to be repaid. Effectively, the banks are extending the loan periods).

For people who have not lost income, these low interest rates represent an opportunity. A simple strategy when interest rates fall is to maintain your current rate of loan repayment. On a principal and interest loan, each repayment has a portion that represents interest and a portion that represents repaid capital. If you make the same repayment after interest rates have fallen, then the portion of your payment which actually repays the loan increases. We show this in the picture: when interest rates are lower, principal is greater.

So, without reducing your available spending money, you can accelerate the rate at which you repay your loan. It's a simple little technique that many people have used successfully over time.

As we have written above, low interest rates will normally encourage people to borrow to buy homes and so these low interest rates become yet another factor affecting demand and supply in the residential property market. Similarly, people who are holding mortgaged residential property will find their mortgage requirements easier to meet at a time of low interest rates. Therefore, the low interest rates will reduce the number of people who feel forced to sell property, which would have a dampening effect on supply of residential property. Low interest rates should increase demand and, during a recession, reduce supply. For both of these reasons, low interest rates can be expected to have a positive effect (that is, an upward effect) on residential property prices.

The Legal Stuff

General Advice Warning

The above information is general in nature and does not take into account your personal situation. You should consider whether the information is appropriate to your needs, and where necessary, seek professional advice from a financial adviser.

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