April 2021 — Over the Horizon Market Commentary by David Offer

The month of April held true to tradition for the Australian share market, with a strong positive return of 3.9% achieved during the month. Since the depths of Covid in March last year, over the last 13 months, only the month of September has been negative. Our share market is up 21.5% for the financial year to date and, with the inclusion of dividends, has returned an impressive 24.5%.

With a steady onwards and upwards march for share markets globally, volatility indicators have been steadily falling from the record highs experienced in March last year. The global benchmark here is the VIX, which is the ticker symbol for the Chicago Board Options Exchange Volatility Index. The VIX measures the stock market's expectation of volatility based on US S&P 500 index options.

When the VIX is reading low, this is often a sign to be cautious, with complacency potentially creeping into share markets. With 7 straight months of gains on our share market and volatility falling, we are arguably due for a breather from the current upward trajectory being experienced by share markets.

On Tuesday night the Australian Federal Government budget was released, with the Federal Government abandoning any notion of fiscal conservatism or prudence. This financial year, Canberra's spending will hit 32% of GDP. This compares to the Global Financial Crisis, when payments reached 25.9%. What was supposed to be a boring budget surplus of $6 billion, instead became a budget deficit of $213.7 billion. For the upcoming 2021/22 financial year, the Federal Government is forecasting a deficit of $112 billion. This time next year, Australia is forecast to have Gross Debt trickle over a trillion dollars and 50% of GDP! Who knew that a pandemic could be so much fun …

Treasurer Josh Frydenberg has stated that the economy, while recovering, remains fragile and therefore more money needs to be spent; particularly with the Reserve Bank of Australia now largely ineffective with interest rates at zero percent. He is nothing but obliging. However, it is interesting to note that Australia's current unemployment rate of 5.6% is lower now than when the Coalition came to power in 2013. We wonder just how one determines 'fragility' in numbers?

The dramatic escalation in spending on aged care, child care and the National Disability Insurance Scheme, key areas of focus for this year's budget, would be noble if we could afford it. Instead, borrowing against the earnings capacity of future generations of Australian tax payers will create the real possibility that those Australians will do without. However, while borrowing costs remain so low, we can afford to kick the can titled 'day of reckoning' down the road a little further for now.

Within the budget there were a number of common-sense initiatives. These included;

- Removal of the work test. From 1 July 2022, individuals up to the age of 74 years will be allowed to make or receive non-concessional or salary sacrifice super contributions without meeting the work test.
- Downsizer contribution. The Government will reduce the minimum age requirement for the downsizer contribution from 65 to 60.
- First Home Super Saver Scheme. From 1 July 2022 the Government will increase the amount of super savings available to first home buyers from $30,000 to $50,000.
- SMSF residency requirements. The Government will amend the SMSF residency requirements to make it easier for funds to maintain their complying status when members move overseas.
- Complying income stream conversions. Individuals will be given two years to exit a specified range of complying retirement income stream products, such as term allocated pensions.

For most Australians, the key benefit will be the retaining of the low-and-middle-income tax offset for the 2021-22 income year. Click **HERE** for a more a more detailed overview of Budget announcements.

The Nation's key decision makers seem increasingly focused on defining a strong economy as determined by wage growth. After a decade of frustratingly soft wage growth, they appear willing for the national economy to becoming overheated to achieve it.

Judith Sloan has penned an interesting **ARTICLE** in The Australian arguing that mass immigration has been a key factor in depressing wage growth in Australia over the last decade. With 250,000 net arrivals per year, equivalent to the population of Canberra, Australia has had ample work force capacity within the economy and this has stymied wage growth. With immigration effectively ceasing and unlikely to resume to any great extent to 2023, Australia is now undergoing a unique social experiment. We suspect that the cessation in growth of Australia's labour pool will result in Australia achieving full employment much quicker than expected. Strong wage growth is likely to follow.

Philip Lowe has boldly gone where no former RBA Governor has gone before and that is to make a long-term prediction on Australian interest rates; namely that Australian interest rates will not rise before 2024. We consider that there could easily be an argument to increase interest rates before the end of 2022. While that might sound bullish, if this eventuated it would be Australia's first interest rate rise since November 2010, a full 12 years prior! If our current bullish scenario continues to unfold, it will be interesting to see if the RBA acknowledges its error in forward projections or holds firm on an increasingly out-of-date view. It could be that ultimately both the Federal Government and the RBA underestimate the strength of economic recovery underway; with the RBA forced to play catch up with a series of rapid interest rate rises to cool an overheated economy. This would not be good news for Australia or investment markets.

However, it would be good news for overseas travellers when our international border does eventually reopen, with the Australian dollar a clear beneficiary of higher interest rates. Morgans' economist Michael Knox (whom many of you know and who has an uncanny knack of hitting 'out-there' predications) has a 90-cent target on AU dollar against the US dollar by the end of the calendar year, with scope for even higher AU dollar appreciation.

With respect to company news on the ASX, our big 4 Banks have recently reported interim profit results. Headline profits have been strong and up significantly on the prior period. However, a large amount of profit turn around was able to be attributed to Banks reversing impairment charges that were provisioned for last year that thankfully did not materialise. With all Banks selling peripheral businesses that are non-core to banking, an earnings gap will emerge over the next few years. There is an expectation that this will be offset with a reduction in costs but the scale of cost reduction required will be a challenge to meet. The upshot will be relatively flat profits for a number of years to come. Ironically, it may be a rising interest rate environment that eventually comes to the Banks' rescue, as a rising interest rate market will enable Banks to reprice loans on more favourable terms.

Also of note is that a new takeover bid for Crown resorts by The Star Entertainment Group at $12.50. Blackburn has also revised its bid to $12.35, up 50 cents on the initial bid of $11.85. While moving the right way, we consider Crown remains undervalued with a takeover price closer to $14.00 ultimately required to secure control of the Company.

I am out of the office this week on some unplanned leave, with a minor operation required to address some saddle soreness attributable to bike riding. Please do not hesitate to contact our office if there are any matters you would like to discuss with respect to your investment portfolio.

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