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Editorial

The $130 billion wage stimulus is astounding in its generosity and scope. Spent over six months, it's equivalent to the annual budgets for defence, education and health combined. A cafe owner told me a casual dishwasher who was paid a maximum of $60 for two hours work a week for the last 18 months now wants the $1,500 a fortnight payment. The AFR reports that of the nation's 81,400 sales assistants, 72% work part time with an average weekly income of $451. The cafe owner doubts the dishwasher will ever return as she will save so much in the next six months. A 100% wage coverage up to a $1,500 cap, not a flat rate, seems more appropriate, or are wage increases paid by the government at a time of mutual sacrifice simply an unintended consequence?

The **Grattan Institute** has produced some good material on coronavirus, including a video and this comment on the stimulus:

"A broad wage subsidy will also make it harder to shift workers from idle sectors (where their pay is subsidised) to expanding ones (where it won’t be). No doubt more wrinkles will be found, and exploited, in time. But given the imperatives of speed and scale for these economic rescue packages, these imperfections are tolerable."

We asked **Shane Oliver** how the $200 billion of stimulus will be funded and whether there is any limit to the largesse. Yes, the unprecedented government fiscal response was needed, but there are future consequences which mean the amount must be fully justified and targetted.

Governments which have pushed hard for decades for Australia to become a market economy, with open borders, budget surpluses and a tight rein on welfare, have thrown away firmly-argued principles. **Newstart** was frozen at about $550 a fortnight since 1994, which was clearly inadequate but apparently all the country could afford. Now it's doubled as Jobseeker and tripled as Jobkeeper. Desperate times, indeed.

PM **Scott Morrison** is making incredibly tough decisions in the most testing of circumstances, and he said:

"Our goal is to protect the lives and livelihoods of Australians, to protect and preserve the very economy that we will depend on so significantly in the months ahead, and on the other side as well, for the generations that will follow us out of this. Many countries, in the months ahead and perhaps beyond that, may well see their economies collapse. Some may see them hollow out. In the very worst of circumstances, we could see countries themselves fall into chaos. This will not be Australia."

Former Governor of the Reserve Bank, **Bernie Fraser**, said on Tuesday:

"The packages that have been put together in recent times are very expensive. There is going to be an awful overhang of debt and at some point there is going to have to be a bit of reckoning with that and some winding back."

This week, we also tap into comments by the legendary investor **Howard Marks**, who in his latest memo to clients concludes:

"I would say assets were priced fairly on Friday for the optimistic case but didn't give enough scope for the possibility of worsening news. Thus my reaction to all the above is to expect asset prices to decline. You may or may not feel there's still time to increase defensiveness ahead of potentially negative developments."

Investing requires a plan for decades not days, and markets are moving 5% to 10% in hours at the moment. The US is shaping up as the main long-term economic problem, as the state-run responses and ambiguity of the President's position means lockdowns will be inconsistent. New cases and deaths will occur for a lot longer than the three to six months everyone is hoping for.

The assumption of unlimited demand for US Treasuries is also dangerous, as **Professor Tom Congdon** of the Institute of International Monetary Research says:

"The market in US Treasuries may be the most liquid on the planet, but that does not mean it overrides the laws of supply and demand. Investment institutions' capacity to absorb that volume of debt – at current yield levels (in the 10-year area) of under 0.7% - must be in doubt."

In a humanitarian context, the most worrying consequences are for the billions of people in Africa, the sub continent, the Pacific Islands and parts of South America and the Middle East, who do not have access to clean water and health facilities. Many live in slums, need to work each day and cannot self-isolate. The world is staring down the barrel at millions of deaths. The Worldometer website is a great resource for accurate statistics.

The Atlantic published an article last week on how long the crisis will last, and we should think about how to survive in lockdown for longer than expected.

A bear market rally?

We saw a strong stockmarket bounce from the initial fall, an impressive recovery of 15% in Australia from the 23 March low to yesterday, but rises always happen during bear markets. Overall, the S&P/ASX200 was down 24% in the March quarter.

Buyers attempt to find the bottom after a sell off as stocks look cheaper, the market rallies until there's more bad news, and the bear continues growling, as it did in the GFC. It's easy to forget how often markets improved during a multi-year decline, as shown below.

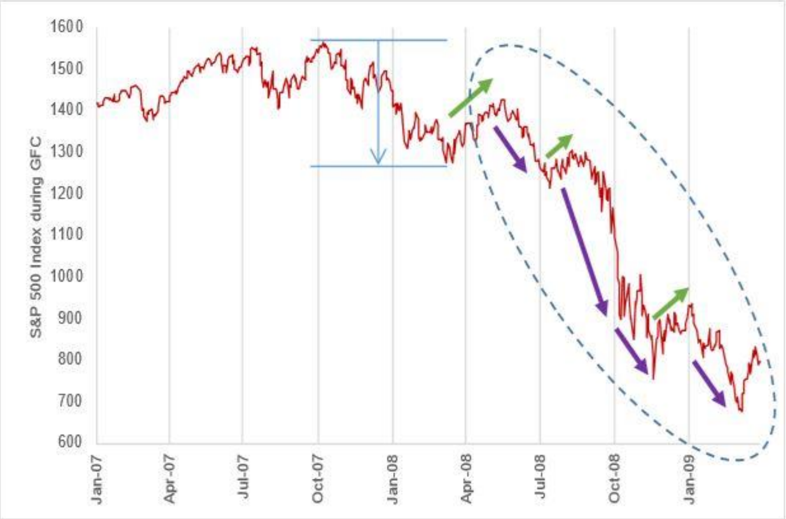
The blue lines show the initial fall from October 2007 to about March 2008, followed by several months of recovery. It was not until September 2008 that the market really collapsed.

Rather than picking tops and bottoms of markets, more important are the words of Nobel Laureate **Daniel Kahneman**. He says the key to good investing is:

" ... a well-calibrated sense of your future regret."

Since most people dislike losses far more than they enjoy gains, I believe market conditions call for a defensive stance.

S&P500 falls and rises during GFC



Source: Jamieson Coote Bonds

We are now publishing most days to the website

Firstlinks is receiving more articles than ever, too many to include in the weekly newsletter without making it longer than the bible. So we are now publishing new pieces to our website as they come in. Please visit there regularly for the most up-to-date contributions.

This week, we feature **John Reckenthaler**'s explanation of the four stages of a typical bear market, and we are somewhere between two and three.

Two further pieces on the virus: **Gofran Chowdhury** says this is a good time to adjust investment portfolios, while **Campbell Harvey** shows why small to medium businesses will bear the brunt of the coming recession. Also loaded soon as an extra on the website, **Frank Uhlenbruch** provides a chart illustrating each bear market is different.

On managing SMSFs, **Graeme Colley** says SMSF trustees need to realise their Investment Strategy is under scrutiny, while **Alex Denham** explains the rules for accessing money from super at a time when many people will be cash-strapped.

On a brighter note, **Mark Williams** looks with optimism at how technology companies make not only good investmennts, but they also contribute to a cleaner planet.

Legal firm **Foulsham & Geddes** has provided a checklist for companies, directors and maybe individuals to follow in these unprecedented difficult conditions.

Two White Papers hot off the press with new views on coronavirus. **Western Asset** calls the Fed stimulus initiative a game-changer in ways we do not expect, and **MFS Investment Management** says panic is the enemy, and disolcations throw up strong investment opportunities.

Morningstar is seeing a dramatic increase in traffic through its newsletters and website, including record sign ups for its Premium services as investors seek independent commentary. For a free four-week trial, including an update on treatment and vaccines for coronavirus, click here.

Graham Hand, Managing Editor

How $200 billion is magically created

Shane Oliver

The Federal Government's latest fiscal stimulus programme centred around a wage subsidy to help combat the impact on the economy of coronavirus-driven shutdowns has generated much community support.

But how will it be paid for? Can we afford it? How does RBA quantitative easing fit into it? And what are the longer-term consequences in terms of inflation and debt?

A rise in public debt of half a trillion

These are valid questions given that together with the previous two fiscal stimulus packages it will add dramatically to Federal Government's budget deficit – by around $200 billion over the next year (or about 10% of GDP). And to this needs to be added the hit to public revenue from the economic downturn we are now in. So the total rise in public debt could be $500 billion or so (or about 25% of GDP).

To the question of how it will be paid for the answer is simple: the Government will issue bonds and borrow the money required.

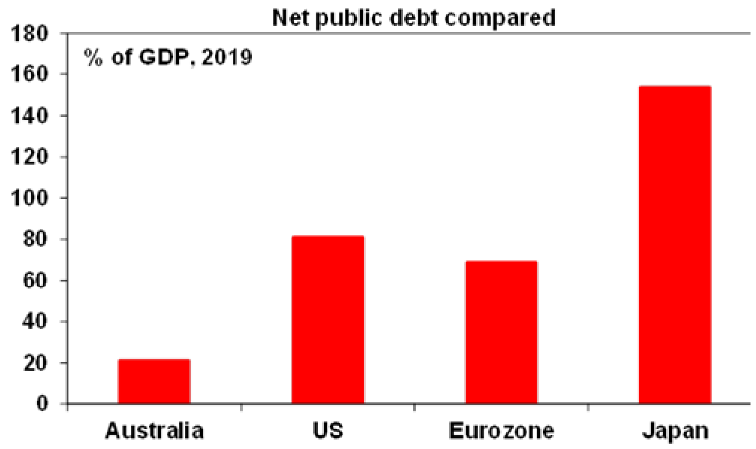
However, there are several things to say on all this.

First, it's absolutely necessary. In normal circumstances, such a massive public stimulus program and boost to public debt - which is nearly double what we saw in the GFC – could not be justified. But these are not normal times. The hit to economic activity in Australia from the shutdowns could be 10% to 15% of GDP. This requires a similarly-sized stimulus programme to offset it, otherwise we risk doing immeasurable collateral damage to the economy. It will take much longer to recover from such damage, ultimately resulting in an even bigger hit to the budget.

Second, to borrow from classic Keynesian economics, it makes sense for the public sector to borrow from households and businesses at a time when they are stuck at home and can't spend. Government spending the borrowed funds helps smooth out the economy.

Sure the stimulus won't stop the virus or spur immediate spending when people are locked up inside but it will help support businesses and household income. Then they can survive this period of hibernation and hopefully bounce back once it comes to an end. The trick for the Federal Government is to curtail the stimulus and its borrowing once the economy bounces back and the private sector starts to borrow again otherwise the competition for funds will boost interest rates and create problems for the economy.

Third, Australia's public debt is far lower than in other comparable countries. In fact, net public debt as a share of GDP is around a quarter of what it is in comparable advanced economies. See the next chart. So Australia has far greater scope to undertake fiscal stimulus than other comparable countries.



Source: IMF, AMP Capital

Fourth, the cost of borrowing for the Federal Government right now is very low at just 0.25% for three years and 0.75% for 10 years. So it's not as if the Federal Government is incurring a huge interest bill or 'crowding out' private sector borrowing or investment.

Finally, the budget blowout may risk a downgrade in Australia's AAA sovereign debt rating, but ratings are a bit of a relative game and Australia's public finances will still look relatively better than others. I would rather a rating downgrade than a deep depression/recession any day … particularly when any downgrade will have no impact on the Federal Government's cost of borrowing!

How does RBA quantitative easing fit into all this?

The RBA is using printed money to buy government bonds in order to help keep interest rates down. It's buying these bonds in the secondary market (eg from fund managers) so it's not directly providing the money to the Government and those bonds still have to be paid back when they mature. So it's not really 'helicopter money', which would see the RBA print money and give it to the Government which it would then spend. But it is aiding the process by helping to keep bond yields down.

In the meantime, the balance sheet of the RBA will rise as it holds more bonds but this is not a major issue unless inflation starts to rise due to all the extra printed money in the system. The Fed, ECB and Bank of Japan have been expanding their balance sheets through QE for years now with no rise in inflation so the RBA presumably has a long way to go in this process before it becomes a problem. In fact if the Fed and others had not been doing QE, their countries would probably be mired in deflation by now. Put simply, there is no magical right or wrong for the level of the RBA's balance sheet.

Longer-term consequences

When the dust settles, Australia will be left with much higher public debt at maybe around 45-50% of GDP in net terms but this will still be below that in other comparable countries. And it will be the price we paid to (hopefully) minimise the loss of life from the virus and at the same time minimise the hit to people's livelihoods from the shutdown.

This may necessitate forgoing the next round of tax cuts due in 2022 or imposition of a new deficit levy at some point. And it may put a burden on future generations much as Government spending to fund the war effort in WW2 did. But I reckon that's a cost most Australian's are prepared to bear given that not acting now with public support mechanisms would likely lead to a far worse outcome.

Dr Shane Oliver is Head of Investment Strategy and Chief Economist at AMP Capital, a sponsor of Firstlinks. This document has been prepared for the purpose of providing general information, without taking account of *any particular investor’s objectives, financial situation or needs. For more articles and papers from AMP Capital, click here.*

Howard Marks' latest on 'Which way now?'

Graham Hand

Howard Marks wrote his previous memo to clients of Oaktree Capital on 19 March 2020, and on Wednesday this week, he issued another one. It's a sign of how quickly the market is changing as he usually writes only once every couple of months.

In the space of 11 days, he seems far more worried. Previously, he wrote:

"Given the price drops and selling we've seen so far, I believe this is a good time to invest, although of course it may prove not (to) have been the best time. No one can argue that you should spend all your money today ... but equally, no one can argue that you shouldn't spend any. The more you want to garner potential gains and don't mind mark-to-market losses, the more you should invest here."

What's his latest view?

In his latest memo, he describes the 'quickest meltdown' in US stock market history, a fall of 34% in little over a month. It was followed by a gain of 17%, the best three-day rise since the 1930s. Amid the turmoil, 106 companies issued an unbelievable $213 bllion of investment grade bonds in a month, another record.

After his decades in the business, Marks is as well placed as anyone to assess the outlook. In his latest views, he catalogues the optimistic and pessimistic views, and reaches a vital conclusion. He starts with:

"It’s important to take time out for a serious discussion of possible scenarios. Are this past week’s remedies certain to work? Are the prior week’s negatives really erased? ***Which will win in the short and intermediate term: the disease, economic ramifications or Fed/Treasury actions?"***

He then divides the arguments into the positive and negative cases.

Positive outlook

1. The virus will be brought under control within three months or so. He says every forecast makes the assumption that isolation, immunity, warmer weather, treatments and a vaccine will flatten and turn down the curve.

2. The negative impact of the disease on the economy will be sharp but brief. The V-shaped recovery assumes a big hit to earnings initially but an even stronger recovery within a short time, probably as little as three months.

3. The government will provide life support to the economy during a lockdown-induced coma and then bring the patient out of the coma after the cure has been effected. Recovery will be helped by improving news on the disease.

Negative outlook

Marks admits he's more of a worrier than a dreamer, with his personal defensive tendencies leading him to find more negatives than positives.

1. He is very worried about the outlook for the disease, especially in the U.S, and believes the headlines on infections and deaths will become much worse.

"The success of other countries in slowing the disease has been a function of widespread social distancing, testing and temperature-taking to identify those who are infected, and quarantining them from everyone else. The U.S. is behind in all these regards. Testing is rarely available, mass temperature-taking is non-existent, and people wonder whether large-scale quarantining is legal."

2. The economy will contract at a record rate, millions will be out of work, company earnings will collapse, and there may even be food shortages. He questions how realistic the V-shape recovery argument is.

"I believe we're likely to see defaults on the part of leveraged entities, based on price markdowns, ratings downgrades and perhaps defaults on their portfolio assets; increased 'haircuts' on the part of lenders (i.e., reduced amounts loaned against a dollar of collateral); and margin calls, portfolio liquidations and forced selling."

3. It will be challenging to resolve the conflict between social isolation and economic recovery. He repeats the point made by President Trump in asking whether the disease merits the severity of the cure. The longer lockdowns continue, the harder it be for the economy to recover. If a decline in new coronavirus cases leads to a resumption of activity, a second wave of infection could hit.

4. In addition to the disease and its economic repercussions, there is a specific impact of the low oil prices on energy companies.

"Due to a confluence of reduced consumption and a price war between Saudi Arabia and Russia, the price of oil has fallen from $61 per barrel at year-end to $19 today."

He then adds negative psychology, fear of more problems and the negative wealth effects to his list of worries. He is even concerned whether enough businesses will continue operating during a lockdown:

"The Treasury can make up for people's lost wages, but people need the things wages buy. So replacing lost wages and revenues will not be enough for long: the economy has to produce goods and services."

Summing up

He makes an important conclusion, saying if it's not too late, investors should increase defensiveness in their portfolios. He says:

"In the Global Financial Crisis, I worried about a downward cascade of financial news, and about the implications for the economy of serial bankruptcies among financial institutions. But everyday life was unchanged from what it had been, and there was no obvious threat to life and limb.

Today the range of negative outcomes seems much wider, as described above. Social isolation, disease and death, economic contraction, enormous reliance on government action, and uncertainty about the long-term effects are all with us, and the main questions surround how far they will go.

Nevertheless, the market prices of assets have responded to the events and outlook (in a very micro sense, I feel last week's bounce reflected too much optimism, but that's me). I would say assets were priced fairly on Friday for the optimistic case but didn't give enough scope for the possibility of worsening news. Thus my reaction to all the above is to expect asset prices to decline. You may or may not feel there's still time to increase defensiveness ahead of potentially negative developments. But the most important thing is to be ready to respond to and take advantage of declines."

Howard Marks is Co-founder and Co-chairman of Oaktree Capital Management, the largest investor in distressed securities worldwide. This article is general information and does not consider the circumstances of all investors.

A full copy of his latest client memo is linked here.

Four stages of a typical bear market - but is this typical?

John Rekenthaler

Typically, bear markets have four stages.

Stage one is recognition. Almost everybody shrugs off a bear market's initial slide as being an ordinary event. The markets rise, and they fall. Treating every bad week as the bear's arrival would not only shred one's nerves, but would cause poor performance, should the investor act upon that instinct. Nine times of out 10, realising a quick 5% or 10% loss would result in a permanent 5% or 10% loss, as stocks quickly return to their previous level.

This coronavirus-driven market achieved stage one during its third week. Stocks were up slightly for the year, before suddenly dropping 11% in the last week of February 2020. In response, advisory firms issued reassuring notes about how these things happen, and market volatility is natural. The stock market surged the following Monday, failed to hold its gains, and then collapsed in week three. The bear was on.

Stage two is panic. This occurs when shareholders realise that the standard advice failed. Buying on the dip wasn't easy money, as it is nine times in 10. Rather, it led to greater damage. Along with the pain (and regret) of unexpected losses comes the surprise that the conventional wisdom was wrong. Investors' faith is tested, and some are found wanting. They sell first, then ask questions later.

We are currently in stage two, maybe testing stage three. Along with the 1987 bust, the current stock market crash - it fully deserves that name, with the Dow down 34% from its peak at one stage but recovering some of the loss since - was the fastest stock-market descent since The Great Depression. It is difficult to apply rational analysis when so much happens, so quickly.

View from the bottom

Stage three is stabilisation. Stocks halt their decline, thereby ending the impression that they will do nothing but fall. The panic subsides but the situation remains grim. Investors believed during the first stage that stock prices slide on a whim. Now they realise that equities stumble for good reason, and that until that reason is eliminated, they will continue to struggle, despite some good days. Shareholders' losses will not soon be recouped.

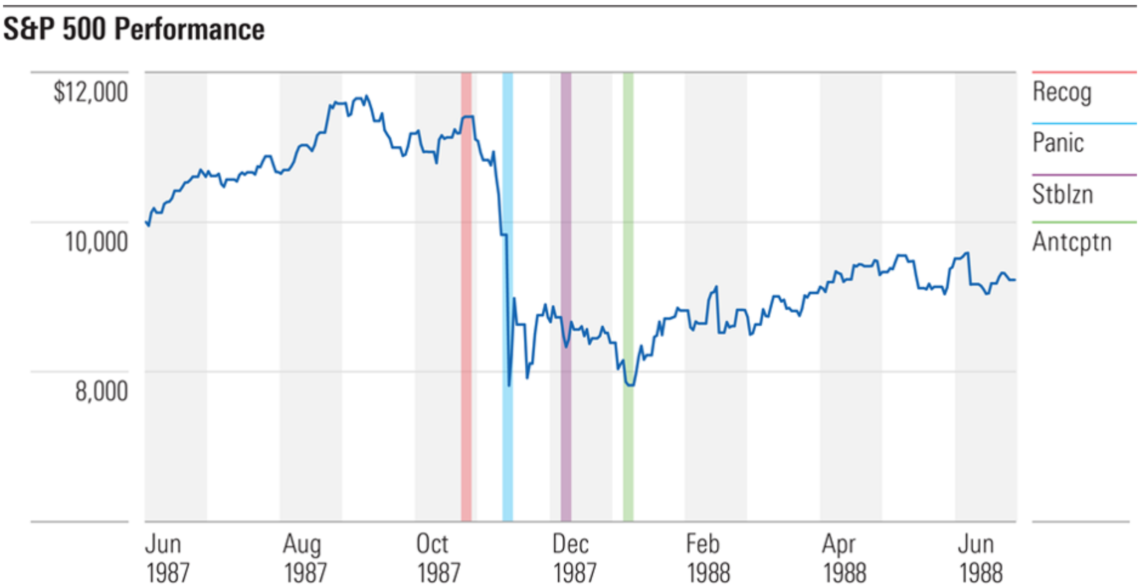
This period is marked by turbulence. Stocks rally, sometimes furiously, only to be knocked back down. Investor sentiment varies between guarded optimism that the end is at least remotely in sight, and despair that the hope was false. This is typically the bear market's longest period, extending for several months. (Several years for The Great Depression, but we do not wish to emulate that example.)

Stage four is anticipation. This is when stocks start their recovery. As with the bear market's beginning, almost nobody recognises its end until after the fact. The news at the time tends to be almost unrelievedly grim, accompanied by articles about how stocks' golden days have passed. However, some investors perceive economic improvement distantly in the future. They make their bids, and stocks begin to rise.

A classic case occurred in March 2009. The recession was in its terrifying midst. Real US gross domestic product declined that quarter, and the next quarter, and the quarter after that. The Morningstar Ibbotson Conference was held that month to empty seats, with the keynote speaker predicting several more months of equity losses. The rally began the next day.

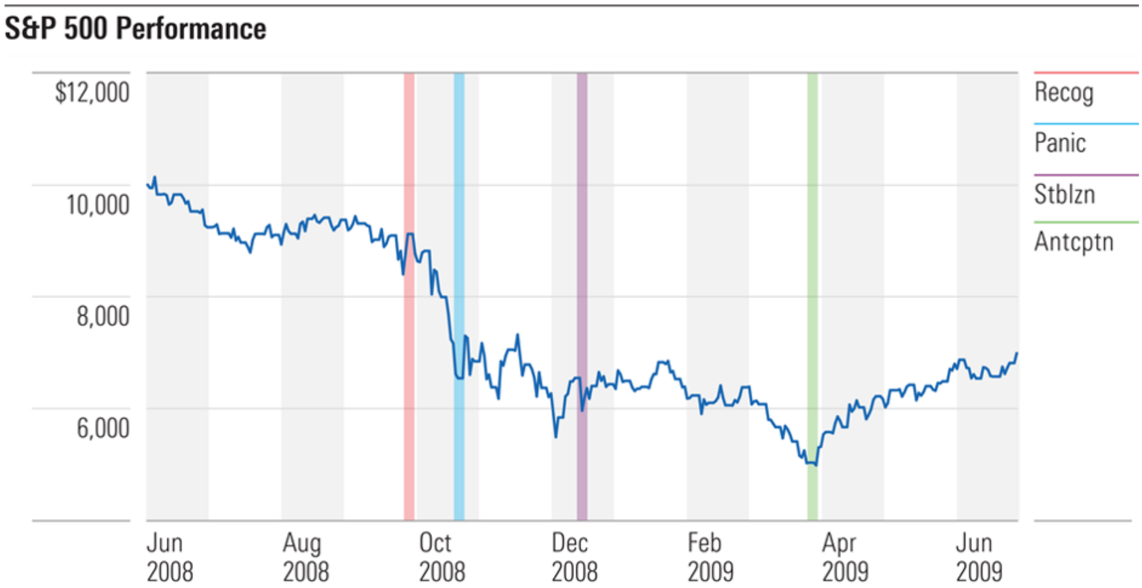
Example #1: Black Monday

This is how the four stages played out 33 years ago in US markets:



Example #2: Financial crisis

And this is how they operated more recently, from late 2008 through early 2009:



Looking forward

This scheme applies to bear markets that are primarily caused by recession fears. In addition to the two historic bears charted above, the scheme can be used to map the much smaller slump of 1990, and 1981's decline, and 1970's sell-off. Of course, the details for each of those markets vary, sometimes substantially but the pattern is roughly similar.

However, the blueprint does not work for bear markets that arise from other causes. For example, the stock market's grinding decline from 1973 through 1974 doesn't map well to the four stages, because it was caused by steadily increasing inflation fears. The 2000-02 technology-stock implosion also fails the test, because the major concern as the New Era concluded was that equity prices had risen too high, not - aside from some of the internet stocks - that earnings would disappear.

The question then becomes, does the current bear market fall into the first category or the second?

The former would be greatly preferable. With that scenario, the enormous uncertainty about the spread of the coronavirus, and the economic damage that the containment efforts will wreak, disappears over the next few months. The problems will remain large, but they will at least be known quantities, and the financial markets are adept at planning for what is known.

Should the picture become clearer, the four-stage scheme figures to be relevant. Fairly soon, I should think, stocks will more firmly enter the third stage, that of stabilisation. That doesn't mean that they won't decline further, but the struggle will at least be bounded. Within months, not years, the stock market recovery should begin.

On the other hand, should uncertainties remain high and unresolved, perhaps because the virus's behaviour confounds the scientists, or because the financial stimulus efforts prove ineffective, then all bets are off. I do not know how to analyse such a situation. I hope that I never shall.

Big hat, no cattle

I have written about buying market puts, giving the right to sell at an index level, as protection on institutional portfolios. But you know what? It was easy for me to talk bravely as a columnist, with no public numbers on the line. It would have been much more difficult to follow through and make the trade as a professional manager, knowing that if stocks didn't quickly tumble that I would have squandered previous performance in protecting against an emergency that did not arrive. I might not in fact have made that trade, and either way, it doesn't count if you don't do it.

John Rekenthaler is Vice President of Research for Morningstar, a columnist for Morningstar.com and a member of Morningstar's Investment Research Department. This article is general information and does not consider the circumstances of any investor.

Small business in path of COVID-19 tsunami

Campbell R. Harvey

Each financial crisis has its own set of circumstances, requiring central banks and federal governments to be nimble, open-minded, and creative in their responses. In this crisis, small- and medium-sized businesses are the most vulnerable sectors of the economy. They need strong support. Policymakers must follow a different playbook from earlier financial crises. The measures taken in 2008, for example, will not work or will be vastly insufficient.

Earlier crises offer meagre guidance

Central banks – in the past, a major source of liquidity to the capital markets – face very real limitations in how much they can do given today's extremely low interest rates. Instead, we must look for much-needed help from other sources, such as government support for bridging loans, to address the serious challenges markets and economies are dealing with today. Unfortunately, earlier financial crises offer scant guidance on how to cope with the current crisis because few similarities exist between then and now.

The GFC that began in 2007, and worsened in 2008, resulted from a series of financial events exacerbated by overleveraged, high-risk banks. The target of mitigation, therefore, was to bail out the banks.

Since the GFC, banks' balance sheets have improved substantially, and regulators have imposed stress testing to ensure they stay that way. The banks were the most vulnerable part of the economy in 2008, but the most vulnerable element today is small- and medium-sized businesses that are integral to global supply chains.

This crisis is also very different from the GFC when the US Federal Reserve's target interest rate was 5.25% before the first rate cut in September 2007. Contrast that to a target rate of 1.5% earlier this month. That's a big gap in how much ammunition the Fed had to work with.

Similarly, the Reserve Bank of Australia has little room to slash rates as it has already reached the lowest cash rate in the nation's history.

We can also look to 9/11, an event that sparked a crisis of confidence and much uncertainty. Likely the closest comparable to the current crisis, it nevertheless provides little guidance for the path forward today because the market was in a drawdown when crisis struck. The current crisis began when the market was at an all-time high.

The trigger of our current crisis is biological rather than financial. Comparable historical health-related crises are the 1918 Spanish flu pandemic and the 2003 SARS epidemic. The first comparison is problematic. Indeed, although many more people died from the flu than died from combat in World War I, the equity markets actually did quite well because the war was over and people believed the economy would be strong. The markets benefited from the peace dividend.

The 2003 SARS crisis resembles in many ways the unknowns surrounding the COVID-19 crisis. Yet, in 2003 the equity markets rose, much like in 1918–19. How is that possible? The answer is that the starting points of the market differed. In 2003, the S&P 500 Index was in drawdown, having lost over 40% of its value after the tech bubble burst at the beginning of the decade. The market was already cheap.

In 2020, however, the equity market was quite expensive, at an all-time high with historically high valuations, when the downturn began. That is why we are seeing an unusually steep decline and high volatility as the market revalues itself.

A different playbook

Policymakers must ensure (not just hope) that banks do not choke off the flow of credit to households and businesses, especially small businesses. We don't want to repeat the mistake of the GFC when large corporations got first priority and small- and medium-sized businesses were relegated to the back of the queue.

This crisis impacts everybody, unlike the GFC. Therefore, we need to focus on making sure the supply chains are maintained and supported. As consumers, we know the final seller or major producer of a good, but are much less familiar with the critical smaller businesses that supply the parts of that good.

Small- and medium-sized businesses are a very important part of our economy. They are responsible for 49% of employment in the United States and 44% in Australia. More importantly, 64% of US employment growth comes from small- or medium-sized businesses. In Australia, this figure is 57%. Not adequately meeting the cash-flow needs of small businesses will make the almost inevitable recession more painful and delay the recovery.

Many companies were very successful when this exogenous event, the COVID-19 pandemic, struck swiftly like a natural disaster and put them at risk. Extraordinary steps are necessary. To let high-quality businesses fail would be a serious mistake. If these firms, many of which are integral to the supply chain, go under, there will be a painful spike in unemployment.

Of course, banks will be stressed, perhaps beyond the stress tests they have all passed, but the focus should not be on the banks. The focus should be making sure that the banks make at least an equal amount of lending available for both small and large businesses. Policymakers should insist on this.

Guarantees to keep the Commercial Paper (CP) market open offers no direct benefits for small businesses because they don't issue it. There is an indirect benefit, however, in that to the extent large businesses can find funding through the CP market, banks have more to lend to smaller businesses.

Looking ahead

The turning point in this particular crisis will be when the number of new COVID-19 cases starts to decrease. This will be very clear and hopefully happens fairly quickly. This contrasts with the GFC, which was a very long recession. In real-time during the GFC, we were not sure how serious the situation was, maybe a problem with a few banks or maybe more. Then it became a slow-moving train wreck. It just got worse and worse and worse.

The current crisis appears to have a timeline. We can observe other countries' experiences, so we can actually see our future. A good comparison is South Korea, which indicates maximum pain may be short-lived. The real question is, can we mitigate the damage to the economy so that we can snap back with a V-shaped recovery rather than a U-shaped or, even worse, an L-shaped growth path? It is incumbent upon our policymakers to make sure we are in the best possible shape in terms of our economic recovery.

And, of course, all of this is secondary to the issue of health.

Campbell R. Harvey, Ph.D., is a Partner and Senior Advisor to Research Affiliates and Professor of Finance at Duke University in the United States.

For Research Affiliates' latest views on the economic impact of this evolving crisis, click here.

Why technology stocks are good for the future

Mark Williams

Technology companies have been hit with volatility as investors react to the COVID-19 pandemic. Apple has responded to lockdowns in some of its Chinese manufacturing hubs by announcing it will temporarily close stores. On the other hand, tech companies like video-conferencer Zoom have benefited as more people work from home. While short-term performance will remain volatile, over the longer term the IT sector is likely to continue to drive the global economy.

Technology is the engine that powers business and enables the instant communications and connectivity we take for granted. It also has enormous potential to transform how we use resources across other business sectors – with significant benefits to the environment and society.

We believe technology will play a key role in the transition to the renewable-powered economy of the future, and that's part of the reason our portfolios have an overweight position in the IT sector.

Embracing the cloud

In recent years, there's been a strong trend away from storing data on in-house servers. Instead, more companies are outsourcing data storage to the cloud which is managed in large data centres, creating a significantly more efficient option than on-premise servers.

The energy used by these data centres is nonetheless substantial and a challenge in its own right. However, some major data centres, including those owned by Apple and Google, are now 100% powered by renewable energy. Meanwhile, Nordic centre DigiPlex has pledged to use waste heat from one of its data centres to warm up to 5,000 apartments in Oslo.

Companies like Microsoft are taking impressive measures to limit their carbon footprints. Rather than just aiming to be carbon neutral, Microsoft is on a pathway to become carbon *negative* by 2030. The company says that by 2050, it will have removed from the environment "*all the carbon the company has emitted either directly or by electrical consumption since it was founded in 1975".*

Saving energy, saving trees

One of the best-known advantages of technology and digital solutions is that they can reduce a company's reliance on paper. Logging trees to make paper is one of the key causes of deforestation, which impacts on biodiversity and contributes to climate change.

Using digital solutions, like viewing documents online and sending email instead of letters, can help save trees – and therefore our forests, with a flow on effect to our climate. To illustrate, an Argentinian study concluded that producing a four-page direct mail letter and envelope accounts for 25 grams of carbon, even before it is sent. Compare this with email, which is estimated to generate just 4 grams.

Three highlighted technology stocks

At its launch, our new Australian Shares SMA strategy held 5.2% of its portfolio in the IT sector (compared with the benchmark S&P/ASX200 sector weighting to IT of 3.1%). This was represented by one stock, Link Group. An additional 6.8% of the SMA portfolio was represented by Domain Holdings and Seek Ltd, two businesses we categorise as Technology due to their digitally focused businesses but officially sit in the Communications Services and Industrials sectors, respectively.

In line with the broader Australian stock market, these companies' share prices have been hit hard in recent weeks. However, we believe they remain good long-term investments that provide a positive benefit to society.

Link Group

Link Group provides administration services and digital tools for financial market participants. Their clients are varied and include listed companies (to help manage and communicate with their shareholders), industry funds (to help with membership administration) and lenders (to assist with loan administration).

Under the Australian Ethical Charter, Link Group receives a positive assessment for its technology and administration services because they create more efficient solutions for financial services businesses and their customers.

We also think Link Group is an attractive investment because it is a global business that generates long-term stable cashflows. We also think that the PEXA asset, an online conveyancing platform, is an attractive investment by the company as Australia transitions towards a 100% digital conveyancing process.

Domain

Domain provides residential and commercial property marketing services through its online listings portal. The company's digital advertising platform is positive under our Charter as an efficient medium of advertising compared to print advertising. Because it also helps people secure housing, Domain attracts a positive adjustment under our Charter.

From an investment point of view, Domain is firmly established as the number two in digital property advertising in Australia behind REA Group. There are structural tailwinds supporting these businesses as property listings continue to flow out of print and into online platforms. We believe Domain has a strong management team backed by Nine's ownership of the company, healthy cashflows and the potential for higher earnings growth.

Investing for good

We believe investments need to do more than deliver strong financial returns – they also need to generate a positive impact. Used well, technology can help improve efficiency, reduce waste and improve peoples' lives.

Mark Williams is the portfolio manager of Australian Ethical's Australian Shares SMA strategy. Australian Ethical is a sponsor of Firstlinks. This article is general information and does not consider the circumstances of any investor. For more articles and papers from Australian Ethical, please click here.

Avoid complacency with your SMSF's investment strategy

Graeme Colley

Your SMSF is required to have an investment strategy which is a plan for making, holding and realising investments in line with the fund's investment objectives. It's a common misunderstanding that the strategy should be a mere statement of the types of investments your SMSF will invest in.

There's more to it than many trustees think

But that's not enough. The Australian Taxation Office (ATO), as a regulator of SMSFs, has recently said that trustees need to explain why the fund has made the investments. They also are interested in how the strategy provides benefits to each fund member on retirement or how it will provide for their dependants after the member's death.

Don't be surprised if the auditor of your SMSF takes greater interest in the investment strategy because it's a requirement that it is reviewed regularly.

If your SMSF's investment strategy is general and has not considered the risks in making, holding and realising investments in addition to the likely returns, it may have a problem complying with the superannuation law. As trustee, you need to consider the objectives of the fund and any cash flow requirements plus the members' insurance requirements.

The superannuation law requires that a fund trustee must consider:

1. The fund's investments as a whole and include the extent to which those investments are diverse or involve exposure of the fund to risks from inadequate diversification.
2. The liquidity of the fund's investments, having regard to its expected cash flow requirements.
3. The ability of the fund to discharge its existing and prospective liabilities.
4. Whether the trustees have considered insurance cover for one or more fund members.

You may be the sole member of your SMSF or have recently become the sole member of an SMSF because of a change in membership. Your adviser may recommend a review of your SMSF's investment strategy to fine tune any change in the fund's cash flow requirements, investments and maybe the insurance needs of members. If you don't have an adviser, then it could be time for you to review it.

Investment strategy and fund audits

During the last six months, the ATO has focussed especially on SMSFs that have high concentrations of investments in one asset class such as property, shares, cash or fixed deposits. It sent out around 18,000 letters to remind SMSF trustees that the fund's investment strategy should justify the is a lack of diversification.

In the first instance, they require the fund auditor and you as trustee to make any changes. We have seen a renewed interest by auditors in closely examining funds to ensure the investments are consistent with the fund's investment strategy. This is usually brought to the attention of the trustees in the auditor's Management Letter but in the worst cases may be brought to the ATO's attention.

If your SMSF's investment strategy doesn't adequately demonstrate what the law requires, you probably have one of two options:

- Replace your SMSF's current investment strategy with one that meets the Superannuation Industry (Supervision) Act, or

- Provide an amendment to the current investment strategy which provides additional information on how the trustee(s) have considered the above requirements.

In most situations, auditors have accepted an amendment that includes the extra information required. This usually covers how the trustee has considered the SIS requirements and why investments have been made to provide the required benefits.

What you need to do if there is a change

Your SMSF's investment strategy must adequately reflect changes. This is especially true following recent stockmarket falls, where asset allocations may have fallen outside defined bands. A good SMSF administrator should advise you when this happens, as we do with clients of SuperConcepts. Other changes include where:

- the cash flow requirements of the fund alter if you decide to start or stop an income stream
- a lump sum is to be paid in cash,
- someone has joined or ceased as a fund member.

The law requires a regular review and the trustee's confirmation that it has taken place, usually each year.

Graeme Colley is the Executive Manager, SMSF Technical and Private Wealth at [SuperConcepts](), a sponsor of Firstlinks. This article is for general information purposes only and does not consider any individual's investment objectives. For more articles and papers from SuperConcepts, please click [here]().

How an SMSF member can access cash under COVID-19 rules

Alex Denham

What a shattering few weeks for Australia and for the world.

I'm reluctant to write this, as it will be out of date by the time I get to the end. The superannuation team at the ATO must be exhausted. Every day, they issue more announcements, policy decisions and information.

For context, as I write this it's the week beginning 30 March, and it's now apparent that these are the early days of the coronavirus crisis. I write from home, in the guest room that has been converted to an office. I'm lucky, as our business at Heffron SMSF is well set up for remote work. My home office is exactly the same as my desk at work with three screens and the online phone system that we converted to last year. It's been a relatively seamless transition from office to home.

We are all becoming familiar with this 'new normal', to adopt an overly-used phrase. Yesterday, I was on a phone hook-up where the ATO provides an update to industry and fields questions on superannuation related matters. One participant had forgotten to mute their phone, so all we could hear was kids yelling in the background.

But we are the lucky ones so far and not in 'That Queue' yet, so no complaints from me, and we'll all get better at it.

The new announcements

As SMSF administrators and educators, we are fielding calls from fearful accountants, advisers and SMSF trustees looking for clarification and solutions. Over the last two weeks, a range of announcements affecting the SMSF space include:

- Early release of $10,000 a year for two years from individual's superannuation balance for those whose employment or income has been affected by COVID-19.
- The halving of the minimum drawdown rate for certain superannuation pensions, most commonly account-based pensions but also including market-linked pensions and transition to retirement pensions.
- ATO clarification on rent relief for SMSFs that lease business premises to related parties.
- ATO position on SMSF in-house assets levels being over 5% at 30 June.

If nothing else, we will all be much more tech savvy when we emerge from this mess.

Here are some war stories from us in SMSF land:

The business owners

The jeweller

Terry (not his real name) has closed the doors of his jewellery shop for the first time in 50 years. He has laid off all staff and shut up shop. He's in his early 50s – too young commence a Transition-to-Retirement Income Stream from his super - and estimates that he needs around $200,000 to service debt and push through the next six months (this conversation took place before any Government relief announcements).

Terry has some gold that he has collected through the years that he doesn't want to sell to a third party at this stage and asks if his SMSF can buy it from him.

Unfortunately, the answer for Terry is no. SMSFs are generally prohibited, with some exceptions, from buying assets from related parties to the fund. However, there are exceptions to this general rule, so we talked about those:

- **Listed securities and units in managed funds** can be sold to an SMSF by a member or related party, as long as the fund buys them at market value. Terry personally holds some listed shares that he could sell on market, but he didn't want to as he felt they were companies that would improve when the economy starts recovering. The SMSF can buy the shares from Terry and participate in the market upswing when it eventually happens which benefits him when he retires, and he will have use of the cash.
- **Business real property** – Terry's business owns the shop premises that holds the jewellery shop. He doesn't want to sell it as he hopes to reopen one day, and of course now is not the time to sell commercial property. SMSFs are permitted to buy Business Real Property from related parties, so we talked about the options of the SMSF buying some or all of the premises. This is a complex area and proper advice should be obtained before going down this path.
- **Investment in or a loan to the company**: an investment in, or a loan to, a related party of a fund is called an 'in-house asset'. Funds can acquire and hold in-house assets, but the value allowed is strictly limited to less than 5% of the total assets of the fund. We talked about the possibility of the fund lending an amount to Terry's business to keep it going. Again, this is fraught with conditions and compliance hoops, so proper advice needs to be obtained before going ahead.

Overarching all these ideas, are the strict superannuation laws. Importantly – and this is what may prevent many SMSFs from going ahead with these strategies - whatever Terry's fund decides to do, it must be for the 'sole purpose' of providing benefits for the members in retirement. Any other benefits to the transaction (ie extracting cash for Terry) must be incidental.

For example, if the SMSF buys listed shares from Terry, care needs to be taken that the companies it buys have good prospects for growth or income in the future. The sole purpose test question cannot be compromised.

The tenant

Client question: My SMSF owns real property and wants to give my tenant – being my business – a reduction in rent because of the financial impact of COVID-19. Charging a related party a price that is less than market value is usually a contravention. Given the impacts of COVID-19, will the ATO take action if I do this?

The ATO has advised it will not take action on SMSFs giving a tenant a temporary rent reduction for 2019/2020 or 2020/2021. This gives some flexibility to SMSF trustees and business owners.

However, SMSF trustees must not take that as carte blanch to reduce rent in any circumstances. The fund auditors will still want to see the commerciality of the decision to reduce (or defer or forgive) rent and that the reasons are genuinely:

- a direct consequence of the adverse economic effects of COVID-19
- necessary, and
- temporary.

The self-funded retirees

The halving of the minimum pension drawdown rate was welcome relief for the self-funded retiree cohort. We are getting tricky questions from retirees hoping to sneak money back into their fund:

Q: If I withdrew more than the minimum pension prior to this measure, can I put the excess back?

No – not unless you are eligible to contribute it and then it comes under all the usual contribution rules and caps.

Q: Can I treat previous pension payments that are now over the new minimum as a loan to members so they can repay it into the fund?

No – SMSFs are prohibited from lending to members or providing financial assistance so there would be a breach of the superannuation law.

Q: I've already received my minimum pension as calculated under these new rules. Can I stop the pension?

Yes, that you can do. If you have already received your minimum this financial year (calculated as 50% x the usual percentage factor x account balance on 1 July) you can instruct your super fund to stop paying it.

There are more questions on SMSFs with related-party loans, investment strategy issues, transfer balance caps, but no room to put them all down today.

It's a bewildering time for the world, that's for sure. Most Australians have never before experienced this rate of change to lifestyles, livelihoods and potentially health. As all the pollies keep saying "we are all in this together" which as cliched as it is, is important to remember when many of us will be feeling so disconnected and isolated. All I keep thinking is thank goodness the January fires are out. Imagine if that was still going on with this on top of it.

Keep on swimming, peeps.

Alex Denham is a Senior SMSF Specialist at Heffron SMSF Advisers. This article is general information and does not consider the circumstances of any individual.

Six steps in COVID-19 emergency plans for companies

Foulsham & Geddes

The federal and state governments are taking appropriate steps to mitigate the spread and impact of COVID-19. Further restrictions and stimulus packages are announced almost every day, and this article is based on an understanding of the environment until 24 March 2020.

The impact of these restrictions and rules on businesses and individuals will be severe, with some welcome opportunities.

Duties of directors and steps for business owners over the coming months

Businesses and particularly directors of corporations need to take steps now to deal with these restrictions and should incorporate government policy into their planning. This is important because even though the government has announced a moratorium on personal action against directors for insolvent trading, they may still face some kind of personal liability for their company's debts if they do not act in accordance with their duties under the Corporations Act over the coming months.

Below is a summary of recent announcements by the government. Based on these announcements, we recommend the following actions be taken immediately:

Step 1 – Develop a cash flow plan

Review your cashflow situation:

- Assess the revenue you expect to receive from ordinary business over the next three months, with three different scenarios (best, expected, worst case).
- Consider reducing expenditure which is not critical to the operation of your business.
- Obtain advice about the amount of government stimulus/assistance you may be eligible to receive over the coming months.

- Develop a cash flow forecast which incorporates your superannuation payment obligations, business activity statements, and regular reoccurring expenditure.
- If you operate on an accruals accounting basis, consider writing off bad debts so the business can take advantage of GST credits in the next lodgement.
- Consider the lodgement of BAS on a monthly basis, rather than quarterly.

Step 2 – Navigate HR issues

Review your employment situation:

- Determine if your business falls within the definition of "small business" within the meaning of the Fair Work Act. "Small businesses" are treated differently when it comes to redundancy and unfair dismissal laws. Generally, a business with 15 employees by headcount (including casuals) is a small business.

- Review employment contracts and any relevant Awards applicable to employees to ascertain your responsibilities with regard to stand down, redundancy, change to work arrangements and agreed leave arrangements.

- Consider the needs of your business and the following possibilities relating to employees:

- Working from home
  - Arrangements for taking of leave
  - Possible 'stand down'
  - Redundancy

- Always consult with employees before committing to making changes in the workplace. If it is not a requirement under an Award or the Fair Work Act, it is just good practice.

- Be aware that workplaces in NSW are subject to the Work, Health and Safety Act (and equivalent legislation in other states) and employers have a duty to ensure the safety of employees. Appropriate systems and processes need to be put in place in the event of an employee contracting COVID-19. The NSW government has published materials to assist businesses in this regard (see: https://nsw.gov.au/covid-19/businesses-and-employees).

Step 3 – Consider key areas of risk

Review continuing contracts with suppliers and customers, including leases.

- What obligations are there to your landlord? Watch for updated announcements, especially rent amnesties.

- Do your contracts with suppliers or customers contain a *force majeure* clause that allows termination in the event of a pandemic? If so, what impact does that have on your business? Can you enact such a clause to your benefit?

Step 4 – Finance

Review your financial situation:

- If your business has finance, you should review your loan and security documentation to determine what your obligations to your financier are. For instance:

- Is it a condition of your finance facility that you do not enter into payment arrangements with the ATO or creditors without notifying the bank first?

- Generally, what do your security and loan agreements say about situations where the business is interrupted due to external events beyond your control?

- Ask for assistance from your bank including:

  - Reduction in interest rates and ongoing charges.
  - Deferral of repayments and interest.

Step 5 – Negotiate

Develop a plan to deal with payments to third parties over the coming months:

- Consider discussing your finance facilities with your bank and proposed steps.
- If appropriate, enter into discussions with your landlord regarding payments under your lease.
- Discuss payment arrangements with the ATO, provided that in doing so you are not inadvertently breaching conditions of your finance facility.

Step 6 – Insolvency/winding up

Consider if more drastic steps such as voluntary administration or winding up are more appropriate.

Because of recent government policy concerning actions for debts against companies, at this stage, a company should only consider voluntary administration if it is facing imminent court winding up by creditors. Voluntary administration gives a company the benefit of all court proceedings being suspended for a period of time, so as to allow the company to get its affairs in order and to come to an agreement with creditors. Such an arrangement is usually embodied in a Deed of Company Arrangement (DOCA).

Summary of key areas of government policy

Expansion of 'Safe Harbour' exceptions to insolvent trading?

For the next six months at least, directors of corporations will benefit from reduced personal liability in the case of insolvent trading by a company. Normally, a company will be insolvent if it cannot pay its debts as and when they fall due and directors may be personally liable for debts incurred by an insolvent company. These are the words of the federal Treasurer Josh Frydenberg on 22 March 2020:

"We will also provide relief from directors, from personal liability, where the company is trading while insolvent."

Directors should not assume that they have 0% risk of liability if they do nothing.

Depending on how they are applied, the rules make it clear that in order to obtain the benefit of safe harbour, action that is reasonably likely to lead to a better outcome for the company and its creditors (than the appointment of an administrator or liquidator to the company) must be taken.

Restrictions on enforcement of debts

The federal government has announced that the threshold to initiate insolvency processes against corporations has been increased to $20,000.

This means, for the next six months at least, a creditor cannot issue a statutory demand to a corporation unless the debt is more than $20,000.

If a statutory demand is issued, the debtor will have six (6) months to comply before a creditor can take action for winding up through the Courts.

Cash flow measures for business

The government is providing up to $100,000 to eligible small and medium-sized businesses, and not-for-profits (NFPs) that employ people, with a minimum payment of $20,000.

Small and medium-sized business entities with aggregated annual turnover under $50 million and that employ workers are eligible. NFPs, including charities, with aggregated annual turnover under $50 million and that employ workers will now also be eligible.

Under the enhanced scheme, employers will receive a payment equal to 100 per cent of their salary and wages withheld (up from 50 per cent), with the maximum payment being increased from $25,000 to $50,000. In addition, the minimum payment is being increased from $2,000 to $10,000.

An additional payment is also being introduced in the July – October 2020 period. Eligible entities will receive an additional payment equal to the total of all of the Boosting Cash Flow for Employer payments they have received. This means that eligible entities will receive at least $20,000 up to a total of $100,000 under both payments.

Temporary relief for financially-distressed businesses

The economic impacts of the coronavirus and health measures to prevent its spread could see many otherwise profitable and viable businesses temporarily face financial distress. It is important that these businesses have a safety net to make sure that when the crisis has passed, they can resume normal business operations. One element of that safety net is to lessen the threat of actions that could unnecessarily push them into insolvency and force the winding up of the business.

The government is temporarily increasing the threshold at which creditors can issue a statutory demand on a company and the time companies have to respond to statutory demands they receive. The package also includes temporary relief for directors from any personal liability for trading while insolvent and providing temporary flexibility in the Corporations Act 2001 to provide temporary and targeted relief from provisions of the Act to deal with unforeseen events that arise as a result of the coronavirus health crisis.

The ATO will tailor solutions for owners or directors of business that are currently struggling due to the coronavirus, including temporary reduction of payments or deferrals, or withholding enforcement actions including Director Penalty Notices and wind-ups.

Quick and efficient access to credit for small business

The government is cutting red tape by providing a temporary exemption from responsible lending obligations for lenders providing credit to existing small business customers. This reform will help small businesses get access to credit quickly and efficiently.

Provided by Foulsham & Geddes law firm. This document and its contents are general in nature and do not take into account your personal circumstances and may not be right for you. You should always seek independent legal advice which takes into account your circumstances before taking any steps.

This information is current as at 24 March 2020. Circumstances are changing rapidly and therefore the contents of this document may be out of date.

Volatility is the new normal, so it’s time to adjust your portfolio

Gofran Chowdhury

Markets perform well when the key indicators behind economic growth are strong. But when those foundations are rocked, things can get a bit scary.

And that’s where we are now.

How effective will the stimulus packages be?

Since the start of the year Australia’s economy has been hammered by a series of events, including horrific bushfires, the spread of the COVID-19 virus and a resumption of falling interest rates to try to stimulate a sluggish economy suffering from a lack of consumer spending.

It has led us to reduce this year’s forecast economic growth for Australia from an already sluggish 1.7% to an anaemic 1%. The risk of Australia going into recession is real, despite the massive stimulus packages from the federal government. The third package of $130 billion takes fiscal expenditure to a level never seen before, with this one decision costing more than the total annual health and social security budget.

But we are also at the mercy of global and unpredictable events, sometimes known as ‘VUCA’ (volatility, uncertainty, complexity and ambiguity).

Take interest rates in the US, for example. In December, markets were talking up the expectation for rates to rise. Weeks later the US Federal Reserve cut rates by 0.5%, and following the dramatic realisation of the terrble impact of coronavirus, it was lowered effectively to zero, a range of 0% to 0.25%, on 15 March 2020.

You cannot predict events like COVID-19 or Russia erupting into an oil production war with Saudi Arabia, but your portfolio will have to be prepared for such events.

Investing with VUCA

You also cannot predict how long such events will impact markets. Coronavirus will remain an overwhelming issue for many months, and the impact on government budgets will play out for years. It was the same with the trade wars, something that initially seemed a matter for diplomacy to resolve, but it continued to escalate throughout last year with rising market impacts.

For now, that's yesterday's news as coronavirus and oil shock fears have combined to create fears of global recession.

The shockwaves from those fears have created a series of record market movements, the type of volatility in prices not seen since the peaks of other crashes such as during the GFC and, indeed, the Great Depression. Heavy falls one day are followed by market bounces as investors scramble to take advantage of what were perceive to be low share prices.

The investors selling into the market were panicking, which is never a good time to make investment decisions. But were the people buying making a better decision? Buyers look like heroes one day, then late to the party the next.

Don't try to time the market

Investors deciding how they want their portfolio to perform should not only think about returns. A major consideration is the ability to be able to withstand unexpected impacts. We have seen many examples of market-moving events over the past decade and each has one thing in common – unpredictability, as you can see in the timeline below.

At Citi, from the early part of 2020, we noticed an increase in clients wanting to lock in returns and reduce risk. 'VUCA' is driving a renewed focus on income options such as corporate bonds and tailored investments that can give investors access to equities in a structure that can reduce risk. Even before the full impact of coronavirus was appreciated, investors were moving into instruments that allow individual shares to drop between 30-40% without an impact on their capital and return.

We have also seen a significant increase in foreign exchange transactions as investors shift into US dollars to take advantage of the USD's safe-haven status. We have long been an advocate that a portfolio needs to be diversified not just by asset class but also geographically.

What should you do in these unprecedented times, and in fact, at all times?

- Stress-test your portfolio regularly to understand how it performs during market uncertainty.
- Ask yourself if the income from your investments is sufficient for your needs in a low interest environment over the long term.
- Diversify smartly by combining asset allocation with instruments which can earn a positive return, even if the market drops. For example, Citi offers a tailored investment which pays clients an income of 5% per

annum if the equity market goes up but it also pays a positive return of 5% even if the market drops by less than 25%.

- Consider buying another currency - you buy many products from overseas, should you take the same approach for currency?

Gofran Chowdhury is Head of Investment Specialists at Citi Australia, a sponsor of Firstlinks. This article is general information and does not consider the circumstances of any individual.

For other articles by Citi, see here.