Firstlinks
a Morningstar company

Edition 411, 11 June 2021

Contents

ETFs are the Marvel of listed galaxies, even with star WAR *Graham Hand*

Four leading tech stocks now look cheap *Vikram Barhat*

Why copper prices are at all-time highs *Tal Lomnitzer*

Baby bust: will infertility shape Australia's future? *Emma Davidson*

The Ultimate SMSF EOFY Checklist 2021 *Liam Shorte*

How long will the bad inflation news last? *Tim Congdon*

The 'cosmic' forces leading the US to Modern Monetary Theory *Andrew Macken*

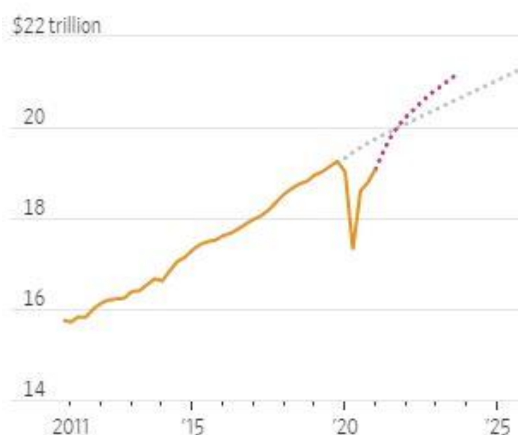
Editorial

Go figure!

Investing 101: When employment rises, the economy is stronger and the stock market rises.
Investing 102: When employment rises, interest rates rise and the stock market falls.
Investing 201: When governments spend, the economy is stronger and inflation rises.
Investing 202: When governments spend, central banks buy the debt and there is no impact on inflation.

Economics (and investing) is more art than science. Analysts can pick whichever scenario suits them. Markets rise because there are more buyers than sellers. Shares are liquid until they aren't. Tight bid/offer spreads evaporate when most needed. Asset prices fall in a pandemic. Unregulated markets are efficient and the best way to allocate resources. Take your pick.

The theories on the ways governments, markets and assets behave have been thrown into more doubt than ever in the last year. The **Wall Street Journal** polled US economists last week on real GDP growth forecasts and the 'snapback' is stronger than anyone thought possible.



Meanwhile, it's so crazy in some segments that a declining company that has not made a profit for two years, **AMC**, trades 750 million shares a day when it only has 500 million on issue, its market value is up from US$500 million to US$30 billion in a few months priced at 200 times revenue (not profit because there isn't any), so what does AMC management do? Raise new capital, of course, advising in bold on the front page of its prospectus:

"We caution you against investing in our Class A common stock, unless you are prepared to incur the risk of losing all or a substantial portion of your investment."

Investing 301: Look back on this moment in a few years.

In Australia, residential property shows no sign of easing as investors compete against owner-occupiers, with the ABS advising:

"The value of new loan commitments for owner-occupier housing reached another all-time high in April 2021, up 4.3% to $23.0 billion. New loan commitments for investors rose 2.1% to $8.1 billion, which was the highest level since mid-2017."

Over $30 billion of new loan commitments in one month! And in the history of Australian banking, it has never been easier to raise funding, with deposits pouring in despite no real returns, and the RBA's Term Funding Facility (which provides the banks with three-year money at 0.1%) was drawn by an additional $7.6 billion last week, taking outstandings to $127 billion. There is still $73 billion available until 30 June. Anyone for a home loan?

In this week's articles ...

We look at the long-running war between **ETFs** and **LICs/LITs** to find a clear winner, in the same way the biggest two movie franchises in the world, **Star Wars** and **Marvel**, are on different growth paths. The launch of the first new LICs since 2019 do not indicate a general revival for the structure.

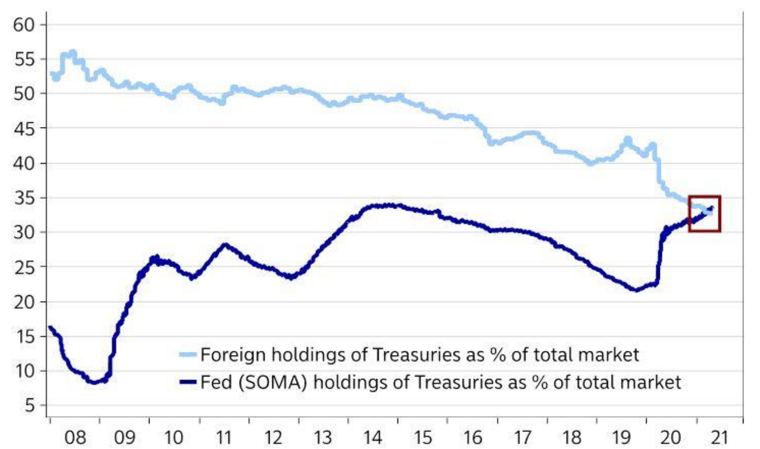
Accessing **Morningstar**'s global analysts, **Vikram Barhat** reports on attractive value in the biggest tech companies in the world, offering investors an entry point for the winners that blitzed the pandemic economy.

Then **Tal Lomnitzer** explains why copper has an electronic future that has driven prices to all-time highs. This may be a traditional metal but there is nothing traditional about the ways it is driving technology.

As we are well into June, financial adviser and SMSF specialist **Liam Shorte** updates his annual definitive list of items to check for the EOFY. It takes a bit of effort to plough through the detail but the rules and regulations are always changing.

Emma Davidson backs up statements made last week by **Jeremy Grantham** about toxicity and declining birth rates, drawing out implications for retirees and economic growth. Where are the young workers who will pay the taxes to support our pensions and health systems in decades to come?

Maybe we no longer need to worry about deficits as governments continue to spend more than their revenues and central banks buy more bonds. It's finally reached the point where the US central bank now owns more US Treasury bonds than all foreigners. It should not be good for the reserve currency of the world when the Fed crowds out countries like China and Japan which hold their reserves in US bonds.



Two articles focus on this world where anything seems possible with government spending. **Professor Tim Congdon** explains the consequences of rising money supply on inflation (remember when we used to worry about that?). Then back on cosmic forces, **Andrew Macken** says the rules on who can vote in the US Senate will determine whether **Joe Biden** and the Fed plunge fully into Modern Monetary Theory. Both are easy-to-read summaries of vital subjects.

This week's White Paper from **Neuberger Berman** focusses on the transition to net-zero emissions and implications for companies, especially timely as Prime Minister **Scott Morrison** heads off to G7 to discuss Australia's policies.

ETFs are the Marvel of listed galaxies, even with star WAR

Graham Hand

The first Star Wars movie was released in 1977 to instant success, and '*A New Hope*' became the highest-grossing movie of all time due to its revolutionary visual effects. Star Wars soon established itself as a lucrative movie franchise for George Lucas, and he sold LucasFilm to Disney for US$4 billion in 2012. The Star Wars franchise now includes 12 movies with the most recent released in 2019.

For most of the 44 years since the start, Star Wars was the world's biggest movie franchise, but it has been overwhelmed in recent years by the Marvel comic characters, or Marvel Cinematic Universe. With 23 movies including the record-breaking *Avengers: Endgame*, Marvel is now undoubtedly the most lucrative movie franchise ever, with Avengers movies catching up with Star Wars after only four movies.

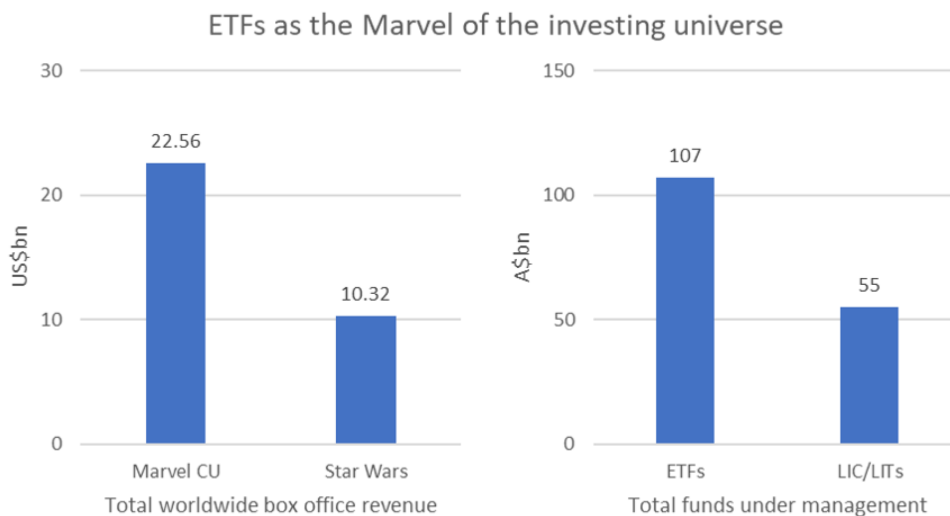
Marvel is to ETFs as Star Wars is to LICs

It's a similar battle between two types of listed vehicles: the Star Wars equivalent are the LICs and LITs (Listed Investments Companies and Listed Investment trusts) and for Marvel, it is Exchange-Traded Funds (ETFs). ETFs have come from a long way behind to usurp LICs as the dominant listed fund vehicles and their lead will increase from here.

LICs started first by a long way. Our early heroes commenced when Whitefield (WHF) was established in 1923. Australia's largest LIC, AFIC (AFI), began in 1928 and changed to its current name in 1938. LICs were well on their way in a galaxy far away before Jack Bogle of Vanguard had any inkling about index funds.

The first ETFs listed in the US were SPDRs in 1993, benchmarked to the S&P500. ETFs did not make their way onto the Australian exchange until 2001 with S&P/ASX200 and S&P/ASX50 funds. LICs therefore had a start of about 70 years but the ETF empire struck back.

Total outstandings of ETFs are now $107 billion while LICs/LITs are about $55 billion. ETFs have grown rapidly to 221 issues while LICs are at 101. The proportional amounts are now the same as Star Wars and Marvel, with one around double the other.

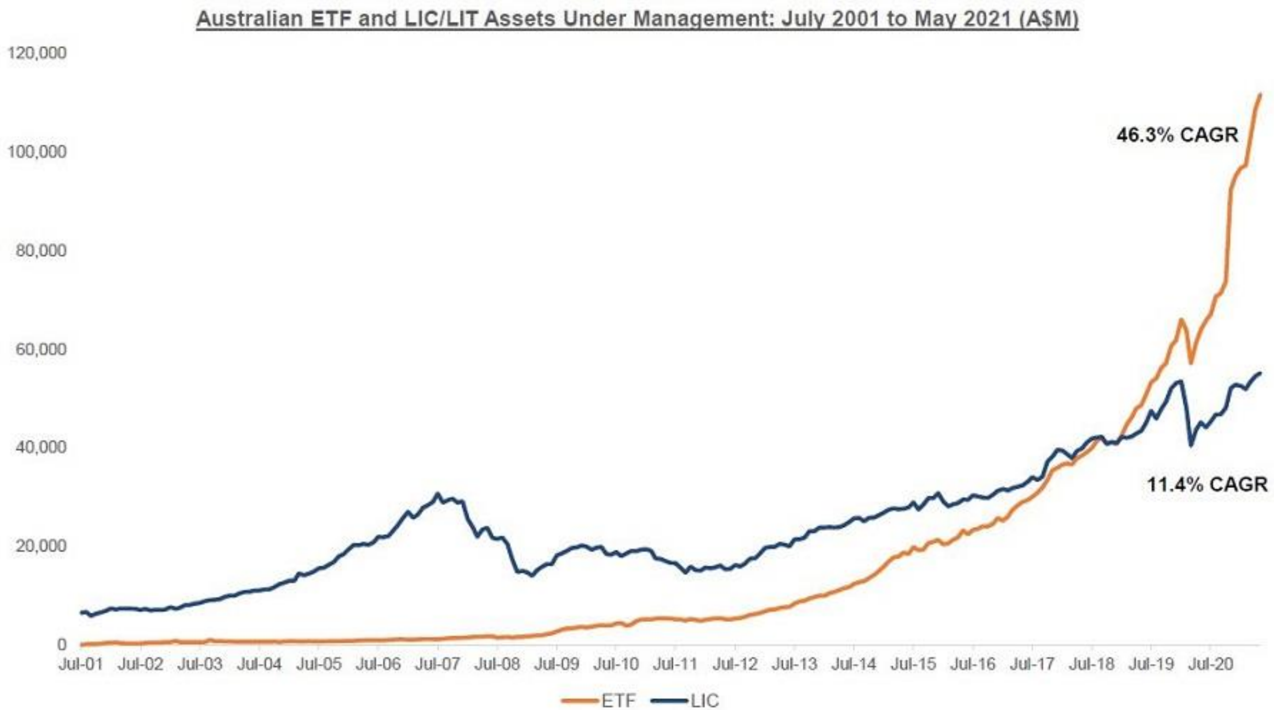


Sources: Statistica, ASX

A long time for Marvel and ETFs to become established

The Marvel movies were not significant successes until Disney acquired Marvel Entertainment in 2009. Marvel now reigns with a range of superheroes including Iron Man, Spider Man, Captain America, Thor, Black Panther, Ant Man and the Incredible Hulk.

ETFs also had a slow start from that first transaction in 2001, making little progress by the time the GFC came in 2008. LICs flourished while they had the support of financial advisers and handsome stamping fees paid by issuers. It was not until the end of 2018 that ETFs finally took over LICs, as shown below. ETFs have since become the avengers, sweeping LICs aside with the inclusion of a wide range of indexes, sectors and niche products, and a big boost from the Magellan active funds.



CAGR: Compound Annual Growth Rate. Source: ASX, Chi-X, BetaShares.

The LIC number disguises the fact that there have been no new transactions since 2019 and the growth is overwhelmingly due to stock markets rising to all-time highs. In fact, in the 12 months between April 2020 and March 2021, the number of LICs/LITs fell from 111 to 102 while the number of ETFs rose from 212 to 220.

There are many reasons why ETFs dominate:

1. The rise of passive, low-cost index ETFs.
2. The broad acceptance of ETFs among advisers and investors after a decade of intense education by the likes of Vanguard, BetaShares, VanEck and iShares.
3. The removal of the ability of LICs to pay stamping fees to brokers and advisers to push their products to their clients.
4. The relatively poor investment experience of many LIC and LIT investors where issues traded at large discounts to the value of the underlying assets (Net Tangible Assets or NTA) whereas ETFs trade much closer to NTA.
5. The development of Active ETFs, stealing the active management space once the domain of LICs.

The next generation of major investors is on the journey too. Rather than flocking to the Millennium Falcon, Millennials are flocking to ETFs.

It’s as if Chewy jumped to Marvel as some LICs switch

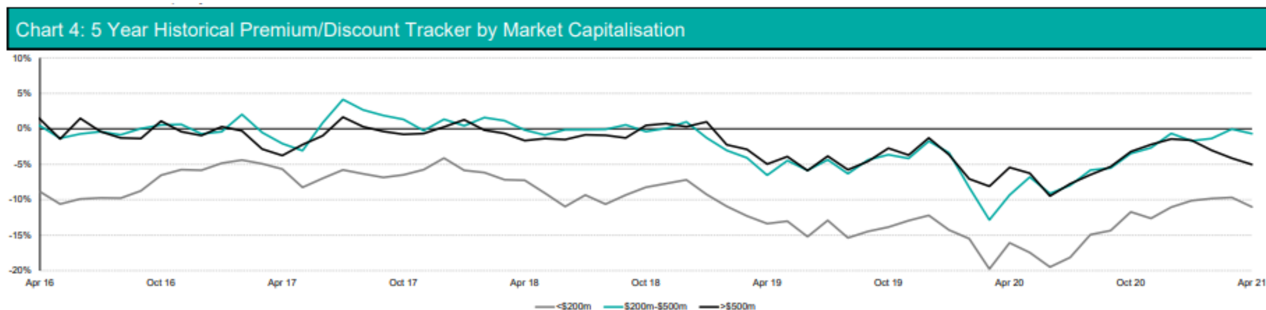
The problems with LICs and LITs trading at a discount became so acute that some managers have switched their LICs into either unlisted funds or Active ETF structures.

It’s as if Star Wars’ Chewbacca jumped out of Han Solo’s ship to become a Marvel character.

For example, two prominent LICs that gave up managing the discount to NTA discontent are Monash and Ellerston. On 10 May 2021, Monash’s MA1 shareholders voted to change the structure from a LIC to an Exchange Traded Managed Fund (ETMF). They will use a technique pioneered by Magellan with a dual registry structure which allows investors to buy and sell both on- and off-market.

Similarly, Ellerston Global Investments managed by well-known fund manager Ashok Jacob gave up its LIC structure in late 2019 and converted to an unlisted fund, immediately removing its material discount which Jacob had struggled with for years.

The following chart from Bell Potter shows historical premiums and discounts for LICs and LITs by market capitalisation. All segments have materially improved since the depths of COVID in April 2020 but the general discount to NTA problem continues, especially for small funds.



Source: IRESS, Company Data, Bell Potter Estimates

"I am your father" – but the new star WAR is not a LIC comeback

The father of LICs in Australia is Geoff Wilson of Wilson Asset Management (WAM), formed in 1997, well before any ETFs were listed in Australia. His own franchise of eight LICs includes a variety of sectors such as global, small cap, alternatives and large caps. Wilson's business has thrived in the closed-end structure of LICs in a way none of the newer fund managers have come close to replicating.

If WAM were a movie, with its $4 billion in funds under management equivalent to gross takings at the box office, it would be in the same league as Jurassic Park and Lord of the Rings.

Wilson dominates public discourse on LICs although the largest LICs are the older structures such as AFIC (AFI, $9.2 billion) and Argo (ARG, $6.4 billion). He is currently in the market with the first new LIC since 2019 with WAM Strategic Value, which appropriately will trade on the exchange under the code WAR. WAR will target underperforming LICs which are trading at a discount to their NTA. Wilson talks of 'buying $1 for 80 cents' and there is no doubt he will raise his initial target of $225 million. Watch for acceptance of 'oversubscriptions'.

But Wilson going to WAR is not a LIC resurgence to threaten the recent dominance of ETFs. Wilson is a unique beast in the LIC universe, as unlike other new LICs, he does not need stockbrokers or financial advisers to sell his funds.

WAM has nurtured a direct retail buyer base with its weekly newsletter now sent to over 50,000 subscribers. It can sell new issues, including regular share purchase plans, readily without the assistance of brokers. Such is Wilson's following that most of his LICs trade at premiums, and he has successfully taken over other LICs and removed most if not all their discounts. Recent examples include Perennial Value's Wealth Defender (which did little to defend wealth) and the alternatives portfolio of Blue Sky. WAR does not signal new demand for LICs, but it is a continuation of successful strategies at WAM.

There is irony in Wilson benefitting from LICs struggling at a discount when he is the biggest promoter of the LIC structure.

Wilson has also nurtured a profile as a retail investor's friend. He was at the forefront of the campaign against the evil empire, the Labor Party, and its proposal to deny refunds of franking credits at the last election.

Another smaller LIC is coming from Salter Brothers Capital, an emerging companies issue for about $20 million. Salter specialises in unlisted assets including property, for which there is not a liquid market, and smaller companies, so it is suited to the permanent capital of a LIC. However, a $20 million transaction is more of a bit-part in a movie and hardly signs of a new franchise.

Prior to these two transactions, the previous LIC was in November 2019 with VGI's VGI Partners Asian Investments Limited (VG8) and the KKR Credit Income Fund (KKC). KKC took a hammering in March 2020 and traded at less than 50% of its issue price, and VGI is facing considerable pressure from shareholder activists to convert to unlisted funds to remove persistent discounts, including on its larger flagship, VGI Partners Global

Investments (VG1). VGI has responded by bringing in a new CEO, increasing its marketing activity, rolling out share buybacks and targeting a 4% annual dividend yield.

The (New) Empire Strikes Back

Star Wars has millions of fans who adore the movies and know the stories intimately. Similarly, many of the long-term LICs such as AFIC, Argo, Milton (MLT, $3.3 billion) and Djerriwarth (DJW, $660 million) have traded tightly around NTA during their long histories and delivered strong and growing dividends. The charitable Hearts and Minds (HM1, $891 million) is likewise well-supported. Some assets are well-suited to closed-end structures where the underlying assets are less liquid, such as corporate loans (for example, Metrics, MXT, $1.5 billion), non-investment grade credit (for example, Neuberger Berman, NBI, $832 million) and private equity (for example, Bailador, BTI, $192 million).

But outside of institutional placements, share purchase plans and the special case of WAM, new issuers will struggle to find a market when so many quality LIC managers cannot hold their transactions at NTA. A genuine resurgence of new LICs looks some way off.

Meanwhile, the Marvel characters and ETFs roll on, and in the 12 months to April 2021, the following new flows were generated into ETFs:

- Global equity, $12,026 million
- Domestic equity, $6,529 million
- Domestic fixed interest, $3,224 million
- Commodities, $812 million
- Global fixed interest, $730 million.

That's $20 billion not including market rises. Luke Skywalker, Han Solo and Princess Leia may come flying across the limitless horizon but Iron Man and his fellow heroes are ready for them.

Graham Hand is Managing Editor of Firstlinks. This article is general information and does not consider the circumstances of any investor.

Four leading tech stocks now look cheap

Vikram Barhat

The recent drop in technology stocks has created some rare buying opportunities for investors looking to add or expand exposure to the technology sector. However, given the level of economic uncertainty and jitters over higher inflation and rising interest rates, investors should be careful in their stock selection. Luckily, the relative underperformance so far this year of the tech sector compared to the benchmark may make things easier.

The Morningstar U.S. Technology index (just under 6%, expressed in U.S. dollars) is currently underperforming the S&P 500 (over 11%) for the year to date, as of May 27, 2021. However, the tech sector has handily topped the broader index over the one-, three- and five-year periods.

These tech heavyweights in Morningstar's coverage universe are trading at double-digit discounts to their fair values, indicating potential for upside. The sizeable margin of safety and strong fundamentals make these names compelling prospects for economic reopening and advertising growth play.

Microsoft Corp (MSFT)

- Price: US$250.16
- Forward P/E: 30.21
- Fair Value: US$278
- Moat: Wide
- Star rating: ****

Data as of May 27, 2021

Tech major Microsoft (MSFT) is the second most valuable company by market cap, behind Apple. Best known for its Windows operating system and Office productivity suite, the company develops and licenses consumer and enterprise software. The firm's business comprises three segments: productivity and business processes, intelligence cloud, and personal computing.

Under CEO Satya Nadella, Microsoft has reinvented itself into a cloud leader. Additionally, the company has accelerated the transition from a traditional perpetual license model to a subscription model, while divesting from low-growth

low-margin business. "These factors have combined to drive a more focused company that offers impressive revenue growth with high and expanding margins," says a Morningstar equity report.

The tech heavyweight's cloud service platform Azure has grown to become the crown jewel of the company. "Azure is an excellent launching point for secular trends in AI, business intelligence and Internet of Things, as it continues to launch new services centred around these broad themes," asserts Morningstar equity analyst, Preston Caldwell, who puts the stock's fair value at US$278.

Microsoft is also moving some of its traditional on-premises products to cloud, including such critical applications as LinkedIn, Office 365, and Dynamics 365.

Alphabet Inc (GOOG)

- Price: US$2,428
- Forward P/E: 31.75
- Fair Value: US$2,925
- Moat: Wide
- Star rating: ****

Data as of May 27, 2021

Silicon Valley giant Alphabet (GOOG) is best known for its search engine Google, which generates 99% of its revenue. The company's other revenue streams include sales of apps (Google Play), video streaming business (YouTube) and hardware (Chromebooks and the Pixel smartphone).

Wide-moat Alphabet recently saw a 2% decline triggered by fears of rising rates and a slowdown in digital ad spending growth. These fears are disputable and while rising rates should pressure multiples, Alphabet has "already been trading at what we view as unwarranted discount compared with peers," says a Morningstar equity report.

As for the ad revenue declaration in the second half of 2021, the report assures it would be a short-term effect resulting from the pandemic. "We expect digital ad revenue growth will remain at strong double-digit rates for both firms [Alphabet and Facebook] for several years," says Morningstar equity analyst, Ali Mogharabi, who pegs the stock's fair value at US$2,925.

Alphabet boasts sustainable competitive advantages built on the company's significant intangible assets including technological expertise in search algorithms and machine learning, as well as access to and accumulation of data that is deemed valuable to advertisers.

Facebook Inc (FB)

- Price: US$331.03
- Forward P/E: 27.40
- Fair Value: US$390
- Moat: Wide
- Star rating: ****

Data as of May 27, 2021

World's largest social network with 2.5 billion monthly active users, Facebook (FB) provides a platform for users to exchange messages and share news events, photos, and videos. Advertising revenue represents more than 90% of the firm's total revenue, with 50% coming from the U.S. and Canada and 25% from Europe.

Facebook's sticky ecosystem comprises the Facebook app, Instagram, Messenger, WhatsApp, and many features surrounding these products, which helps the company amass valuable user data. "The growth in users and user engagement, along with the valuable data that they generate, makes Facebook attractive to advertisers in the short and long term," says a Morningstar equity report.

While Facebook has been facing fierce political pressure over its handling of data, "advertisers will continue to allocate a higher percentage of their ad budgets" toward Facebook due to the platform's colossal user base, says Mogharabi, who estimates the stock's fair value to be US$390. He remains confident that the wide-moat firm will benefit significantly from the economic recovery as ad spending perks up.

Tencent Holdings (TCEHY)

- Price: US$78.35
- Forward P/E: 33.90
- Fair Value: US$103
- Moat: Wide
- Star rating: ****

Data as of May 27, 2021

Chinese internet heavyweight Tencent (TCEHY) offers a wide variety of internet services and contents. The firm's main services include communication and social networking, online PC and mobile games, content (news, videos, music), cloud services, and financial technology.

Tencent's social media app WeChat (locally known as Weixin) has 1.2 billion aggregate monthly active user base while its instant-messaging software QQ has 600 million users.

The wide-moat company has been investing in areas with strong competitive advantages including cloud, business services, enterprise software, and high production value games targeting the global market. "The trend for enterprises to digitalize, especially in light of COVID-19, and the proven business model of cloud in the West has established the need to invest in business services," says a Morningstar equity report.

As well, the Chinese tech juggernaut's short-form video strategy has improved to include both the long- and short-form video platforms.

Tencent is particularly ambitions to expand its dominance in the global gaming industry. "It leverages globally popular console and PC gaming IPs of its investees or popular anime IPs and develops mobile games for the international market," notes Morningstar equity analyst, Chelsey Tam, who appraises the stock to be worth US$103.

Vikram Barhat is a Toronto-based financial writer. This article does not consider the circumstances of any investor and you should consider financial advice to check whether these stocks are suitable for your portfolio.

Why copper prices are at all-time highs

Tal Lomnitzer

Copper has played a vital role in civilisation since its discovery in the Neolithic era nearly 10,000 years ago. More than many other commodities, copper represents progress, and when it is in demand, it means industries and economies are moving forward.

Often known as Dr Copper for the uncanny way its price anticipates future economic activity, at the time of writing, copper prices hit all-time highs of $US10,460 per tonne (US$4.76/lb). Coming up from 3-year lows in the midst of the COVID-19 induced recession in 2020, current prices reflect a strong rebound as the global economy switches back on. But are these prices merely a post-COVID phenomenon or is there more to it? This article discusses the forces at play and strategies to benefit from the electric metal's strength.

What is pushing prices higher?

There are a few forces at play that are affecting the price of copper, but for ease of explanation a simple way to group them is into supply and demand factors.

Supply factors:

- **COVID-19 dislocation:** As we are well-aware, the COVID-19 pandemic resulted in widespread lockdowns leading to a drop off in global copper supply at all points in the supply chain. As the COVID-19 crisis eases (in some areas), supply chains are able to return to their normal pre-pandemic operating levels.

- **Lack of new discovery:** According to S&P, of the approximately 1 billion tonnes of copper resources discovered since 1990, only 8% has been discovered in the past decade. This is despite exploration spend between 2009-2019 seeing a 68% increase on the prior decade. Given it can take 20 years for production to commence following discovery, this represents a long-term supply-side issue.

- **Diminishing ore quality:** Copper ore is finite in supply and its quality has declined, which means more rock needs to be mined and processed in order to extract the same amount of copper. In Chile, the world's largest copper producer, average copper ore grades have deteriorated by 30% since 2005. Even with reductions in ore quality, miners can't perpetually ramp up production, there is a limit to annual production and how much copper remains to be mined.

- **Scrap supplies:** While scrap metal supplies of copper are a viable and important source of supply, scrap historically takes time to respond to market dynamics, and considering COVID-19 related logistical constraints, deficits are expected in the near-term, further strengthening copper prices.

Demand factors:

- **Post COVID-19 activity and fiscal stimulus:** The return to 'normal' activity, as well as making up for lost time through the COVID-19 lockdowns are a strong but shorter-term impact. Against the backdrop of

mega trends such as mass urbanisation, demand for copper for use in building construction is one of the largest markets (e.g. water pipes, electric wiring) and while COVID lockdowns can slow a trend, they can't stop it completely. Government fiscal stimulus is resulting in increased economic activity and thus demand for copper.

- **Clean energy transition:** The US climate summit saw declarations by a number of nations to net zero emissions targets and the US re-signing the Paris Agreement. Crucially China's President Xi also pledged to cut coal consumption starting from 2026 and reiterated the country's 2060 carbon neutrality target. Two of the world's largest economies reminded us that they are aligned in their pursuit of lower carbon emissions and promotion of renewable energy. Without copper there can be no decarbonisation meaning demand for copper where it relates to clean energy is set to grow strongly in the years ahead. According to the International Energy Agency, it is estimated that around 45% of demand for copper will come from clean energy technologies in 2040, up from just 24% in 2020. Total demand for copper by clean energy technologies is estimated to see a three-fold increase by 2040, requiring investment in the near-term and production to ramp up drastically to meet demand. Against some of the supply factors mentioned above, this will likely put pressure on copper prices.

Can the price keep going up?

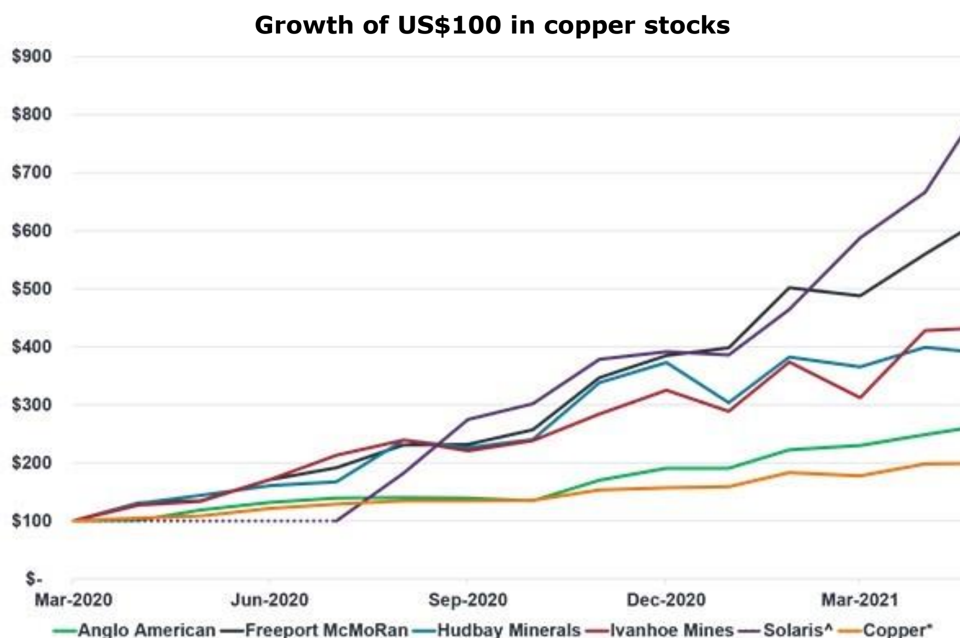
In the near-term the precise degree of inventory reductions will be a key determinant of copper prices. Speculative positioning is rather extended, China may well slow its purchasing given high prices and moderation in consumption growth may moderate causing a price correction.

If scrap supply is able to respond sufficiently to stop major refined inventory drawdowns, the copper price would also suffer. A bull case would see easier than anticipated Chinese policies, Fed yield curve control and European growth surprises, whilst a bear case would see global policy support waning, a growth slowdown and positioning unwinding sharply.

Are the rising copper prices reflected in your copper stocks?

Five copper stocks that we hold are Ivanhoe Mines, Freeport McMoRan, Anglo American, Solaris and Hudbay Minerals (as at 30 April 2021 and holdings are subject to change). In the chart below, we plot the copper price relative to these companies' stock prices as a growth of $100 chart since the COVID crisis in March 2020.

In our view, copper equities are the best investment vehicle for exposure to copper. Historically commodity equities have outperformed their underlying commodities due to their additional growth, value creation potential and an equity risk premium to harvest.



*Source: Bloomberg, Janus Henderson Investors. As at 23 May 2021. *LME Copper 3 Month Rolling Forward. ^Solaris listed in July 2020 and therefore shows no change from March to July 2020. Past performance is not a guide to future performance. References made to individual securities should not constitute or form part of any offer or solicitation to issue, sell, subscribe or purchase the security.*

We see attractive opportunities in copper producers, developers and explorers. While there may be shorter-term volatility in copper and share prices, we are witnessing a long-term trend driven by the decarbonisation of the global economy, while large sources of new supply will be slow, expensive and difficult to bring to the market.

The Anthropocene Epoch is used to describe the current period in Earth's geologic history when human activity has induced a significant impact on the planet. As we reverse this impact through a new green industrial revolution that offers cheap, clean energy, copper is very much part of the solution.

Tal Lomnitzer is a Senior Investment Manager in the Global Natural Resources team at Janus Henderson. This article does not in any way constitute advice or an invitation to invest. It is solely for information purposes and subject to change without notice.

Baby bust: will infertility shape Australia's future?

Emma Davidson

Editor's introduction: At the 2021 Morningstar Investor Conference in Sydney last week, GMO's Jeremy Grantham said that during lockdowns, he had been reading more and thinking about the future. He highlighted the impact of toxic chemicals on the natural world and birth rates as a major change facing us all. Grantham said:

"We have a bee in our bonnet about toxicity, I think pesticides and plastics are doing a job on health and the health of the insect world and the health of the whole natural world, and sperm count has dropped, in my opinion looking at the data, to a third of what it was the day I was born. And that's a hell of a drop. The first 80% of that drops didn't matter as we were over-engineered like a good Victorian bridge. But finally, it's whittling us down to a level where in the last 10 or 15 years it's begun to matter. And we've gone from almost nobody having trouble (conceiving) to about 15%. One in eight young couples having trouble, and it's progressing almost 2% a year. Which is a sinister number because that's about the rate that the insect population is disappearing, and it's showing no sign of slowing down. And that makes me feel that the plastics industry, the chemical industry, pesticide industry are all under potential threats from toxic lawsuits."

In this article, Emma Davidson uses a 1% drop in sperm counts and a 1% rise in miscarriages which would equate roughly to a 2% increase in couples having trouble conceiving, which is Jeremy Grantham's number.

***

Let's talk about the 1%. No, not *that* 1%. Not 'the top 1%' wealthiest people, a phrase popularised by the Occupy Wall Street Movement. I mean a different 1%.

The world is heading for a baby bust, and it has a lot to do with the 1% - the 1% drop in the global total fertility rate (TFR) that's occurred annually between 1960 and 2018.

It's a figure that's likely to have a huge socio-economic impact on Australia in the future, and it's just one of many troubling '1%' fertility stats.

According to *Count Down*, a new book by award-winning reproductive epidemiologist Shanna Swan, there has been a "1% effect" across a whole spectrum of fertility issues in Western countries.

Each year, we're seeing a 1 percentage point:

- Drop in sperm counts;
- Decrease in testosterone levels;
- Increase in testicular cancers; and
- Rise in miscarriages.

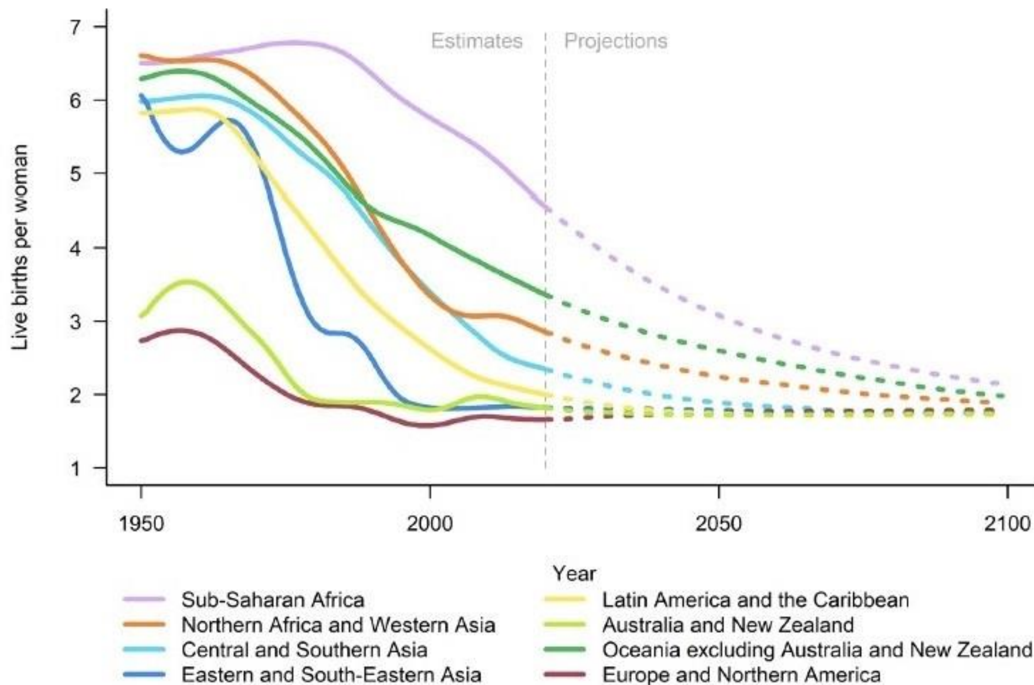
All these trends are seriously affecting our ability to reproduce, and the most worrying thing is that some show no signs of levelling off. For example, sperm counts have dropped 50% over the last 40 years, and the rate of decline isn't slowing down.

It's not just men with fertility struggles; aspiring mothers face their own struggles. One Danish study found that the average twentysomething woman in the country today will find it harder to fall pregnant than her grandmother did in her mid-30s.

An infertile world?

Swan says if the situation doesn't change, we're on course for a largely infertile world by 2045, with most couples needing to use IVF and other assisted reproduction techniques to have children.

As we can see from the graph below, the TFR is predicted to continue dropping across multiple regions over the coming decades.



From World Fertility and Family Planning 2020 by UN Department of Economic and Social Affairs, ©2020 United Nations. Reprinted with the permission of the United Nations.

This isn't a problem that's far off in the distance. I'm a mother to two young children, and they'll still be in their 20s when the world becomes largely infertile - assuming Swan's timelines are accurate.

That's a terrifying thought for me and, I'm sure, for many other parents and grandparents. Not least because infertility can have severe mental health repercussions for both men and women.

What's causing these infertility issues? Well, we don't exactly know. Birth rates are obviously affected by social trends, such as people choosing to have kids later in life - or not at all. But this is unlikely to be causing lower sperm counts or falling testosterone levels!

Swan believes endocrine disruption is the main culprit. Essentially, environmental toxins are wreaking havoc on our body's hormonal systems (and reproductive capabilities). Chemicals in plastics, pesticides, cosmetics and even food have been shown to cause endocrine disruption.

Now, Swan recently admitted it's "speculative to extrapolate" on current infertility trends, but the research is persuasive. And Australia hasn't escaped the fertility crisis.

In 1961, Australian women had 3.5 children on average. By 2018, this figure stood at just 1.7.

Along with many other countries, Australia has fallen below the replacement fertility rate of 2.1. In other words, not enough babies are being born to replace the number of people who are dying, leading to a declining population.

This is already happening. Australia's population shrunk for the first time since World War 1 in the third quarter of 2020.

It would be disingenuous for me to suggest that's entirely because of fertility issues, of course. Border closures due to Covid-19 have significantly restricted immigration levels, a major driver of Australia's population growth.

On the other hand, perhaps this merely emphasises how immigration figures have been concealing the country's steadily declining birth rate, until now.

Why does this matter?

Last year, Stanford University Economics Professor Charles Jones modelled some of the possible outcomes of population decline in his ominously titled 'The End of Economic Growth?' paper.

The upshot? He predicts that vanishing populations will lead to less innovation, minimal economic growth and a stagnation in living standards at a global scale. This paints a pretty bleak picture.

Admittedly, the true economic impact of declining populations is difficult to forecast accurately. One aspect of this seems to be clear, however, there will be a dramatic shift in national demographics over the coming decades if current trends continue. Put simply, there will be a far greater number of retirees than working-age people.

Covid-19 has accelerated these demographic trends, with the Australian economy estimated to be 5% smaller - permanently - than pre-Covid forecasts due to a population slump of approximately 4%. That is the equivalent of 1 million Australians.

Demographer Bernard Salt recently wrote an article on the topic of Australia's baby bust, in which he explained how the transitioning of the baby boomer generation into retirement is coinciding with the fallout of the pandemic.

Salt predicts this may cause problems for politicians, business leaders and bureaucrats, as they will face a more vocal, energetic, and active population of retirees.

It will also be the first time in Australia (and other countries) that such a large group of older people will need to be supported by a far smaller cohort of workers.

Working together

That the trends Mr Salt identifies are occurring against a backdrop of plunging fertility rates should give us even more cause for alarm. According to Dr Swan, the current trend of declining sperm counts could leave half of the Western male population impotent by 2045. That prospect is terrifying on its own before we consider these additional structural headwinds.

Thus, like Mr Salt, I agree there are challenges ahead for Australia in a world where the ratio of workers to retirees will become heavily skewed in favour of the latter.

However, I also believe there are a lot of reasons to be optimistic.

First, we have excellent healthcare and superannuation systems, which should offset a lot of the pressure that most ageing nations face.

Second, I don't think more people holding off retirement is a bad thing. In fact, I think it is possibly a solution. We should actively be encouraging over-65s to remain in the workforce.

Retiring in your mid-60s may have made sense in decades past, when people weren't expected to live a long and healthy life post-employment, but this clearly isn't the case today. Men aged 65 between 2016-18 will live another 20 years on average, while women of the same age could expect to live another 22 years.

The skills, experience, and mentorship abilities this generation possesses is invaluable to businesses. After all, we are going to need every bit of expertise at our disposal to continue driving innovation forward in the future.

As for solving the fertility crisis, that is a bit beyond my expertise! However, it will likely require co-ordinated efforts at the national level. If chemicals are to blame, finding safer substitutes (and introducing new regulations) could be a part of the solution. If its obesity and diet, then that will need to be the focus.

And if you want to make personal changes that boost your reproductive health, Swan has some tips: eat a Mediterranean diet (certified organic if possible), keep active, reduce your stress levels, and lower the chemical footprint in your home.

That is probably good advice for everyone, not just prospective parents.

Emma Davidson is Head of Corporate Affairs at London-based Staude Capital, manager of the Global Value Fund (ASX:GVF). This article is the opinion of the writer and does not consider the circumstances of any individual.

The Ultimate SMSF EOFY Checklist 2021

Liam Shorte

Here we are with a few weeks left to the end of the financial year to put our SMSF or other super funds in order and ensure we are making the most of the strategies available to us.

Here is a checklist of the most important issues that you should address with your advisers before the year-end.

Warning before we begin

In the rush to take advantage of new strategies, don't forget how good you may have it already. Be careful not to allow your accountant, administrator or financial planner to reset any pension that has been grandfathered under the pension deeming rules that came in on 1 January 2015 without updated advice on the future consequences of losing the grandfathering. Point them to this document.

1. It's all about timing

If you are making a contribution, the funds must hit the super fund's bank account by the close of business on 30 June. Some clearing houses hold on to money before presenting them to the super fund.

In addition, pension payments must leave the account by the close of business unless paid by cheque in which case the cheques must be presented within a few days of the EOFY. There must have been sufficient funds in the bank account to support the payment of the cheques on 30 June.

Get your payments in by Friday 25 June or earlier to be sure (yes I’m Irish).

2. Review your Concessional Contributions (CC) options and new rules

The government changed the contribution rules from 1 July 2020 to extend the ability to make contributions from age 65 up to age 67. Read more here. Maximise contributions up to CC cap of $25,000 but do not exceed your limit. Note that the CC cap will increase to $27,500 from 1 July 2021.

The sting has been taken out of excess contributions tax but you don’t need additional paperwork to sort out the problem. Check employer contributions on normal pay and bonuses, salary sacrifice and premiums for insurance in super as they may all be included in the limit.

3. Consider using the ‘carry forward’ CC cap

Broadly, the carry forward rule allows individuals to make additional CC in a financial year by utilising unused CC cap amounts from up to five previous financial years. Eligibility requires a total superannuation balance just before the start of that financial year of less than $500,000 (across all your super accounts).

This measure applies from 2018-19 so effectively, this means an individual can make up to $75,000 of CC in a single financial year by utilising unapplied unused CC caps since 1 July 2018.

4. Review plans for Non-Concessional Contributions (NCC) options

From 1 July 2020, the new age limit of 67 applies to NCCs (that is, from after-tax money) without meeting the work test (increasing to age 74 from 1 July 2022). You have the option of making $100,000 NCCs per year up to 67 (or 74 from 1 July 2022). Check out ATO superannuation contribution guidance.

Unfortunately, Parliament is yet to pass the long-delayed legislation allowing use of the 'three-year bring forward rule' up to age 67.

- **Current** option if turned 65 in 2020-21: NCC of $100,000 or $300,000.
- **Proposed** option: NCC $100,000 2020-21, NCC $100,000 2021-22, NCC $300,000 2022-23.

NCCs are an opportunity to move investments into super and out of a personal, company or trust names.

Even up spouse balances and maximise super in pension phase up to age 74. Couples where one spouse has exhausted their transfer balance cap and has excess amounts in accumulation are able to withdraw and recontribute to the other spouse who has transfer balance cap space available to commence a retirement phase income stream. This can increase the tax efficiency of the couple’s retirement assets as more of their savings are in the tax-free pension phase environment.

Make your tax components more tax free by using recontribution strategies. SMSF members can cash out their existing super and re-contribute (subject to their contribution caps) them back in to the fund to help reduce tax payable from any super death benefits left to non-tax dependants. They can now do this until they turn age 75 and 28 days.

5. Downsizer contributions

If you have sold your home in the last year and you are over 65, consider eligibility for downsizer contributions of up to $300,000 for each member.

From 1 July 2022, the eligibility age to make downsizer contributions into superannuation will be reduced from 65 to 60 years of age. All other eligibility criteria remain unchanged, allowing individuals to make a one-off, post-tax contribution to their superannuation of up to $300,000 per person from the proceeds of selling their home. These contributions will continue not to count towards non-concessional contribution caps.

The $300,000 downsizer limit (or $600,000 for a couple) and the $330,000 bring forward NCC cap allow up to $630,000 in one year contributions for a single person and $1,260,000 for a couple subject to their contributions caps.

6. Calculate co-contributions

Check your eligibility for the co-contribution, it's a good way to boost your super. The amounts differ based on your income and personal super contributions, so use the super co-contribution calculator.

7. Examine spouse contributions

If your spouse has assessable income plus reportable fringe benefits totalling less than $37,000 for the full $540 tax offset or up to $40,000 for a partial offset, then consider making a spouse contribution. Check out the ATO guidance here.

From 1 July 2022 you may also be able to implement this strategy up to age 75 as a Spouse Contribution is treated as a NCC in their account (and therefore counted towards your spouse's NCC cap).

8. Give notice of intent to claim a deduction for contributions

If you are planning to claim a tax deduction for personal concessional contributions, you must have a valid ‘notice of intent to claim or vary a deduction’ (NAT 71121).

A notice must be made before you commence the pension. Many people like to start pension in June and avoid having to take a minimum pension in that financial year but make sure you have claimed your tax deduction first. The same notice requirement applies if you plan to take a lump sum withdrawal from your fund.

9. Consider contributions splitting to your spouse

Consider splitting contributions with your spouse, especially if:

- your family has one main income earner with a substantially higher balance or
- if there is an age difference where you can get funds into pension phase earlier or
- if you can improve your eligibility for concession cards or age pension by retaining funds in superannuation in the younger spouse’s name.

This is a simple no-cost strategy I recommend for everyone here. Remember, any spouse contribution is counted towards your spouse's NCC cap.

10. Act early on off-market share transfers

If you want to move any personal shareholdings into super (as a contribution) you should act early. The contract is only valid once the broker receives a fully valid transfer form so timing in June is critical. There are likely to be brokerage costs involved.

11. Review options on pension payments

The government has extended the Temporary Reduction in Minimum Pensions as part of the COVID-19 response. Ensure you take the new minimum pension of at least 50% of your age-based rate below. If a pension member has already taken pension payments of equal to or greater than the 50% reduced minimum amount, they are not required to take any further pension payments before 30 June 2021. For transition to retirement pensions, ensure you have not taken more than 10% of your opening account balance this financial year.

Minimum annual payments for pensions for 2020/21 and 2021/22 financial years.

Age at 1 July	***Standard minimum % withdrawal***	*50% reduced minimum pension*
Under 65	4%	2%
65–74	5%	2.5%
75–79	6%	3%
80–84	7%	3.5%
85–89	9%	4.5%
90–94	11%	5.5%
95 or older	14%	7%

If a pension member has already taken a minimum pension for the year, they cannot change the payment but they can get organised for 2021/22. So, no, you can't sneak a payment back into the SMSF bank account!

If you still need pension payments for living expenses but have already taken the 50% minimum then it may be a good strategy for amounts above the 50% reduced minimum to be treated as either:

a. a partial lump commutation sum rather than as a pension payment. This would create a debit against the pension members transfer balance account (TBA). Please discuss this with your accountant and adviser asap as some funds will have to report this quarterly and others on an annual basis.

b. for those with both pension and accumulation accounts, take the excess as a lump sum from the accumulation account to preserve as much in tax exempt pension phase as possible.

12. Check your documents on reversionary pensions

A reversionary pension to your spouse will provide them with up to 12 months to get their financial affairs organised before making a final decision on how to manage your death benefit.

You should review your pension documentation and check if you have nominated a reversionary pension in the context of your family situation. This is especially important with blended families and children from previous marriages that may contest your current spouse's rights to your assets. Also consider reversionary pensions for dependent disabled children.

The reversionary pension has become more important with the application of the $1.6 million Transfer Balance Cap (TBC) limit to pension phase.

Tip: If you have opted for a nomination instead then check the existing Binding Death Benefit Nominations (many expire after 3 years) and look to upgrade to a Non-Lapsing Binding Death Benefit Nomination. Check your Deed allows for this first.

13. Review Capital Gains Tax on each investment

Review any capital gains made during the year and over the term you have held the asset and consider disposing of investments with unrealised losses to offset the gains made. If in pension phase, then consider

triggering some capital gains regularly to avoid building up an unrealised gain that may be at risk to legislation changes.

14. Collate records of all asset movements and decisions

Ensure all the fund's activities have been appropriately documented with minutes, and that all copies of all statements and schedules are on file for your accountant, administrator and auditor.

The ATO has now beefed up its requirements for what needs to be detailed in the SMSF Investment Strategy so review your investment strategy and ensure all investments have been made in accordance with it and the SMSF Trust Deed, including insurances for members. See my article on this subject here.

15. Arrange market valuations

Regulations now require assets to be valued at market value each year, including property and collectibles. For more information refer to ATO’s publication Valuation guidelines for SMSFs.

On collectibles, play by the new rules that came into place on 1 July 2016 or remove collectibles from your SMSF.

16. Understand COVID relief on in-house assets

If your fund has any investments in 'in-house assets' you must make sure that at all times the market value of these investments is less than 5% of the value of the fund. Do not take this rule lightly as the current SMSF penalty powers make it easier for the ATO to apply administrative penalties (fines) for smaller misdemeanours ranging from $820 to $10,200 per breach per trustee.

Due to COVID, the ATO will not take action against SMSFs where:

- at 30 June 2021 the market value of an SMSF’s in-house assets is over 5% because of the downturn in the share market
- the trustee of the SMSF prepares a rectification plan
- by 30 June 2022, the rectification plan either cannot be effectively implemented because of market conditions or does not need to be implemented because the market recovers and the 5% test is again satisfied at 30 June 2022.

17. Document COVID-19 rent relief

If you have provided rent relief to a tenant, related or not, ensure it is documented before 30 June including the reasoning behind the trustee decision and the details of the relief provided.

The ATO has provided a non-binding practical approach of not applying resources to this issue for FY2021. However, this announcement while positive, should not be relied on given the considerable downside risks. Auditors will want full documentation.

18. Check the ownership of all investments

Make sure the assets of the fund are held in the name of the trustees (including a corporate trustee) on behalf of the fund. Check carefully any online accounts and ensure all SMSF assets are separate from your other assets.

We recommend a corporate trustee to all clients. This might be a good time to change, as explained in this article on Why SMSFs should have a corporate trustee.

19. Assess estate planning and loss of mental capacity strategies

Review any Binding Death Benefit Nominations (BDBN) to ensure they are valid, and check the wording matches that required by the Trust Deed. Ensure it still accords with your wishes.

Also ensure you have appropriate Enduring Powers of Attorney (EPOA) in place to allow someone to step into your place as trustee in the event of illness, mental incapacity or death.

Check your Trust Deed and the details of the rules. For example, did you know you cannot leave money to stepchildren via a BDBN if their birthparent has pre-deceased you?

20. Review any SMSF loan arrangements

Have you provided special terms (low or no interest rates, capitalisation of interest etc) on a related party loan? Review your loan agreement and see if you need to amend your loan.

Have you made all the payments on your internal or third-party loans, have you looked at options on prepaying interest or fixing the rates while low? Have you made sure all payments in regard to Limited Recourse Borrowing Arrangements (LRBA) for the year were made through the SMSF trustee? If you bought a property using borrowing, has the Holding Trust been stamped by your state's Office of State Revenue.

21. Ensure SuperStream obligations are met

For super funds that receive employer contributions, the ATO is gradually introducing SuperStream, a system whereby super contributions data is made electronically.

All funds should be able to receive contributions electronically and you should obtain an Electronic Service Address (ESA) to receive contribution information.

If you change jobs your new employers may ask SMSF members for their ESA, ABN and bank account details.

22. ASIC fee increases from 1 July 2021

ASIC is increasing fees by $1 for the annual review of a special purpose SMSF trustee company $55 > $56. The Government is moving gradually to a "user pays" model so expect increases to accelerate in future years. For $387 you can pre-pay the company fees for 10 years and lock in current prices with a decent discount. There is a remittance form linked here.

23. Relaxing residency requirements for SMSFs from 1 July 2022

SMSFs and small APRA funds will have relaxed residency requirements through the extension of the central management and control test safe harbour from two to five years. The active member test will also be removed, allowing members who are temporarily absent to continue to contribute to their SMSF. The Government expects this measure will have effect from 1 July 2022.

Tip: Probably useful post-COVID for those working or travelling to stay with family or get away from them for extended periods overseas.

24. Legacy retirement product conversions (probably from 1 July 2022)

Individuals will be able to exit a specified range of legacy retirement products, together with any associated reserves over a two-year period. The specified range of legacy retirement products includes market-linked, life expectancy and lifetime products, but not flexi-pension products or a lifetime product in a large APRA-regulated or public sector defined benefit scheme.

Currently, these products can only be converted into another like product and limits apply to the allocation of any associated reserves without counting towards an individual's contribution cap.

There is considerable additional detail in this feature so consult an adviser if you are affected, especially to ensure you do not lose other entitlements such as the age pension.

25. Improving the Pension Loan Scheme – Social security benefits for you or your mum and/or dad

Current: The Pension Loan Scheme (PLS) allows a fortnightly loan of up to 150% of the maximum rate of Age Pension to help boost a person's retirement income by unlocking capital in their real estate assets. It can be available for self-funded retirees who are Age Pension age but do not receive a social security pension. Interest is compounded fortnightly at 4.50% pa, and any debt under the scheme is paid back when the property is sold or the person dies.

Proposed: From 1 July 2022, the Government will introduce a No Negative Equity Guarantee for PLS loans and allow people access to a capped advance lump sum payment.

- No negative equity guarantee - Borrowers under the PLS, or their estate, will not owe more than the market value of their property, in the rare circumstances where their accrued PLS debt exceeds their property value. This brings the PLS in line with private sector reverse mortgages.

- Immediate access to lump sums under the PLS - Eligible people will be able to access up to two lump sum advances in any 12-month period, up to a total value of 50% of the maximum annual rate of Age Pension (currently $12,385 for singles and $18,670 for couples).

Don't leave it until after 30 June. Review your SMSF now and seek advice if in doubt.

Liam Shorte is a specialist SMSF adviser and Director of Verante Financial Planning. He is also a Director of the SMSF Association and he writes under the social media identity of 'The SMSF Coach'. This article contains general information only and does not address the circumstances of any individual. It is based on an understanding of relevant legislation and rules at the time of writing, which may change.

How long will the bad inflation news last?

Tim Congdon

Like other central banks, the US Federal Reserve has been complacent about inflation risks. The complacency was challenged by the 12 May announcement that the increase in the consumer price index was 4.2% in the year to April. Will US consumer inflation exceed 5% and, if so, when? And will the inflation increase prove temporary, persistent, or even permanent?

The next CPI release is on 10th June and will relate to May. In May 2020 the CPI fell by 0.1%. So an increase in May 2021 of 0.7% or more would take the annual rate to 5%. The average monthly increase in the CPI so far this year has been just above 0.6%, while business surveys indicate price-raising pressures are at their most intense for over a decade. Evidently, there is a possibility that the annual rate of consumer inflation will soon go above 5%.

As discussed in this video, the increases in the CPI were quite large in mid-2020, but then negligible (with an average monthly increase of half of 0.1%) in the last four months of the year. A good bet is that – if the annual rate does not exceed 5% next month – it will do so before the end of the year. (I discuss these developments in more detail in a recent article in *The International Economy* magazine).

In these e-mails the emphasis of the inflation discussion in 2020 and early 2021 was on asset price buoyancy and the remarkable surge in commodity prices from April 2020's trough. But news is now emerging of big wage increases. McDonalds has raised pay by 10%, in order to recruit enough staff to deal with an anticipated boom in demand when lockdowns end. Meanwhile the Bank of America plans to add 25% to its minimum hourly wage between now and 2025. The labour market is tight. As the Covid-19 restrictions are relaxed and more people return to work, it will tighten further. Upward pressures on costs and prices will become even more general.

The Fed chair, Jay Powell, believes that it is his institution's task to deliver 'full employment' and seems concerned that US employment is still several millions lower than in early 2020, ahead of the Covid-19 devastation. No one seems to have told him:

- first, that the stability of the Great Moderation is often attributed to the argument that no long-run trade-off exists between unemployment and inflation, and,
- second, that this argument leads to the prescription that central banks should concentrate on price stability.

Further, his research staff have evidently failed to explain to him that a monetary explanation of national income and the price level – in which inflation is determined mostly by the excess of money growth over the increase in real output – has a long and distinguished pedigree in macroeconomics.

Anyhow the answer to the question, "will the US inflation increase prove temporary, persistent or even permanent?", depends on current and future rates of growth of the quantity of money, broadly defined. To recover the macroeconomic stability and negligible inflation of the 2010s, it is necessary for that rate of growth to be brought down to about 0.3% a month.

Two main difficulties need to be highlighted.

First, US banks are now keen to expand their profitable loan assets and to reduce the excessive ratio of unremunerative cash reserves to total assets. With M3 broad money at about $26,000 billion, increases in

banks' loan portfolios of $100-150 billion a month *by themselves* add about 0.5% to the quantity of money. (This assumes – perhaps wrongly in current circumstances – that banks finance the new loans by adding the same amount to their deposit liabilities. As just noted, they may reduce the ratio of cash to assets instead.)

Second, the Federal deficit is widely expected to reach $3,000 billion in the 2021 calendar year, or about $250 billion a month. Again, if that is financed to the extent of $100-150 billion a month from the banking system, the quantity of money rises by about 0.5%. On the face of it, US policymakers will not find it easy to restrain money growth to the low figures that are consistent with inflation of under 2%.

While the USA may have trouble over the next few years in dampening money growth and restoring low inflation/price stability, China is veering towards credit restriction. China has become far more authoritarian under Xi Jinping, while his Harvard-educated top economic adviser, Liu He, is reported to dislike excessive debt. In the three months to April, M3 went up by only 1.8% (or at an annualised growth rate of 7.6%). Annual money growth of little more than 5% would be the lowest since China's opening to the world began after the death of Chairman Mao in 1976.

Professor Tim Congdon, CBE, is Chairman of the Institute of International Monetary Research at the University of Buckingham, England.

Professor Congdon is often regarded as the UK's leading exponent of the quantity theory of money (or 'monetarism'). He served as an adviser to the Conservative Government between 1992 and 1997 as a member of the Treasury Panel of Independent Forecasters. He has also authored many books and academic articles on monetarism.

The 'cosmic' forces leading the US to Modern Monetary Theory

Andrew Macken

One of the important debates of today is whether or not inflation will become a problem as the global economic cycle rebounds post-virus, aided by significant fiscal spending in many of the world's large economies. This question of inflation or no inflation is part of a larger ongoing debate on the merits or otherwise of an increasingly popular idea called Modern Monetary Theory (or MMT).

MMT is redefining government debt and deficits

The core idea of MMT is that governments who issue debts in their own currency can never default. They can always print money to repay their debts, if need be. (An interesting corollary of this idea is that taxes are not required to fund government budgets, though are still a useful tool to drain money from the economy should it overheat). Indeed, the only limiting constraint on government spending is inflation. And so, as long as inflation remains low, then governments should spend on projects and schemes that are productive.

Should the world's largest economy adopt a true MMT framework to govern fiscal spending, the investment implications would be enormous. On the one hand, expected economic growth would be materially greater due to significantly increased government consumption. But on the other hand, the rate of inflation and the level of interest rates would also be much higher. Importantly, the probability of policy mistakes would arguably much higher, creating possible scenarios of inflationary spirals and subsequent balance sheet recessions.

With President Biden announcing a proposed US$1.7 trillion infrastructure spending programme before the ink had even dried on his US$2 trillion Covid-stimulus package, many are asking if MMT has already arrived in the US.

Of course, it has not. Despite controlling the White House, the House of Representatives and the Senate, Democrats do not have the power to enact any government spending they deem appropriate. Under the arcane rules of the US Senate, Democrats have a limited number of simple-majority-only budgetary measures, called Reconciliation. Limited budgetary changes to law can be made under this process which requires only 51 votes. It was under this Reconciliation process that Biden's US$2 trillion Covid stimulus was passed.

But by and large, most other substantial legislation requires 60 votes (out of 100), not 51. The probability of either party controlling 60 votes in the Senate is very low for the foreseeable future. As such, long-term political gridlock, not MMT, is the most likely fiscal scenario going forward.

The 'filibuster' allows Senate opponents of a proposed law to prevent a vote by speaking for as long as they wish on any topic unless 60 out of 100 vote to close the debate.

Enter the 'cosmic' forces of filibuster changes

However, the filibuster rules may change and lead the US to a truly MMT-enabled economy. In July last year, legendary civil rights activist and House Representative from Georgia, John Lewis, passed away. As part of his lifetime service to the civil rights movement, he had also spent many years writing proposed legislation for the expansion of voting rights. Today, this legislation is included in H.R.1, also known as "For the People Act of 2021", which aims to:

"*Expand Americans' access to the ballot box, reduce the influence of big money in politics, strengthen ethics rules for public servants, and implement other anti-corruption measures for the purpose of fortifying our democracy…*"

This legislation – which, on its face, has nothing to do with MMT – is widely supported by Democrats but carries little support from Republican lawmakers. Indeed, since the US general election last November, Republican lawmakers in 43 states have proposed at least 250 new laws that would "*limit mail, early in-person and Election Day voting with such constraints as stricter ID requirements, limited hours or narrower eligibility to vote absentee.*" So the chance of H.R.1. legislation making it through the Senate is effectively zero.

That is, of course, unless the filibuster were to be removed.

Before November's general election, the probability that Democrats would take control of the Senate was less than a coin toss. But then something extraordinary happened in John Lewis' home state of Georgia: Democrats flipped two Republican Senate seats to reach 50 seats which, with the Vice President's vote as the tiebreaker, gave Democrats an effective majority in the Senate.

And this gives Democrats the power – assuming all were in favour – to remove the filibuster and pass any legislation they like. And their first priority is H.R.1. As some Democrats believe, this is John Lewis continuing his 'cosmic' civil-rights work from the grave.

Opening the door for MMT

Under a filibuster-free scenario in which all laws could be passed with a simple majority in the Senate, one could safely assume that long-term US government spending, deficits and borrowings would expand significantly. That is, MMT.

It remains far from clear, however, if Democrats will proceed down this path. Multiple Democratic Senators do not support the removal of the filibuster. The probability is not zero, however. A vote on H.R.1. in the Senate is being slated for late June. And this comes after a momentous vote in May, in which Senate Republicans used the filibuster to block the establishment of an independent commission to investigate the 6 January Capitol riot. Democrats were furious.

In the broader Democratic party, a sense of desperation appears to be building. There are fears that under new voting laws established by Republican-controlled state legislatures, minority rule in the US could be enshrined into law indefinitely. Multiple Obama-era advisors have been vocal recently, framing the filibuster as an existential issue for the future of American democracy.

That said, even if Democrats were to proceed along this path over the coming weeks and months, we are likely to remain a long way from a truly MMT-enabled US economy. While the principles of MMT have been warmly embraced by left factions of the Democratic party, there are plenty of more moderate Democratic Senators (as well as a Democratic President) who remain sceptical of the idea that government debts are irrelevant in the face of contained inflation.

MMT is an idea that probably remains a long way off from widespread adoption. But it is far from impossible. Some Democrats believe there at cosmic forces at play which are laying the foundations to expand voting rights in America. If so, these same cosmic forces are paving the way towards an MMT-enabled US economy. We will know more by the end of this month.

Andrew Macken is Chief Investment Officer at Montaka Global Investments. This article is general information and is based on an understanding of current legislation.

Disclaimer

This message is from Morningstar Australasia Pty Ltd, ABN 95 090 665 544, AFSL 240892, Level 3, International Tower 1, 100 Barangaroo Avenue, Barangaroo NSW 2000, Australia.

Any general advice or 'regulated financial advice' under New Zealand law has been prepared by Morningstar Australasia Pty Ltd (ABN: 95 090 665 544, AFSL: 240892) and/or Morningstar Research Ltd, subsidiaries of Morningstar, Inc, without reference to your objectives, financial situation or needs. For more information refer to our Financial Services Guide (AU) and Financial Advice Provider Disclosure Statement (NZ) at www.morningstar.com.au/s/fsg.pdf and www.morningstar.com.au/s/fapds.pdf. You should consider the advice in light of these matters and if applicable, the relevant Product Disclosure Statement before making any decision to invest. Past performance does not necessarily indicate a financial product's future performance.

For complete details of this Disclaimer, see www.firstlinks.com.au/terms-and-conditions. All readers of this Newsletter are subject to these Terms and Conditions.