Are we sure we're in a Recession?

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Josh Frydenberg and the Government have said that we are in a recession. However, if you judge by the resilience of asset classes such as property and shares then the answer is absolutely **NO.**

So what are we currently going through and what should we consider when investing during these times?

Australia has had one of the most spectacular runs in the world's modern history, with close to 30 years of un-interrupted economic growth without needing to use the "R" word. Although we have had a few close calls through events such as 9/11, GFC, the Asian Financial Crisis and on-going global trade uncertainty. Not bad for a country that consists of 1.7% world economy whilst only having 0.3% of the world's population. We are now ranked the 14th largest economy versus GDP in the world[1]. For a small country, we are certainly punching above our weight.

Based on the technical definition of a recession, however, it will indeed be a close call.

The ABS announced Australian GDP results for Q1 2020 at -0.3% [2]. A surprisingly very honorable result, considering we had been through drought, bushfires and resultant subdued tourism levels for that period and finally, let's not forget the start of a once in a hundred-year pandemic. On the flip side we recorded the largest trade surplus in our record of AU$10.6B off the back of strong exports Iron ore, coal, gold and agriculture.

Q2 will certainly be a shocker, reflecting the majority of impacts felt from the COVID-19 Lockdown. With unemployment expecting to peak beyond 10% [3], we all know that this will be an extremely gloomy figure without the ABS official release. The outlook for Q3 is generally more positive, with an expectation of a rebound with a positive GDP figure.

The Q1 figure is so marginal that there is a large probability that this figure may be revised back to positive territory once the nerds at the ABS reconcile the data, this has happened on several occasions before in the past.

If this eventuates and the Q3 figures are indeed positive, Australia may well manage to avoid a technical recession for more than 30 years.

Won't that be a great headline.

Before we decide to crack open the champagne let's not dismiss the sheer economic calamity, disruption and uncertainty that we are presently living through due to Covid-19. Both job-keeper and job-seeker could be masking actual an underutilisation rate of labour could be as high as 20%[4].

Once the payments stop from September, we will only then start to understand how deep and severe the damage is to our economy.

Another aspect that will rear its ugly head later this year, is the collapse of zombie companies. A zombie company continues to operate, whilst not being profitable, and is kept on life support through access to cheap and increasing debt. I believe these two factors will end up delaying the economic pain that we may see for the next 6 months up to 3 years. A recent survey from Money.com.au survey found 62% of small business where close to the brink at some time prior to COVID-19.

With small business consisting of 35% of our GDP and employing 44% of the workforce. We at this stage do not know the quantum of zombie companies and the multiplier effect to the broader economy resulting in the ultimate failure of these companies.

The best summation of the situation is a Warren Buffet saying,

"Only when the tide goes out do you discover who's been swimming naked"

Despite the semantics of whether we are going through a technical recession or not, it is disingenuous to call this a recession as most of us have not yet felt the true pain of a recession. Especially for those who have in the past lived through a gradually weakening economy, high unemployment, high interest rates, falling asset values, low consumer spending and a great deal of economic and social household pain all the while with a bleak outlook to the future.

Australia's success to date is off the back of two main factors; 29 consecutive years of economic growth in conjunction with incredibly low government debt entering the COVID-19 crisis, enabling the unprecedented amount of fiscal support and stimulus pumping liquidity into markets as a means to avert economic Armageddon.

The second was the ability to control the spread of the virus. Australia is a contrarian outlier economy; able to defy international trends, blessed with a unique bountiful array of natural resources and a highly resilient workforce.

But what about property?

In regards to Australia's favourite asset class, we could still be on track for a 5% to 10% temporary asset fall despite property showing no signs of weakness. The weakness could only be reflected for a very short period whether we can get back to normal efficiency prior to September when governments life supports end. Equally opening the international borders is critical, we have gone from significantly under supplied in the property post COVID-19 to be over supplied literally overnight, with 100's thousands of tourists and students not requiring somewhere to stay, creating a rental glut further exacerbating investors cash flows and the equilibrium of property demand and supply mechanics.

Another issue worth mentioning is the medium density building quality fiasco, as a result prior to COVID-19 this issue was growing momentum with COVID-19 adding insult to injury. Confidence in off the plan property purchases is dead, sending the construction industry off an absolute cliff. We have gone from delivering 30,900 apartments in 2018 to less than 10,000 projected for 2021 in Metropolitan Sydney[5]. This will have a significant impact on the economy and jobs whilst limiting supply and actually cushioning property prices from falling.

In considering this, investors should be diligent and protect their downside to their investments. In times of uncertainty capital preservation is key, as we see a further flight of capital to defensive investments predominately in the category of "fixed income". The danger is that this sector encompasses so many options that vary in risk and characteristics, cash, term deposits, REITs and mortgage funds.

Never before have the differences been so wide, careful consideration and time should be taken in understanding the risk and rewards of each one.

We believe Mortgage funds are an underappreciated asset class, which is shining in the current economic environment due to its ability to generate returns from 6-15%p.a., it's defensiveness against market volatility and secured by property which is supported by 100% full recourse guarantees - whilst giving investors regular monthly income that one can rely on.

At Msquared Capital, our unique contributory structure allows investors to choose which direct mortgage investments they would like to participate in, giving investors peace of mind that their investment is secured bricks and mortar.

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

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