Strategy Hubb

Strategy Hubb's Economic Compass

Outlook June 2020

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It may be painful and last a little longer than expected, but eventually, everything recovers, rebounds and excels.

Is there upside in a downturn?

Every recession causes financial strife. There is more risk in markets, and more risk equates to fewer investments and less spending. In Australia, 600,000 people are out of work, even with the help of the JobKeeper and Jobseeker programs. A reduction in consumer spending or a lack of customers causes some businesses to slow down dramatically, or also go out of business entirely.

These slowdowns trigger job losses, and cost-cutting initiatives as business strategies are re-evaluated. At Strategy Hubb, we are focussed on finding solutions to combat this health crisis, so that it does not become an enduring financial crisis.

As consolidations take hold, and the appetite for risk is significantly depleted as businesses buckle up for turbulence. Turbulent times in industry can either strengthen or weaken your company. They can make your company stronger by bringing to light the hidden fractures within your organisation, or they can fast track the demise of the business. If recognised early enough, you could have the time to fill in the cracks that would have inevitably caused the company to crumble.

With so much negativity in the global market, what can businesses do to stay afloat? The current disconnect between markets and the new economic reality is a problem which all companies are attempting to solve. There is no magic wand that can change outcomes, but practical thinking can limit risk, and assist in spotting the opportunities, while, your competitors focus on consolidating and mitigating risk.

On the other hand, some businesses thrive in downturns and are more resilient to the fluctuations of general market conditions. Netflix and Amazon are examples of companies that continue to expand, even in contracting markets, while companies in the high-end retail, travel and leisure space are mostly stagnant. Luxury goods, travel and leisure, are industries that excel in an upturn or an expanding economy when consumers have more money to spare.

These procyclical businesses feel the impacts most, when economies slow, because there is very little disposable income at the fingertips of consumers. These business types follow market conditions and follow the same graph as the economic cycle. When the economy is good, these businesses flourish, but when the economy is terrible, they tank.

Practical thinking can limit risk, and assist in spotting the opportunities.

Discovering the upside for business in a downturn

When companies enter a recession, they ultimately try to achieve more with less and try to maintain the same output at a reduced cost. These practices lead to an uptake of automation and automation, diminishes the requirement for human resources. Enhanced technologies also lead to multiplied efficiencies as machines can run 24 hours a day, if, and when, required. So, technology can be used as a driver for gains in a downturn market, as cost reductions in workforce requirements coupled with extended hours of machine productivity, can afford a business higher profit margins even if the consumer prices were to reduce.

Reducing the labour force is not the answer to the problem; but, for manufacturing businesses, it can be. I want to highlight that there is an upside to most things if you look at the world of business, from multiple perspectives. Being the optimist that I am, I seek diligently for the bright side of life and the upside to any downturn. In the middle of the COVID-19 crisis, business professionals, and the individuals who lose their jobs, find it practical to enhance their learning, by going back to school, university, or by attending trade courses, to add skills to their repertoire. This, to become more valuable and marketable when things turnaround.

As the global market continues to contract, higher education becomes a prerequisite for business owners who find it necessary to employ staff. The complexities of business activity require a higher standard of professionalism to enhance business in turbulent times. The professional services industry sometimes expands in a recession as think tanks, the world over, try to solve the issues of a global crisis.

EIA expects Brent crude oil prices will rise to an average of

$32/b

during the second half of 2020 and

$48/b

on average in 2021, reaching

$54/b

by the end of the year.

Stimulus in a bid to reignite the economy

When economies enter a recession or are pre-empting a recession, the Federal Reserve attempts to increase consumer spending by making money cheaper. Central banks influence retail banks and other lending institutions, to ensure lenders and borrowers have access to credit and loans. When money is cheap enough, individuals and businesses take on higher loans at much lower rates, which makes it affordable to gain more, for less, than when the opposite occurs—in effect, making money more accessible in a bid to stimulate borrowing and consumer spending.

Consumer spending is a crucial component to reviving an economy as an estimated 70% of business turns because of consumer spending. Cheaper payback rates also equate to lower default ratios, which in turn, maintain credit ratings, and a new cycle of expenditure emerges. This information may seem like an economics lesson, but it is imperative to understand how stimulus works to find out how to make it work for you.

Governments also work diligently to reignite a slowing economy by releasing their stimulus packages targeted at specific parts of the market that require a more urgent allocation of capital, to stay afloat, or to maintain regular trading activity. Governments heavily subsidise pivotal organisations that control transport, the maintenance of roads, and all the necessities of life, like clean water, gas, electricity and the internet. These industries are propped up by stimulus, or the government underwrites their loans.

$688 million has been committed by the government toward the housing industry to encourage movement in that sector. Total dwelling approvals were up 5.7% in the year to April, despite falling 1.8% during the month. The move to keep the housing market pressing forward is not due to actual declines, but instead on the premise that there will be a slowing demand due to no new migrants being able to enter the country.

Increased government activity requires more human resources to facilitate, and the second wave of professional services is onboarded. In times of recession, the government's labour requirements pick up some of the slack from the unemployed side of the balance sheet as governments work harder at finding ways to create jobs. Businesses should pivot or start gravitating to serving the needs of industries who boom or bloom in times of recession.

Recession-proof industries

- Government Department
- Aged Care
- Healthcare /Medicare
- Medical Technologies
- General Cleaning
- Online Security
- Medical Facility Cleaning
- Pharmaceutical Industries
- Streaming Services
- Consumer Staples
- Private Medical Practices
- Software Development

Recession-proof industries continued

- Information Technology
- DIY and Repairs
- Freight & Logistics
- Essential Transport
- Essential Infrastructure Maintenance
- Essential Retail
- Food & Beverages

The above industries can also be somewhat blueprinted when considering the right stocks to invest in, within a recession. That is, if you are picking stocks for the short-term and not the long-term. Predicting long-term stocks, requires the analysis and forecasting diligence that focuses on long-term risks.

‘The mark of great leaders is the ability to understand the context in which they are operating and act accordingly.’

The esteemed Nelson Mandela (Madiba)

Traditional wealth drivers are in question

Many historical strategies have made people wealthy in times of recession and have made businesses even more prosperous. None more famous than the buying low, selling high strategy. The extremely wealthy look forward to recessions as they find it a (buyer market) when companies are undervalued and are seeking capital to stay above water.

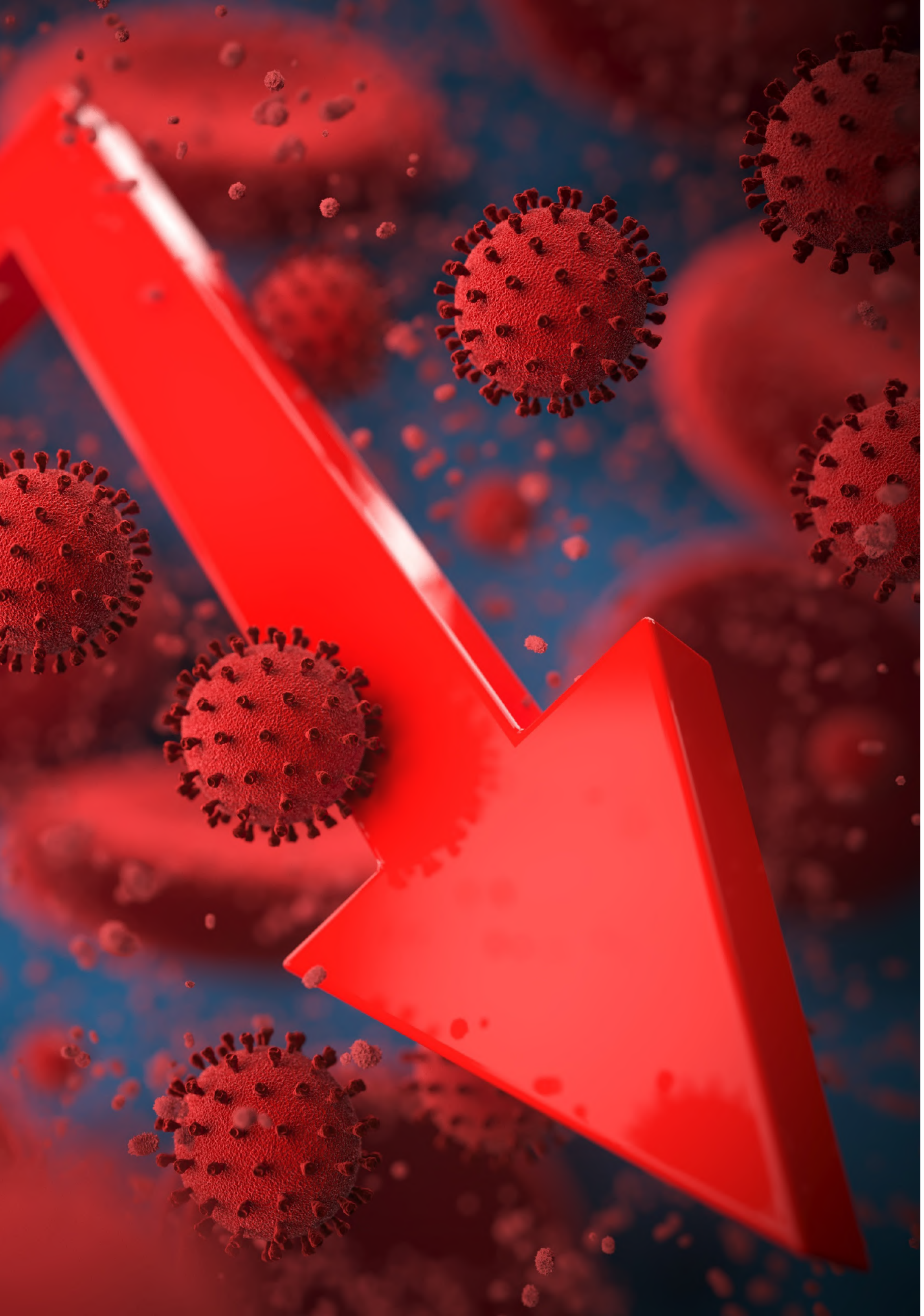
Acquiring companies for sometimes 50% of their actual value is a steal, and when the economy begins to recover the value of the assets or acquisitions, increase significantly. The Mergers and Acquisitions space is receiving much attention. Proactive companies are looking to boost their overall valuations via acquisitions to shortcut the time it takes to build value. The presence of the COVID-19 virus is reiterating the need to assess potential targets for M&A activity. Sights are being set more broadly in terms of further afield opportunities, not only in the local market but in the international markets as well.

This activity is also impacting valuations that could accelerate some deal-making as companies look to acquire competitors to protect and reposition beyond the crisis. This concept of wealth generation has made the rich even more prosperous over time, and has kept the poor stagnant, or declining into deeper levels of poverty.

However, we are in the worst economic decline of the century, as the sudden shock of COVID-19 hit global markets simultaneously with minimal warning. Markets, being unprepared, did not have sufficient liquidity to sustain business fluidity. It took a mere 21 days to drop the global market by 21%, and we are on a slippery slope with a downward trajectory that could lead to the worst economic downturn in history. Certain multiplying factors exist in today's circumstances that previous recessions did not have.

For example, the whole world was on pause at the same time. The multiplying effect of all industries being on a forced hiatus at the same time is unprecedented. The knock-on impact of these industry pauses will be felt way into the future. Economists estimate that it will take at least another 24 months, to see the full extent of the damage.

The thing is this, regardless of the situation we find ourselves in, there is a way out. It may be painful and last a little longer than expected but eventually, everything recovers, rebounds and excels. It takes intuitive leadership to accomplish the seemingly impossible in times of crisis.



Consumer sentiment

As Australian's get back to business, to some degree, there is still apprehension in the air as to how long the Coronavirus will keep a hold of the global economy and how deeply the negative impact will run. Fears of a second wave stifle investments and spending as it becomes arduous to keep recalculating risk from fragmented data. The interconnectedness of the global economy reminds us that we will be seeing and experiencing negative yields for some time, from most industries. When sentiment is dampened, there is a reluctance to spend, or there is no surplus to spend. Consumers are tightening the purse strings, and only necessities are purchased. Home budgets prioritise basic needs, and anything left over is kept for a rainier day. Consumers still see the Coronavirus as a more significant threat than that of geopolitical issues. Trade wars, financial market volatility and increased economic volatility fall in order under the top threat. The official announcement from Scott Morrison on 3 June, that Australia, is officially being in a recession, raised the negative sentiment even further. To sum it up, consumer sentiment is at an all-time low at present, but Australia is better positioned to emerge from a recession faster than other countries of the world because we entered the recession with a surplus budget. The main issue of concern Australia faces, apart from a second wave prediction of COVID-19, is the decoupling from China, who was our saving grace in the last recession.

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Geopolitics affects economics

Slowing economic activity in China, the initial epicentre of the outbreak, has caused deep concern in the Asia Pacific region as well as across the broader world. As the Chinese economy shrinks, ending a nearly half-century of growth, the world is left reeling. The Chinese finance officials say that their economy shrunk 6.8% in the first three months of the year.

The shutting down of the world manufacturing hub during the pandemic halted trade and disrupted supply-chains. The sentiment in developed economies expressed that we were more likely than those in emerging ones, to expect worsening conditions in the next 6-12 months. In light of the increased economic risks from being so reliant on China, our government has made initial steps to deepen relationships with India, Indonesia and our European counterparts.

Australia has 11 Free Trade Agreements currently in force with China, Japan, Republic of Korea, New Zealand, Singapore, Thailand, US, Chile, the Association of South-East Asian Nations (ASEAN) (with New Zealand), Malaysia, and Canada and Mexico (through the Comprehensive and Progressive Agreement for Trans-Pacific Partnership, or CPTPP.)

In response to Australia's bold stance to push for an independent inquiry of the COVID-19 pandemic, the Chinese government responded by boycotting, a growing list of Australian products and began penalising Australia through trade and tourism, to show the world what happens when you oppose China.

Some relief might come from Europe taking up some of the slack of our reduced exports into China. (DFAT) indicates that Australia and the European Union (EU) launched negotiations for a free trade agreement (FTA) on 18 June 2018. Based on 2018-19 data, as a coalition, the EU was Australia's second-largest trading partner, the third largest export destination, and second-largest services export market.

The EU was Australia's largest source of foreign investment in 2018. If negotiations progress fast enough, Australia may be able to claw her way back out of recession.

Currently, China is trying to restart its vast 14 trillion dollar economy, an effort that could give the rest of the world some reprieve, if it were not so tangled in geopolitics with most of the world over COVID-19. The People's Bank of China's preference to use targeted credit measures rather than large-scale interest-rate cuts explains their approach and strategy to stimulate vital points in the market.

"Inflation takes from the ignorant and gives to the well informed."

Venita VanCaspel

When the uncertainties of the world begin to take their toll, even volatile cryptocurrencies like Bitcoin begin to shine once more.

Bitcoin has been the best performing asset by far over the last year and the last decade.

The price of Bitcoin is expected to soar to over $20,000 per coin in 2020.

Economic stagnation

As the global economy shrinks and tax revenues fall, the widespread drop in spending causes an adverse demand shock. Because demand is slumping rapidly with no signs of a V shaped recovery, the economic stagnation will cause longer-term scarring to the economy. With the virus no longer contained to China, increasingly worried consumers everywhere are reluctant to shop, travel or eat out, as usual, fearing a second wave of the virus and containment measures. For central banks, the worry is that rate cuts won't reopen factories or return workers to work.

Negative interest rates won't increase spending if people have no jobs to return to, or if the tightening requirements to access capital, are overly complicated, or constraining. Supply shocks are inherently tougher for policymakers to address, because of the difficulty of quickly restoring the production, transport or communication networks, or natural-resource inputs affected by the hit. This places the onus on policymakers to contemplate more considerable inventiveness. Government spending may not be able to contain the virus spread, but it can help replace free-falling consumer demand. The crash in oil prices this year is indicative of the economic recession, and prices have fallen so far, that many oil firms will be forced out of business, causing job losses and falling investment. Oil importing countries (e.g. Germany, Japan, India) will generally benefit from oil lower prices, but developing economies who rely on oil exports (e.g. Russia, Venezuela) could see a significant fall in export revenue.

Usually, a fall in oil prices would be celebrated by consumers and firms due to the lower prices and costs. However, this fall is due to expectations of a sharp drop in travel and economic recession from the Coronavirus. Therefore, there is little expectation that the lower oil prices will have any positive economic effect. If people cut back on travel, cheaper petrol doesn't make much difference. If people see a fall in income because they are out of work, lower oil prices are only a small compensation.

The reserve bank of Australia (RBA) suggests that a stronger economic recovery is possible, only, if further gains in controlling the virus are achieved in the near term. Early containment will allow most containment measures to be phased out over coming months and with more limited damage to

business and household confidence, and balance sheets.
In this scenario, much of the near-term decline in GDP growth and the rise in the unemployment rate would be reversed over the next few years.

Our one saving grace is that our Australian economy is a highly developed market economy. We had a sizable surplus budget that cushioned much of the impact caused by the Coronavirus for many citizens. JobKeeper and JobSeeker programs spent a considerable portion of the surplus budget, and even more government spending is planned to recover initiatives. Our GDP was estimated at A$1.89 trillion as of 2019.
In 2018 Australia became the country with the largest median wealth per adult but slipped back to second highest after Switzerland in 2019. Data is not yet available to indicate how we are currently placed since the pandemic started.
However, our response to the crisis and recession will dictate the length of time we find ourselves in a contracting economy.

For more on the current state of affairs and how these geopolitical, struggles influence, trade, economics and business, reach out to Strategy Hubb and book a consultation for your business or venture.

About Strategy Hubb

We are an advisory firm which excels at taking businesses into international markets. We are known as the Gateway to Asia and the UAE.

We tackle the most critical challenges of our modern time, and continually spot opportunities, and threats, to better prepare our clients for the political, and economic challenges ahead.

We are data and fact-driven, backed by a team of professionals who aim for the very highest of standards. We take competitive advantage to the next level. as we solve the complexities of business transformation.

Disclaimer

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