Repeat of Mandatory Reminder

There is only one mandatory reminder appropriate for any edition of the Baillie Capital Stable Monitor. You need to be reminded that this Monitor is designed as a reliable source of data and provider of insights to capital qualified Wholesale Investors. The Corporation Act definitions establish the boundaries for the Professional, Expert and Sophisticated Investors that qualify for that status.

Orientation

In the last Baillie Capital Stable Monitor circulated in May 2019, our Chief Research Officer tabled evidence as to why interest rates would be lower for longer than either the market or the economic commentariat was expecting.

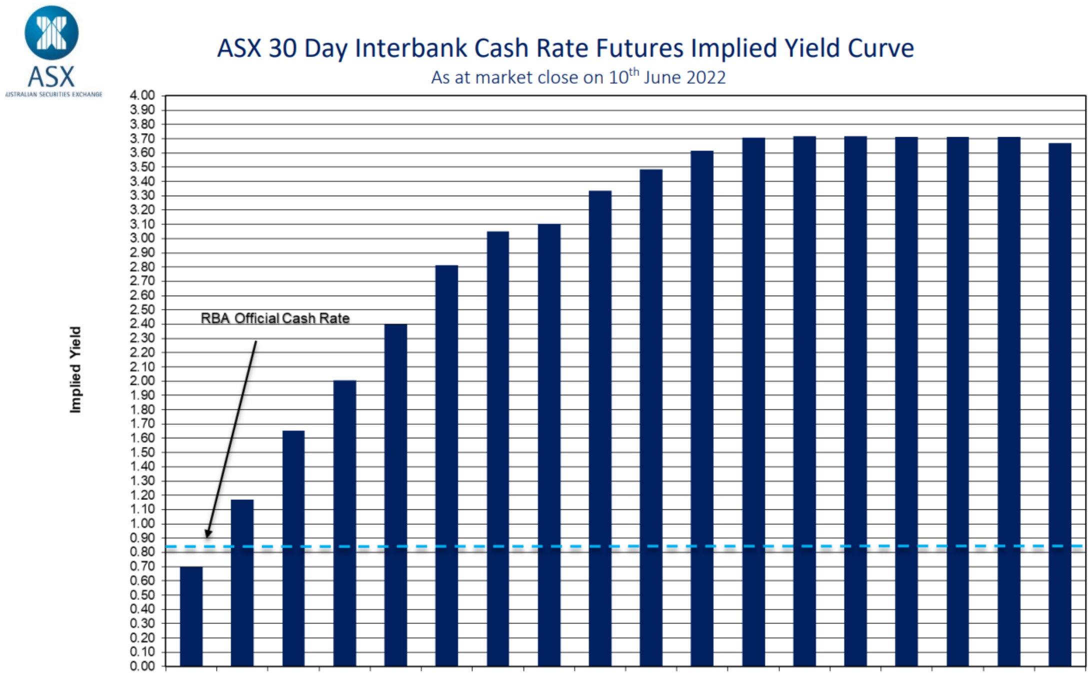
COVID reared its ugly head which introduced a level of indecipherable "noise" with both extraordinary fiscal and monetary policy largesse being delivered to the global populace from amateurs to this type of occurrence.

The conclusion we want you to reach is that interest rates will be higher for longer than the RBA and the economic commentariat are tabling.

Our near fifty years of debt advice and inflation analysis has led us to be highly alert to medicated interest rates, be they "accommodators" or "constricting".

Accommodator interest rates such as we have experienced up until a month ago, ultimately fix the problem that necessitated them in the first place. If the confluence of events that have triggered mid-levels of reinflation had not occurred, then we expected negative interest rates would have moved to a neutral rate of 2% to 2.5%.

As the diagram below shows, the market has nominated cash rates of over 3.7% from May next year.



	Jun-22	Jul-22	Aug-22	Sep-22	Oct-22	Nov-22	Dec-22	Jan-23	Feb-23	Mar-23	Apr-23	May-23	Jun-23	Jul-23	Aug-23	Sep-23	Oct-23	Nov-23
Implied Yield	0.695	1.170	1.655	2.005	2.395	2.815	3.050	3.105	3.335	3.485	3.615	3.705	3.715	3.715	3.710	3.710	3.710	3.670

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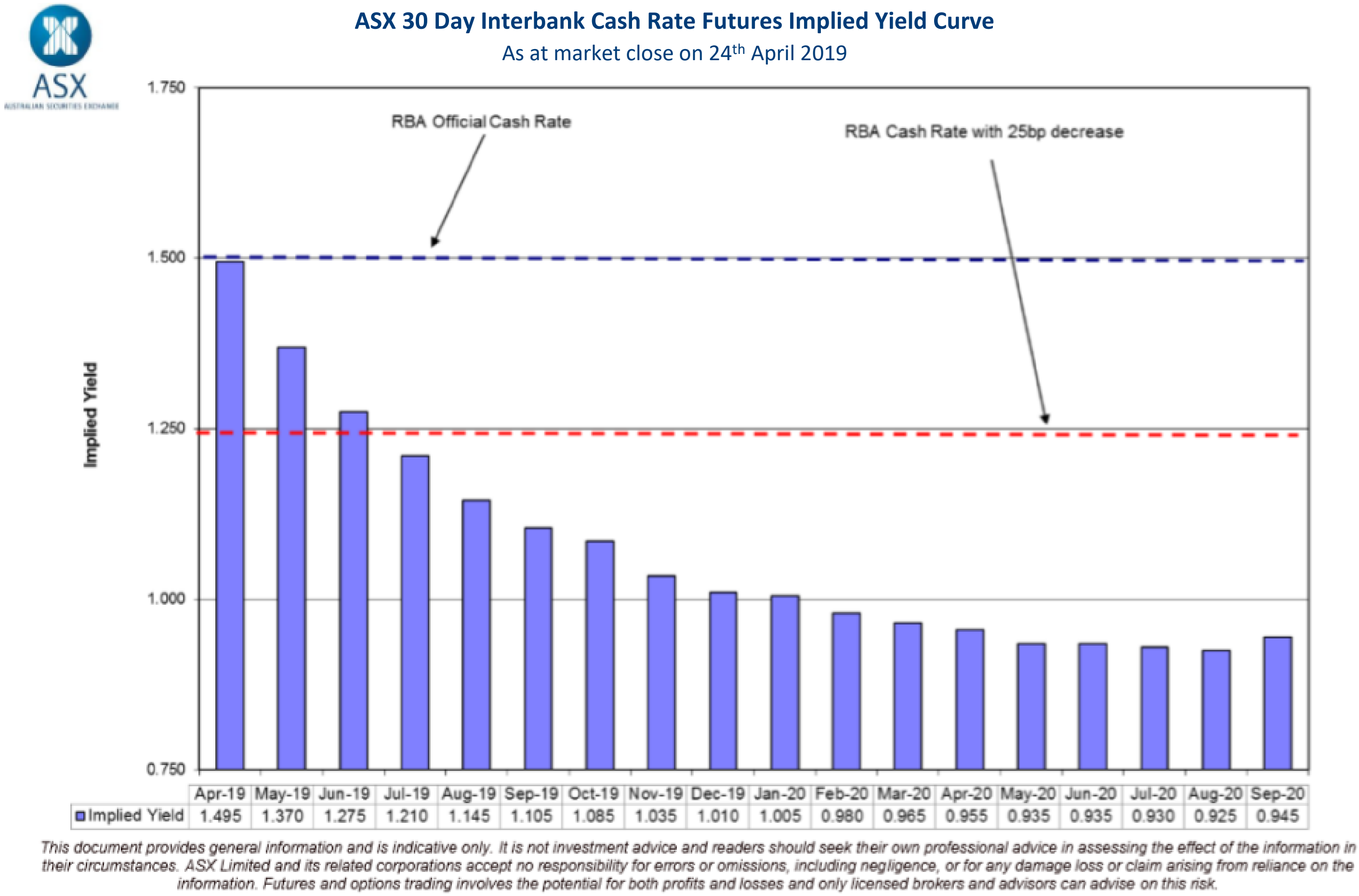
The last time we shared this data with you in 2019, the picture had reducing levels of nominal cash rates.



The Either/Or

Global analysts have assessed, that the US and Australia's Government spending initiatives triggered by COVID, were more than was needed or prudent.

Apart from the issue of the effectiveness of this largesse, if these analysts' conclusions are correct then the excess was inflationary.

Europe did not overshoot, but it is more impacted by the Russia/Ukraine's contribution to inflation.

Whilst the "noise" surrounding inflation will make it difficult to have reliable probabilities, both Jerome Powell and Philip Lowe have "jaw boned" and acted to prove their assertions that they will supress inflation back to their declared targets.

The either/or is that they achieve their objectives in the timetable the market deems sensible, or they fail.

You should take considerable comfort at our RBA's capacity to succeed.

The position in the US where its inflation target is 2% is that we assess their negative long-term rate at -6%. The factor that will slow their remediation is their unemployment rate.

Currently the U6 rate (the measure we prefer in analysis) is 6.7% and the U3 rate is 3.6% just 0.1% more than pre-COVID levels. When U6 is less than double U3 there is an increasing economic resilience in the US.

Our interpretation of the US is that they won't slow down to proving their commitment to reverse the trend of increasing inflation for Wall Street's peace of mind, but they will if the U3 goes above 5%.

Just as inflation is cemented in the psych of Germany's financial monetary deliberations, unemployment is cemented into the US psych.

The economic commentariat is increasing calling into question the ability of the US Government and the Reserve to orchestrate a "soft landing." We believe you need to be prepared for both a "soft" and a "hard" outcome.

Our major concern with the US remains their continued increasing of exposure to a "Minsky moment."

We were heartened to see that in the Fed Reserves May Financial Stability Report that "constricting liquidity" was their prime warning.

Inflation

We consider inflation, even at the target level of 2% to 3%, as theft. In 1984 when the decade rate was running at 8.5%, we tagged inflation of nil to 6% as low, 6% to 12% as medium and 12% or above as high.

The moving of so much manufacturing to China allowed us to posit disinflation as a certainty and deflation an increasing possibility.

From 1990, following the RBA's excessive response to the property bubble, we have experienced inflation of just over 2%. This has been minor theft and we have been lulled into a false sense of security.

Instead of being pick-pocketed, we are now being burgled. You should have significant confidence that you won't be exposed to the highway robbery that Argentinian's are currently being exposed too.

The total your current rate of permanent loss via inflation is 0.5% per month. If this persists than the 3.7% cash pricing that the market has set will be lower than reality.

In Australia the two long-term contributors to inflation are wage increases more than productivity and expectations of future inflation.

The unusual array of confluencing events have led us to conclude that it may be a year before the RBA can evidence a reversal of the current trend and be late 2024 before it can be realistically expected to achieve the top of their target range.

The Good

We only received confirmation 2 weeks ago that Australia recorded its 12th quarterly Current Account Surplus in a row – albeit that Q1 CY2022 was lower than expected.

With two weeks to go we have sufficient empirical evidence to state 13 is in the bag.

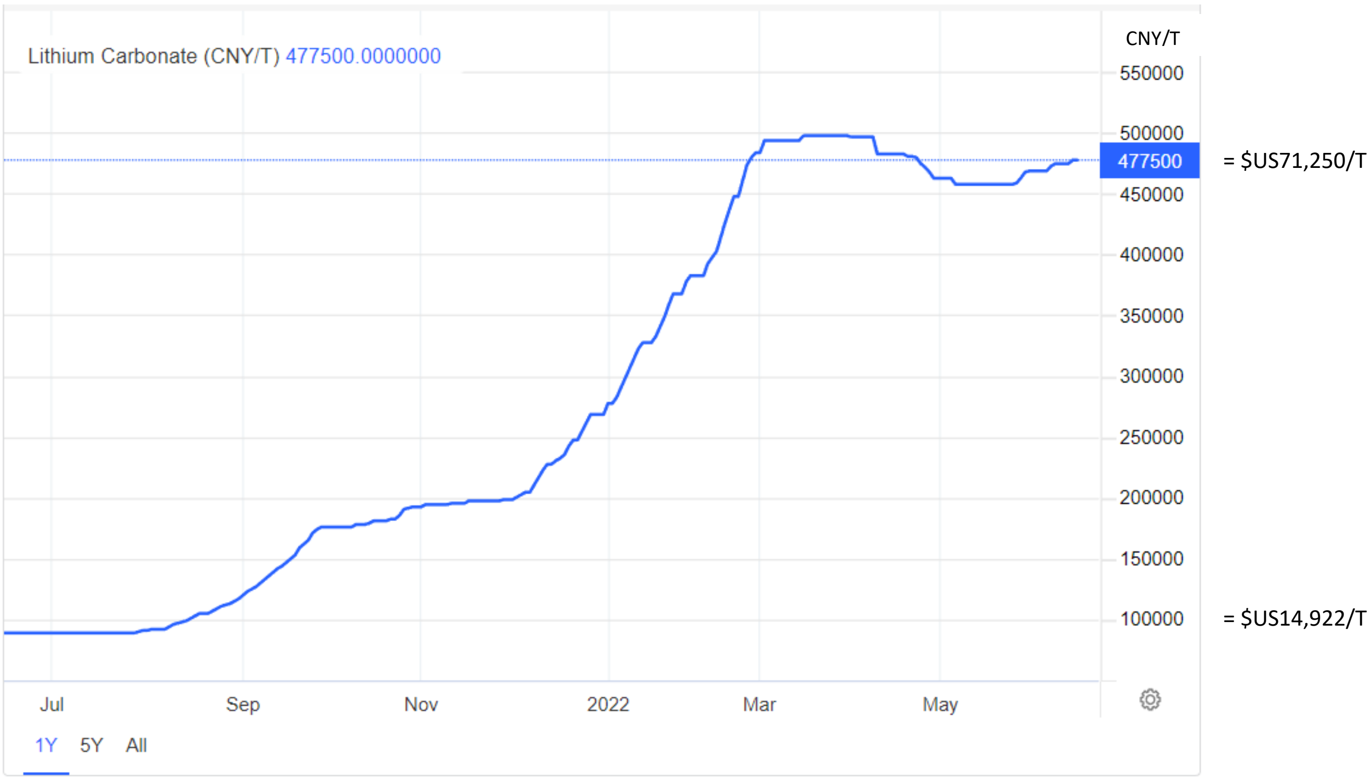
Commodity prices, particularly iron ore, and our increasing terms of trade have facilitated this.

However, we have a compounding giant that will cement our position as a creditor nation.

AusSuper has over $250 billion in assets and its new cash to invest comes from contributions, maturities, realisations, and receipted income. Transfers come in, transfers go out and benefits are paid out. AusSuper public announcement has been made that 60 cents to 70 cents of net moneys arising from the above (our estimate for FY2023 is $50 billion) will be invested internationally.

The Bad

The market price graph for lithium prices shows that instead of being content with price recovery at a 66% gross profit margin, the producers have ignited inflation by exploiting a supply deficit environment to capture gross profit margins of over 90%!!!



Source: tradingeconomics.com

Opportunistic thoughtless price gauging is adding unnecessary to the compounding of inflating factors.

The Ugly

Russian invasion of the Ukraine triggers the capital destruction inherent to all physical warfare. The uncertainty in energy and food supplies will continue until a détente is reached and the terms and conditions can provide a known pathway for the new order.

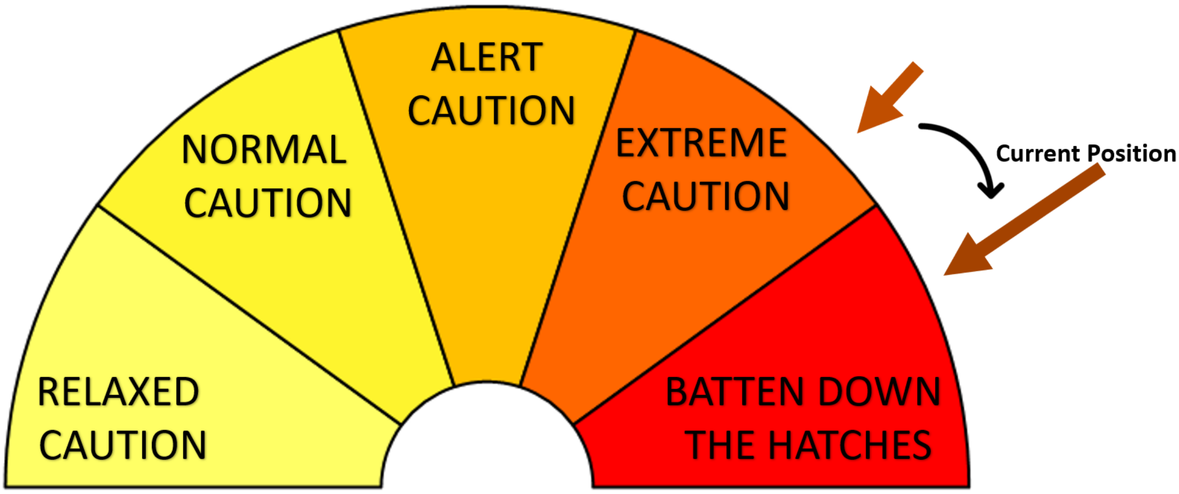
Regardless, the developing economies will suffer the most collaterally, but most compassion should be directed to those directly impacted.

Summary

Our conclusion in 2019 was that achieving capital stability would become more valuable than ever but accessing same would be increasingly hard.

The current position of our Financial Repository Caution Meter is now in the bottom third of “Batten Down the Hatches.”

Financial Repository Caution Meter



With respect to the property sector, property is normally a strong defensive investment asset for inflationary times where it can produce regular, reliable real value income.

Industrial, Medical, and Essential Retail is safe, but the prices paid are excessive so until the muddy waters clear, long leased to low counter party risk tenants are the sole subset.

We place mobile hydroponic infrastructure on the top of the totem pole of having the highest probability of being a successful defence against inflation.

Whilst inflation will impact the nominal replacement cost underpinning this, it will be overridden by the contribution of the economics of the utility of the occupant and the cost and availability of financing.

Fixed Interest needs a thorough analysis of the value of the collateral and the relative ease of realisation following default. Search for the “rare beasts” where the collateral is a multiple of more than twice the loan amount with simple exit in a default position.

Ownership of Business should be driven by sustainable gross profit margins. Working capital for replacement inventory will hinder margin maintenance and will restrict free cash flows.

We repeat previous assertions that volatility is an inappropriate proxy for risk for the readers of this publication. Volatility should be an opportunity and not a threat because Professional Investors can wait out the stupidity of markets that are "in the moment beauty parades" rather than being the "weighing machines" they will ultimately become.