JUNE QUARTER 2022
MARKET OUTLOOK REPORT

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Market and Portfolio Review of March Quarter 2022

Market Performance to 31 March 2022 (in local currency unless otherwise stated):

Aus Equities	**1 Month Return**	**3 Month Return**	**6 Month Return**	**1 Year Return**	**3 Year Return**	**5 Year Return**	**7 Year Return**	**10 Year Return**
S&P/ASX 200	6.89%	2.24%	4.38%	14.97%	10.37%	9.22%	7.81%	10.17%
S&P/ASX Small Ordinaries Index	5.26%	-4.21%	-2.27%	9.68%	9.44%	9.90%	9.52%	6.00%
MSCI Australia Minimum Volatility Index	5.35%	-0.03%	3.79%	14.49%	7.29%	7.41%	7.04%	10.42%
MSCI Australia Value Index	8.84%	12.71%	12.45%	21.48%	13.03%	8.72%	7.47%	12.48%
MSCI Australia Growth Index	5.81%	-3.77%	-0.48%	11.91%	8.64%	11.32%	10.02%	10.67%
MSCI Australia Quality	9.02%	3.69%	11.86%	13.82%	14.23%	11.24%	8.26%	
MSCI Australia Small Cap	9.88%	0.92%	7.18%	15.35%	16.54%	12.79%	11.64%	5.88%
Global Equities (local Currency)	**1 Month Return**	**3 Month Return**	**6 Month Return**	**1 Year Return**	**3 Year Return**	**5 Year Return**	**7 Year Return**	**10 Year Return**
MSCI ACWI Index	2.22%	-5.26%	1.16%	7.74%	13.88%	12.22%	10.27%	10.50%
MSCI World Quality net Total Return USD Index	3.40%	-8.51%	0.88%	11.77%	17.82%	16.09%	13.47%	13.03%
MSCI World Value Index (USD)	2.37%	-0.47%	6.85%	11.37%	10.21%	8.74%	8.05%	9.22%
MSCI World Growth Index	3.27%	-9.60%	-2.20%	9.42%	19.38%	16.92%	13.52%	13.36%
MSCI World Minimum Volatility Index (USD)	4.57%	-2.95%	3.74%	9.54%	8.12%	8.82%	8.35%	9.45%
MSCI World Momentum Total Return Index (USD)	4.45%	-5.71%	-0.27%	7.63%	15.78%	15.99%	13.11%	13.39%
MSCI EAFE Index	0.74%	-5.77%	-3.19%	1.70%	7.98%	7.31%	5.70%	6.75%
Regional Equities (local Currency)	**1 Month Return**	**3 Month Return**	**6 Month Return**	**1 Year Return**	**3 Year Return**	**5 Year Return**	**7 Year Return**	**10 Year Return**
S&P 500	3.71%	-4.60%	5.91%	15.63%	18.45%	15.98%	14.00%	14.54%
Nikkei 225 Japan Index	5.68%	-2.58%	-4.63%	-2.95%	10.99%	10.12%	7.46%	12.73%
MSCI Europe Index	0.96%	-5.18%	2.15%	9.95%	8.75%	6.67%	5.02%	8.64%
FTSE100	1.42%	2.89%	7.78%	16.05%	4.74%	4.50%	5.52%	6.47%
Emerging Market Equities (local Currency)	**1 Month Return**	**3 Month Return**	**6 Month Return**	**1 Year Return**	**3 Year Return**	**5 Year Return**	**7 Year Return**	**10 Year Return**
MSCI Emerging Markets index	-2.25%	-6.99%	-8.11%	-11.13%	4.87%	6.32%	5.07%	3.66%
MSCI AC Asia Pacific Excluding Japan Index	-0.62%	-5.62%	-6.24%	-10.44%	6.35%	7.43%	6.11%	6.41%
Real Assets (local Currency)	**1 Month Return**	**3 Month Return**	**6 Month Return**	**1 Year Return**	**3 Year Return**	**5 Year Return**	**7 Year Return**	**10 Year Return**
FTSE EPRA/NAREIT Develop Index	5.60%	-1.65%	10.62%	21.84%	6.57%	6.68%	5.26%	9.72%
S&P/ASX 200 A-Reit index	1.24%	-7.05%	2.33%	17.86%	5.49%	7.88%	8.10%	12.25%
S&P Global Infrastructure Index	5.90%	7.48%	12.40%	16.61%	7.96%	7.65%	6.61%	7.73%
Domestic Bonds	**1 Month Return**	**3 Month Return**	**6 Month Return**	**1 Year Return**	**3 Year Return**	**5 Year Return**	**7 Year Return**	**10 Year Return**
Australian Bond All maturity Composite	-3.75%	-5.88%	-7.25%	-5.55%	-0.28%	1.86%	1.91%	3.46%
Australian Corporate Bond Composite	-3.05%	-4.63%	-6.11%	-4.83%	0.96%	2.57%	2.74%	4.16%
Australian Inflation Linked Bond Composite	-4.27%	-6.53%	-4.38%	-1.66%	1.98%	3.08%	2.12%	3.83%
Bloomberg Australian Bond Treasury 0+ year Index	-4.03%	-6.26%	-7.62%	-5.54%	-0.61%	1.83%	1.73%	3.15%
Bloomberg Ausbond Credit FRN 0+ Year Index	-0.29%	-0.28%	-0.36%	-0.04%	1.19%	1.85%	2.20%	2.91%
Global Bonds (Local Currency)	**1 Month Return**	**3 Month Return**	**6 Month Return**	**1 Year Return**	**3 Year Return**	**5 Year Return**	**7 Year Return**	**10 Year Return**
Barclays US Treasury Total return (USD)	-3.11%	-5.58%	-5.41%	-3.67%	1.54%	1.76%	1.38%	1.67%
Barclays Global Aggregate Composite AUD Hedged	-2.13%	-4.98%	-4.95%	-4.01%	0.93%	1.99%	2.37%	3.87%
Barclays UK Government All Bonds Total return index (USD)	-2.21%	-7.57%	-5.21%	-5.38%	-0.29%	0.62%	1.87%	2.99%
German Bonds (Euro)	-2.85%	-5.06%	-4.84%	-5.30%	-1.25%	-0.06%	-0.05%	1.52%
Global Credit (Local Currency)	**1 Month Return**	**3 Month Return**	**6 Month Return**	**1 Year Return**	**3 Year Return**	**5 Year Return**	**7 Year Return**	**10 Year Return**
US Investment Grade Credit	-2.52%	-7.69%	-7.48%	-4.20%	3.17%	3.34%	2.99%	3.64%
Global Investment Grade Credit	-2.49%	-7.44%	-7.87%	-6.13%	2.11%	2.75%	2.44%	2.62%
Barclays US Corporate High Yield AUD Hedged	-1.14%	-4.91%	-4.39%	-0.97%	3.39%	3.97%	4.89%	6.44%
European High Yield or BB rated bonds	0.16%	-4.18%	-4.42%	-2.47%	2.26%	2.64%	3.13%	5.37%
Emerging Market Debt (USD/AUD)	**1 Month Return**	**3 Month Return**	**6 Month Return**	**1 Year Return**	**3 Year Return**	**5 Year Return**	**7 Year Return**	**10 Year Return**
JP Morgan EMBI Global Core Index (AUD Hedged)	-0.78%	-9.86%	-10.26%	-7.12%	-0.85%	1.04%	2.86%	4.25%
Commodities	**1 Month Return**	**3 Month Return**	**6 Month Return**	**1 Year Return**	**3 Year Return**	**5 Year Return**	**7 Year Return**	**10 Year Return**
Gold spot in USD	1.49%	5.92%	10.27%	13.45%	14.59%	9.17%	7.29%	1.45%
Gold spot in AUD	-1.51%	2.81%	6.49%	15.14%	12.65%	9.59%	7.54%	4.86%
Crude Oil Prices: Brent	6.85%	38.74%	37.43%	69.83%	16.07%	15.35%	10.08%	-1.49%
CRB Commodity index (USD)	9.70%	27.03%	28.94%	59.59%	16.76%	9.69%	4.85%	-0.56%
CRB Commodity index (AUD)	6.13%	23.32%	24.08%	62.17%	14.72%	10.13%	5.09%	2.78%
LME Index (USD)	6.56%	14.93%	24.35%	36.63%	19.26%	12.60%	9.45%	3.57%
LME Index (AUD)	3.09%	11.58%	19.66%	38.84%	17.17%	13.05%	9.70%	7.05%
Iron Ore (USD)	12.86%	24.89%	18.32%	-7.62%	19.55%	12.18%	14.63%	-0.18%
Iron Ore (AUD)	9.19%	21.25%	13.85%	-6.12%	17.46%	12.63%	14.89%	3.25%
FX	**1 Month Return**	**3 Month Return**	**6 Month Return**	**1 Year Return**	**3 Year Return**	**5 Year Return**	**7 Year Return**	**10 Year Return**
USD index (USDX, DXY)	1.66%	2.76%	4.33%	5.45%	0.37%	-0.41%	-0.01%	2.23%
AUDUSD Spot Exchange Rate	3.73%	3.11%	4.19%	-1.67%	1.72%	-0.37%	-0.23%	-3.22%
EURUSD	-1.21%	-2.44%	-4.13%	-5.47%	-0.41%	0.81%	0.46%	-1.83%
GBPUSD Spot Exchange	-2.17%	-3.04%	-2.34%	-4.67%	0.04%	0.89%	-1.71%	-1.99%
JPYUSD	-5.52%	-5.41%	-8.57%	-9.02%	-2.92%	-1.75%	-0.18%	-3.86%
RMBUSD	-0.49%	0.25%	1.66%	3.35%	1.92%	1.64%	-0.32%	-0.07%
AUDJPY	9.07%	8.83%	13.25%	8.30%	4.77%	1.40%	-0.05%	0.63%
AUDEUR	4.46%	5.82%	8.35%	4.40%	2.16%	-1.14%	-0.67%	-1.44%
AUDGBP	5.22%	6.05%	6.17%	3.31%	1.62%	-1.30%	1.49%	-1.32%
Other	**1 Month Return**	**3 Month Return**	**6 Month Return**	**1 Year Return**	**3 Year Return**	**5 Year Return**	**7 Year Return**	**10 Year Return**
HFRX Index Performance (in AUD)	2.57%	1.53%	1.72%	4.61%	8.35%	5.90%	4.30%	4.40%
HFRX Trend Following in AUD	3.10%	0.88%	0.00%	-0.47%	3.28%	1.80%	-0.02%	0.65%

Source: Bloomberg

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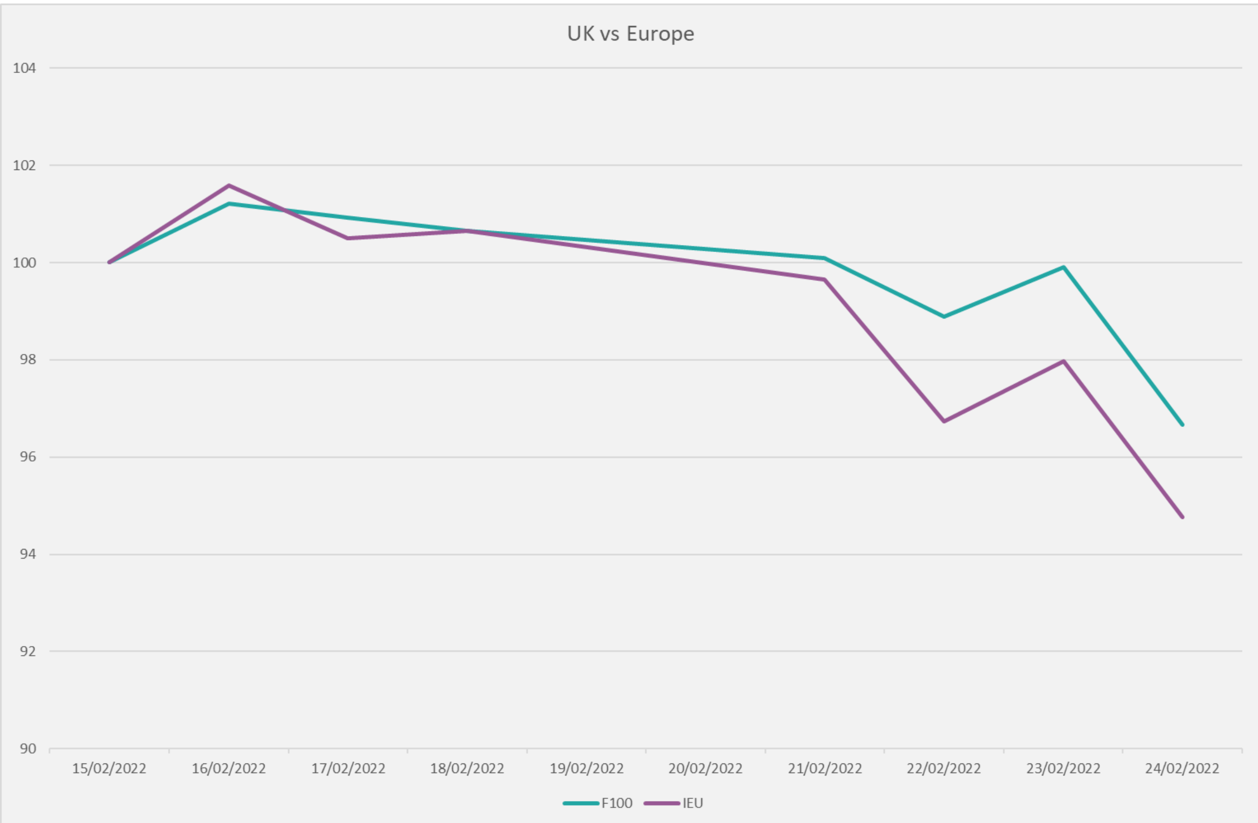
Calendar year 2022 started, almost to the day, with a fall in many major equity markets as fears about inflation finally hit share prices. The US began the year reporting CPI of 7.5% and core inflation (which excludes volatile items such as food and fuel) of 6%. However, performance was not uniform across regions or sectors. Australia fell in January much like the US, and it was the highly inflated tech sector and 'growth' stocks that led the fall. However, markets such as the UK, as represented by the FTSE100 index, actually bucked this trend and staged a small rally in January. February talks turned to the threat of invasion by Russia in the Ukraine, and by the end of February contrary to most expert opinion Russia staged the beginning of its war on the Ukraine. This saw swift action and condemnation from the rest of the world, including sanctions on Russia's central bank preventing trade in USD and exclusion from the SWIFT payments system. This sharply reversed the strong start to the year of areas such as Europe and the UK, but perversely aided the Australian equity market to rally strongly from its lows in January.

In February we produced a number of charts to show the immediate aftermath on specific portfolio holdings, some of which we have reproduced below:



Source: ASX.com.au

The above represents the move out of our European exposure and into the F100 ETF. While losing money isn't good, if you're going to be invested in markets you need to be prepared for it, and do your best to lose less, or as little, as possible.

Below demonstrates that our largest tilt, to Value global equities, acted not only to protect in January but continued to do so in the immediate aftermath of the invasion. Interestingly, the hedge we hold against Value in case our Value call is wrong, Quality

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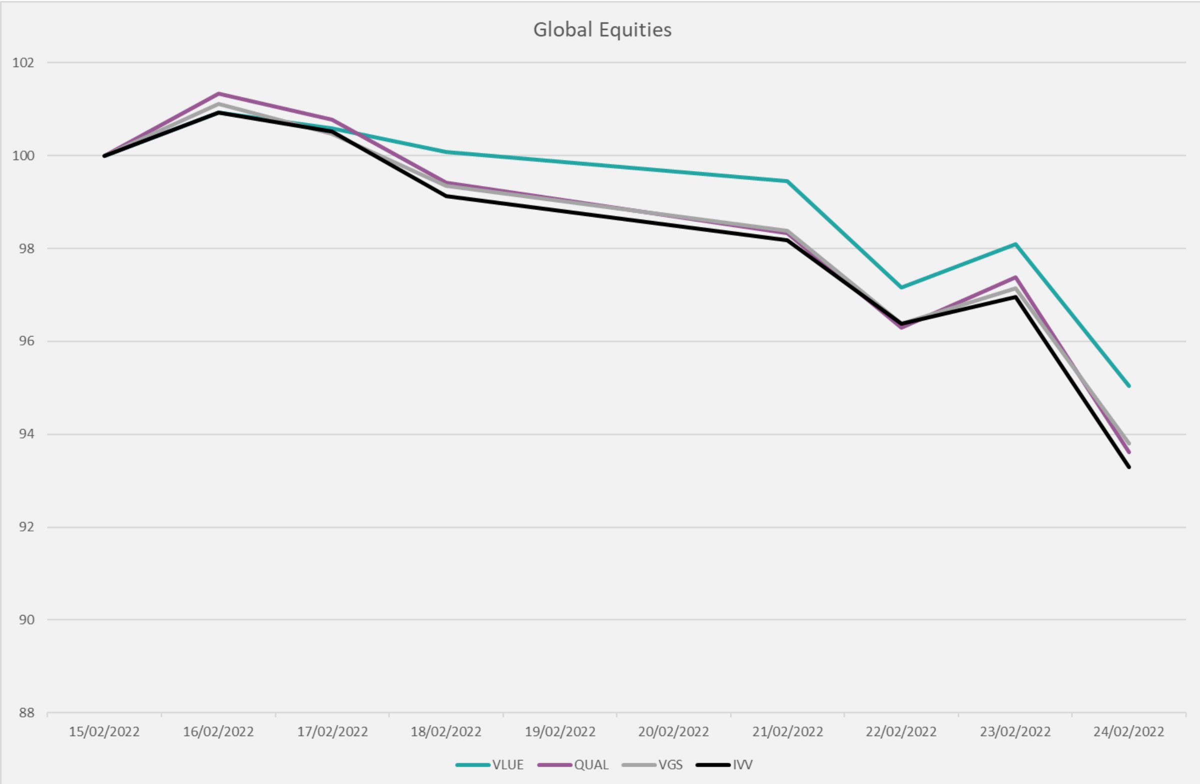
equities in the form of the ETF QUAL, hasn't fallen further than the broader market (VGS ETF) or the S&P500 (IVV ETF):



Source: ASX.com.au

On inflation, the reason it has a large impact on richly priced stocks is reasonably clear – the future earnings of a company (or group of companies) is worth less in the future the higher inflation becomes. The purchasing power of a dollar is reduced because it buys less, therefore the value of the business is reduced. When future earnings are priced in almost to infinity and with little risk associated with those earnings, the loss of purchasing power logically diminishes the worth of those businesses. This is seen in the larger magnitude of the fall in QUAL as well as the S&P500 and International equity ETFs compared to VLUE.

However, if higher prices are driven up by increased demand for goods and services, the price of finite inputs such as energy also increase. Whether supply chain shortages or increased demand began the rise in inflation, we now have high energy and material prices, along with wages growth and increases in cost of goods. While inflation decreases the purchasing power of a company's future earnings, it is also true that some businesses are beneficiaries of higher prices -Australia has been in the fortunate position to be a net exporter of commodities, and so has been a safe haven during this difficult period. In addition, global energy producers, agricultural commodity providers and gold producers have also been beneficiaries.

Asset Allocation and Market Valuation

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Below are our current views on the outlook for a series of investible assets to provide you some context for the positioning within your portfolios. These are the outputs from our asset class risk modelling and return forecasts, which involve the underlying risk and return drivers, including growth outlook and market valuation.

Asset Class	Forecast	Change on QTR
Australian Shares	Neutral to mildly expensive	No Change
Global Shares	Mildly expensive	No Change
US Shares	Expensive	No Change
Asia ex Japan Shares	Neutral	No Change
European Shares	Neutral	No Change
Australian Government Bonds	Expensive long term	No Change
Australian High-Grade Credit	Neutral	Upgrade
Global Sovereign Bonds	Expensive long term	No Change
Global High-Grade Credit	Mildly expensive	No Change
High Yield Bonds	Expensive	No Change
Emerging Market Debt	Expensive	No Change
A-REITs	Mildly Expensive	Downgrade
G-REITs	Neutral	Upgrade
Global Listed Infrastructure	Neutral	Downgrade
AUD	Neutral	No Change
USD	Neutral	No Change
Gold	Positive	No Change
Cash and Term Deposits	Expensive (no real yield)	Downgrade

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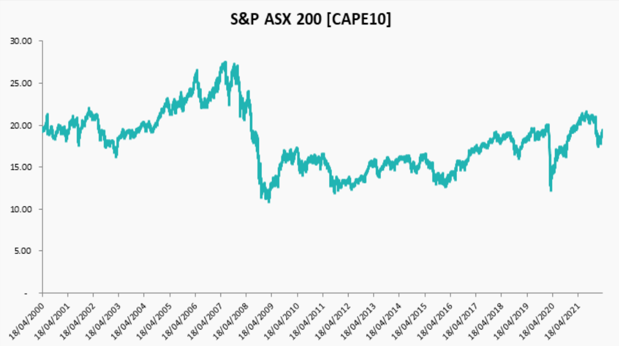
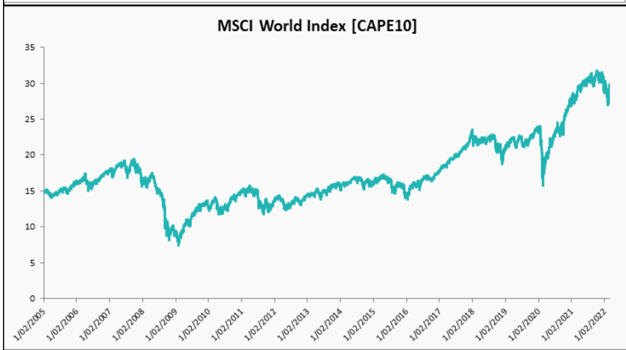
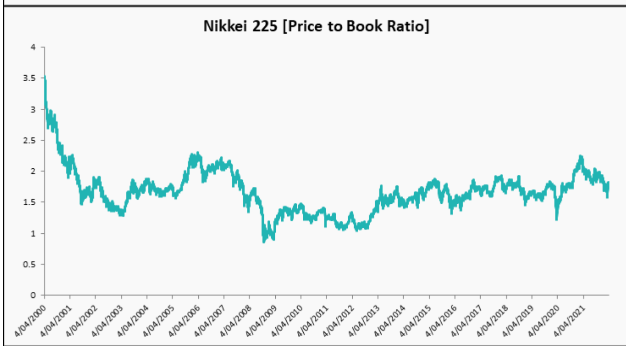
Valuation



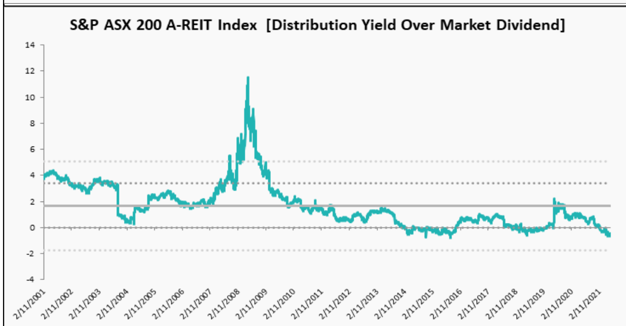
The Australian market has held up well in the current period of market volatility, primarily due to its large materials exposure. Expectations of rising rates may put this under pressure throughout 2022 as the CPI print begins to creep up well above the RBA's target 2-3% inflation band.



The MSCI has fallen over the quarter, making the valuation compared to the end of 2021 more attractive. However, relative to history the fall has been minor, and from a very high level, so has not yet fallen into attractive territory yet.



Japan remains a bit of an enigma. Its recent poor performance makes the valuation associated with the index look better overall, however the reasons underlying its price movement are not clear. Theoretically, it has many of the same growth drivers as the rest of Asia (apart from much worse demographics), and is reasonably priced, yet seems to be lumped in with the capital flight out of the emerging Asia markets. We continue to monitor it closely



A-REITs are once again not yielding a premium over the broader equity market. It is questionable what the longer term outlook for domestic REITs looks like when the broader ASX200 has a higher yield, more diversification, greater growth potential and higher dividend yield.

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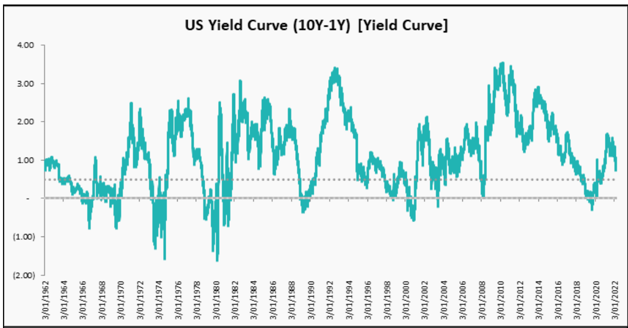
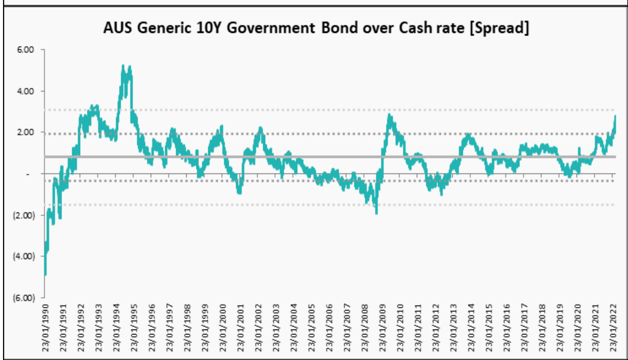
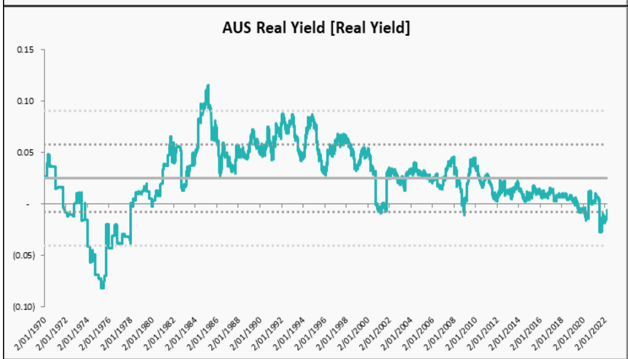
	The US yield curve temporarily turned negative (for 2 days) in the quarter, sparking questions of the potential for a recession in the future. However, the yield curve is not a perfect indicator, and a negative yield curve prior to recession has historically required at least 10 days in negative territory before a subsequent recession. That said, rising rates at a time of economic slowdown could be a meaningful drag on future growth potential
	Even with duration (interest-rate sensitivity) looking unattractive in the face of inflationary pressure, the Australian Government bond rate trades at a yield premium over cash that is above the long-term average. Whilst we want a reduced position in these markets, we think it unwise to exit them completely as they could still act as a good portfolio hedge in times of turmoil, particularly at the current yield/spread level.
	From the spread over cash rates above, Australian Government bonds look reasonably attractive, however, even with the rise in nominal rates, when adjusted for inflation yields are still negative. Whilst real (or inflation adjusted) yields remain negative, there is going to be a headwind for long duration bonds.

Source: Bloomberg, Innova

Asset Class Tilts:

Asset Classes we are tilting towards

- We have tilted to equity markets that have more attractive valuations – UK equities via the F100 ETF providing exposure to the FTSE100 (one of the few equity markets apart from Australia posting positive returns for the quarter in local currency terms [refer to above performance table]). Emerging markets and Asia are still in our portfolios but on watch, whilst recent weakness in Japan provides a potential opportunity. Our preference for robust and sustainable earnings growth may be difficult to come by as economies re-open then shut borders with waves of COVID coming and passing compounded by supply-chain bottlenecks and, importantly, energy input costs in the form of oil and gas.

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- We maintain a bias to high-grade credit and loans, as well as inflation protection and non-correlated sources of return and have increased this exposure with the reduction in negative yielding cash
- We are reducing our tactical allocation to cash to take advantage of price anomalies when they present themselves, and plan to further deploy this tactical cash throughout the year if warranted. We are looking to alternative forms of cash to enhance return where possible without taking undue risk, which can be seen in our short-term fixed income allocations in portfolios

Asset Classes we are tilting away from

- We remain tilted away from US equities based on valuation, and growth style equities in particular, though maintain some exposure through our Quality equity exposure. If the situation eventuates that the economy and/or markets slow, and these equities improve in attractiveness, this is somewhere we are looking at closely to increase allocations at the right price
- We have not taken on excessive credit or duration risk in the fixed income component of our portfolios, and in fact have reduced the relative allocation to duration in favour of floating rate credit given wider short-term yields. In the sub-investment grade and private credit markets (excluding domestic loans) we don't believe investors are being compensated for the risk they are taking.
- We have little exposure to Growth style equities given their stretched valuations, however we maintain an allocation in Australian equities to hedge our value exposure since true 'Quality' exposure is hard to come by due to the large sector biases in the market. This may reverse if inflation concerns cause their prices to fall sufficiently to make them attractive again and our current allocations don't represent as attractive a relative valuation and return outlook

Asset Classes we have a neutral position in

- We are fairly neutral to Real Assets and Australian equities due to valuation levels. Select infrastructure assets and global REITs look reasonable, though we are questioning A-REITs and broad infrastructure in the current geopolitical environment and rising rate environment
- We remain neutral on Global equities, predominantly because of the very high weighting to the US.

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Market Outlook

Our biggest area of focus now is on whether inflation will stay persistent, if the Federal Reserve has left acting too late and therefore likely to sacrifice markets and the economy to squash inflation, or if economic growth is robust enough to allow for real economic growth and higher inflation even during a rate hiking cycle.

To begin, we will draw on our weekly letter from 29 March:

"*To start out, we'll look at the February reports from the Institute of Supply Management (ISM). They provide indicators such as the Manufacturing and Services PMI's (Purchasing Managers Index). When you read about PMI's for various sectors/regions/economies, a number above 50 represents expansion, below 50 contraction. The Global Manufacturing PMI is Feb was 58.6, up 1 point from Jan at 57.6. According to the report, the overall economy is growing, and the rate of change is faster:*

Manufacturing at a Glance
February 2022

Index	Series Index Feb	Series Index Jan	Percentage Point Change	Direction	Rate of Change	Trend* (Months)
Manufacturing PMI®	58.6	57.6	+1.0	Growing	Faster	21
OVERALL ECONOMY				Growing	Faster	21
Manufacturing Sector				Growing	Faster	21

Manufacturing ISM® *Report On Business®* data is seasonally adjusted for the New Orders, Production, Employment and Inventories indexes.
*Number of months moving in current direction.

Source: https://www.ismworld.org/supply-management-news-and-reports/reports/ism-report-on-business/pmi/february/

We have excluded the majority of the detail here for brevity; however, the full report can be taken from the link provided. For the Service sector, things are growing but at a declining pace (and again we have provided the relevant summary plus link):

ISM® SERVICES SURVEY RESULTS AT A GLANCE COMPARISON OF ISM® SERVICES AND ISM® MANUFACTURING SURVEYS*
February 2022

	Services PMI®						Manufacturing PMI®		
Index	Series Index Feb	Series Index Jan	Percent Point Change	Direction	Rate of Change	Trend** (Months)	Series Index Feb	Series Index Jan	Percent Point Change
Services PMI®	56.5	59.9	-3.4	Growing	Slower	21	58.6	57.6	+1.0
Overall Economy				Growing	Slower	21			
Services Sector				Growing	Slower	21			

Services ISM® *Report On Business®* data is seasonally adjusted for the Business Activity, New Orders, Employment and Prices indexes. Manufacturing ISM® *Report On Business®* data is seasonally adjusted for New Orders, Production, Employment and Inventories indexes.
**Number of months moving in current direction.

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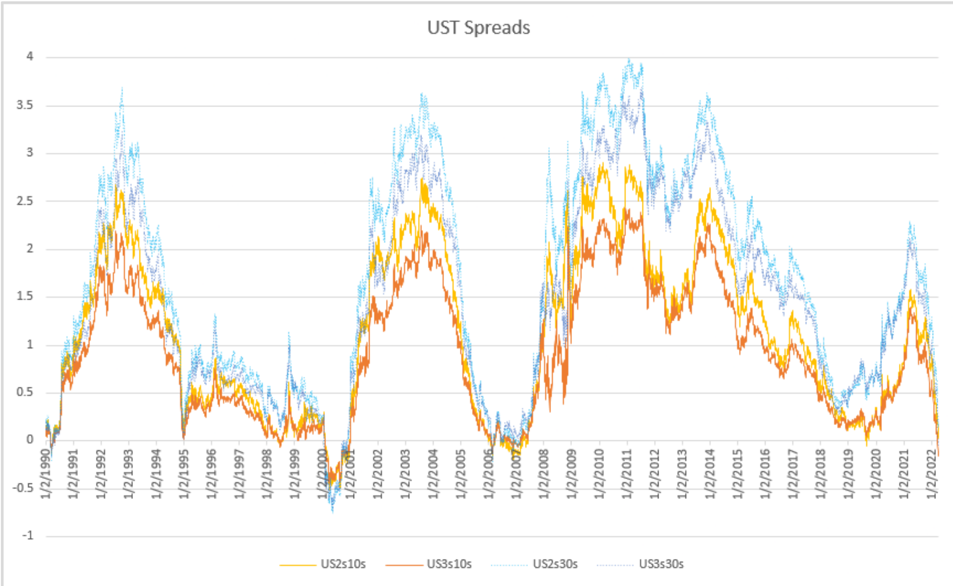
Source: https://www.ismworld.org/supply-management-news-and-reports/reports/ism-report-on-business/services/february/

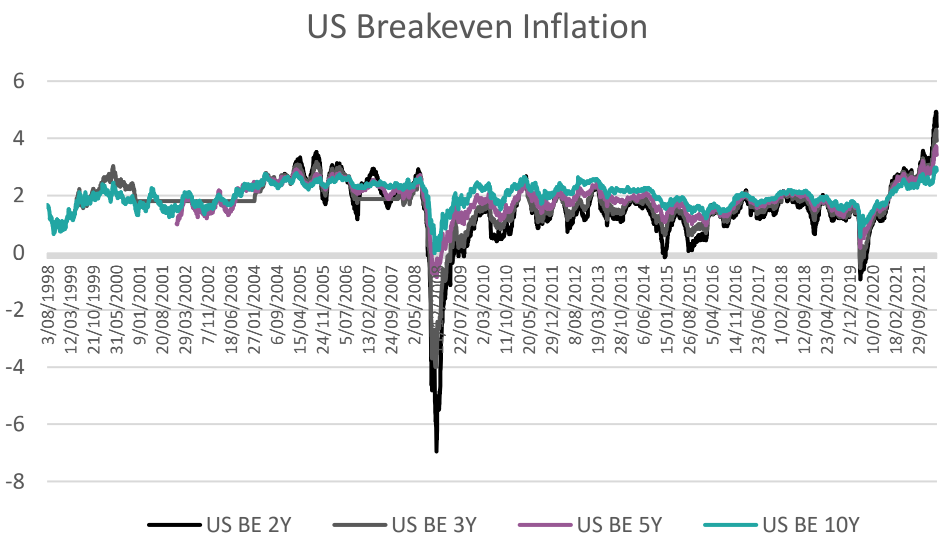
So far so good, an expanding economy, albeit with the rate of change in the services sector slowing. Innova's data concurs with this finding. However, this is readily available data, and if ours concurs with the consensus perhaps we should continue looking elsewhere to draw insights that might give us a better indication of where things are headed?

Whilst there is no shortage of economic forecasters available, one group that has been focussed on economic and inflationary cycles for over 100 years is the Economic Cycle Research Institute (ECRI). Their view is that inflation is neither transitory nor structural, but cyclical. They have developed their modelling over many years (a century) to help model the likelihood of future growth. According to their research, right now they can't say for sure whether the economy is currently vulnerable and likely to recede, as a lot will depend on what the Federal Reserve do over coming months. However, what they are confident of is that the economy is not in a resilient state. So, as it stands today, they are NOT forecasting a recession and subsequent stagflation, however they believe the economy is also not in a resilient position either, so the next few months will be key to determining its path in the future. One of their focusses is on this concept of 'resilience', and in a publicly available podcast they reference how the bombing of Pearl Harbour in 1941 didn't lead to a recession because the economy was in a resilient state, yet the Gulf war in 1990 DID lead to a recession as they forecast that the US economy was already vulnerable to economic shock. They were quoted frequently post the 1987 stock-market crash, publicly stating it was unlikely to lead to recession because they forecast the economy was resilient to exogenous shocks.

So where does this leave us? In short, the base case for cyclical inflation is still in place, and the economy is still growing – so this has a reasonable probability of being positive for reflation positions such as value equities, short-dated and floating rate bonds with a high credit rating, supportive of materials and commodities, as well as Gold."

We have then looked at US Non-farm payrolls, US Real average hourly earnings year-on-year, capacity utilization and home price indices as well as current and forecast EPS growth. The picture is clear as mud – the US, and by extension, the global economy is fragile but not broken. Other market related indicators which also incorporate inflation have been considered, such as various yield curves and Break-Even-Inflation (BEI) for various durations:





Source: Bloomberg

The market seems to be suggesting a slowdown in the market, not necessarily a recession, and higher inflation in the short term with BEI meaningfully higher over 2 and 3 years compared to 5 and 10.

This suggests to us that things could go a number of different ways:

1. The FED makes inflation their primary concern and raise rates even in the face of a slowing economy. This could lead to a market fall
2. The FED may begin doing the above, but at the first signs of market weakness, follow their playbook of the last decade and rush to the rescue with a stop to rate rises and initiation of Quantitative Easing (QE) again. This would likely be inflationary

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3. The economy may be in a position to weather rate rises, effectively instigating a soft landing and return to more 'normal' economic conditions, yet fuelled with higher but reasonable inflation

The first situation is likely the worst for markets, but best for the economy long term. In that environment we believe the positions we hold are the right ones, but we may want more fixed rate sovereign bonds and less equities in general – though maintain the value bias we currently hold

In the second scenario, cyclical exposures that are not overly expensive should benefit the most, and equity exposure should be rewarded

The third would likely initially be beneficial for cyclical businesses as 'growth' stocks get re-rated by the acceptance of higher inflation, but then a resumption of the 'growth' trade. Sovereign Bonds would slowly increase in yield until they return to a more normal upward sloping yield curve.

At this point we are positioned for the second scenario, hope for the third and hope the first does not occur. However, we have a plan in place as more information becomes available and we are better able to probability weight the likelihood of each scenario. We think the next few meetings of Central Banks, primarily the FED but also the RBA, Bank of England and ECB will provide us with a better idea of the more or less likely path.
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