

# Sestante Assertive Index Portfolio



## Monthly Investment Report As of 31/01/2023

### MARKET REVIEW

After having contracted -0.6% in H1 2022, the US economy expanded for the second consecutive quarter from September to December, settling the recession debate once and for all. In fact, US GDP grew by a better than expected +0.7% QoQ for the period, after having risen +0.8% in Q3. Looking at the data on a yearly basis, US GDP continued to slow down as it grew +1.0% YoY in Q4, down from the +1.9% recorded in Q3 and below its long term average trend of +1.5/+2%. Looking under the hood, numbers were not as sanguine as the headline suggests, with inventories and government consumption expenditures accounting for 52% and 21% of the total figure respectively.

(Continues on page 3...)

### Latest performance\*

|                          | 1-mth | 3-mths | 1-yr  | 3-yr | Inception |
|--------------------------|-------|--------|-------|------|-----------|
| Sestante Assertive Index | 3.15  | 5.43   | -0.54 | 2.48 | 6.45      |
| RBA Cash Rate + 3% p.a.  | 0.52  | 1.52   | 4.61  | 3.67 | 3.78      |

\*Past performance is not a reliable indicator of future performance. Performance is calculated before taxes, model management and platform fees and after underlying investment management fees. For full details of fees please refer to the relevant platform offer documents. Performance is notional in nature and an individual investor's actual performance may differ to the that of the model portfolio. Investment performance is shown from 7/2/2019 and represents modelled performance only and assumes income received is reinvested.

### \$10,000 invested over time



■ Sestante Assertive Index

— RBA Cash Rate + 3% p.a.



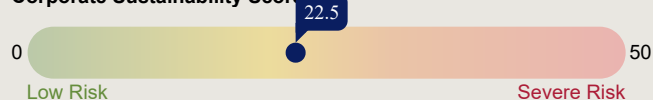
### Portfolio information

- Investment Objective: target RBA cash rate +3.0% per annum over rolling 7-year periods after fees.
- Asset Class: Diversified
- 85% Growth / 15% Defensive
- Portfolio Inception Date: 7 February 2019

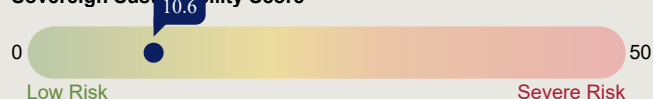
## Sustainability Score

● Sestante Assertive Index

### Corporate Sustainability Score



### Sovereign Sustainability Score



## ESG Pillar Score



6.2

Environmental



9.1

Social



6.8

Governance



0.6

Unallocated

## Major Index Returns

1 Month 3 Months 6 Months 1 Year 3 Years

S&P/ASX 200 TR AUD

— — — — —

MSCI World Ex Australia GR AUD

2.99 -0.61 1.17 -7.43 6.27

Bloomberg AusBond Composite 0+Y TR AUD

2.76 2.20 -0.85 -6.26 -2.74

Bloomberg Global Aggregate TR HdG AUD

2.10 3.15 -3.53 -8.94 -3.08

S&P Global Infrastructure NR AUD

1.04 0.54 -0.02 5.04 0.32

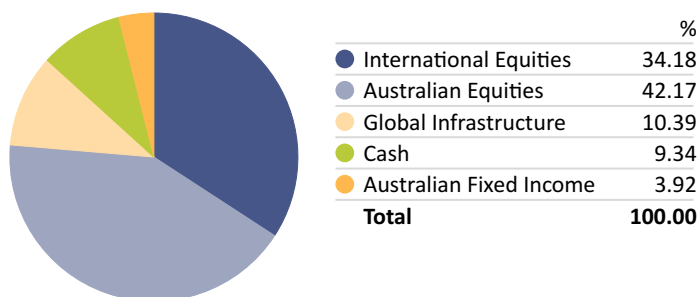
### Important information

The Morningstar Historical Corporate Sustainability Score is a weighted average of the trailing 12 months of Morningstar Portfolio Corporate Sustainability Scores. Historical portfolio scores are not equal-weighted; rather, more-recent portfolios are weighted more heavily than older portfolios. Combining the trailing 12 months of portfolio scores adds consistency while still reflecting portfolio managers' current decisions by weighting the most recent portfolio scores more heavily.

ESG pillar scores are displayed as a number between 0 and 100 with most scores range between 0 and 25. It is the asset-weighted average of the company environmental, social, governance risk scores for the covered corporate holdings in a portfolio. The scores measure the degree to which a company's economic value may be at risk driven by environmental, social, and governance factors. The risk represents the unmanaged risk exposure after taking into account a company's management of such risks.

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## Current Asset Allocation



## Where your funds are invested

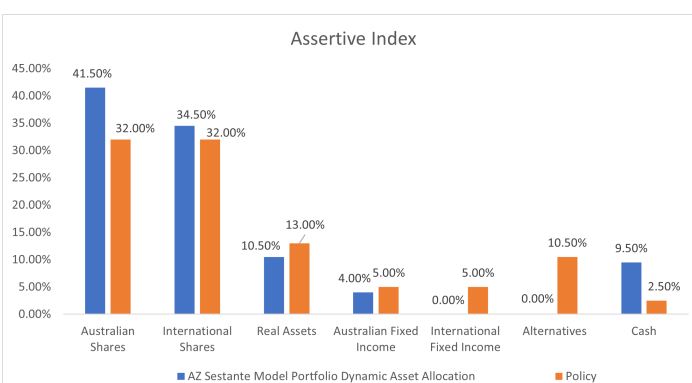
|                                       |               |      |
|---------------------------------------|---------------|------|
| <b>Australian Equities</b>            | <b>42.17</b>  | —    |
| iShares Core S&P/ASX 200 ETF          | 32.64         | ●●●● |
| iShares Australian Equity Index       | 9.52          | ●●●● |
| <b>International Equities</b>         | <b>34.18</b>  | —    |
| Vanguard All-World ex-US Shares ETF   | 17.08         | ●●●● |
| iShares S&P 500 AUD Hedged ETF        | 11.53         | ●●●● |
| iShares S&P 500 ETF                   | 5.57          | ●●●● |
| <b>Global Infrastructure</b>          | <b>10.39</b>  | —    |
| VanEck FTSE Gbl Infrs(Hdg)ETF         | 6.58          | ●●●● |
| Vanguard Global Infrastructure Index  | 3.81          | ●●●● |
| <b>Cash</b>                           | <b>9.34</b>   | —    |
| BetaShares Aus High Interest Cash ETF | 6.53          | —    |
| RBA Cash Rate Target                  | 2.81          | —    |
| <b>Australian Fixed Income</b>        | <b>3.92</b>   | —    |
| iShares Australian Bond Index         | 3.92          | ●●●● |
| <b>Total</b>                          | <b>100.00</b> |      |

**Morningstar's Globe Ratings** are just one tool that can help investors work out a fund's ESG credentials. A 5 Globe Rating indicates a fund is at the top end of its peer group in terms of sustainability, while a 1 Globe Rating shows it is underperforming on sustainability issues.

## Portfolio changes

There are no portfolio changes this month.

## Active Asset Allocation: AZ Sestante Model Portfolio vs Investment Policy Target As of 31/01/2023



However, with the largest economy in the world still humming along, inflation cooling off and the labour market providing signs of normalization, stock markets worldwide took off in January. Sentiment swung abruptly from fear to extreme greed, igniting a frenzied “dash for trash” as the most speculative, economically sensitive and beaten-up risk assets led the way higher. Almost anything that crashed in 2022 boomed during the first month of 2023.

Volatility decreased for the 3<sup>rd</sup> month out of the last 4, as the VIX Index, the measure which estimates the expected volatility of the S&P 500, dropped below 20 for the first time since December 2021. The rally was broad-based, with more than 60% of the S&P 500 stocks closing above their 200-day moving averages, compared to just 5% at the end of September 2022. Historically, strengthening breadth and momentum coupled with “junk” leadership tends to happen in the aftermath of a crisis or a recession and signals the early stage of a new bull market. Notable examples include January 2001, November 2002 and April 2003, April and May 2009 and November 2020. In January 2001 the US economy was two months away from a recession, although a very shallow one, which according to the National Bureau of Economic Research (NBER) lasted from March to November of that year. As a result, the stock market fell more than -40% in the following 18 months. Conversely, in all other instances equities were significantly higher 6 months later, as the US economy had already exited a recession and it was on track towards full recovery (November 2002 and April 2003, November 2020), or it was about to do so (April and May 2009).

#### **International Equities**

US equities rose sharply for the month, with the S&P 500 (+6.18% in USD terms) and the Nasdaq 100 (+10.62% in USD terms) recording their best January since 2019 and 2001 respectively. The Russell 2000, which tracks the performance of smaller companies, was up +9.69% even though 40% of its constituents were unprofitable in 2022. Gains for the “Old economy” heavy Dow Jones Industrial (+2.83%) were more muted as investors rotated aggressively from value to growth and from defensives to cyclical. As a result, the oldest benchmark for US stocks underperformed the Nasdaq 100 by the largest amount since October 2002. Healthcare, utilities and consumer staples ended the month in the red, the latter sector recording its worst relative month ever vis-à-vis consumer discretionary, which instead posted double digit gains to record its 4<sup>th</sup> best month ever. Communication services, materials, technology, financials and real estate outperformed the general index. Despite a solid performance in nominal terms, US equities underperformed the rest of the world (as exemplified by the MSCI AC World Index ex USA TR Index) for the third month in a row as the greenback softened across the board. Europe topped the list, as Eurostat confirmed that the region avoided an economic contraction in Q4 2022 with its GDP expanding +0.1% QoQ. The Old Continent was helped by a warmer than normal winter, which contributed to a collapse in the price of natural gas to levels well below the start of the Russian invasion of Ukraine, alleviating the energy crisis. Emerging markets outperformed the general index, led higher by North Asia. Chinese equities rallied following the easing of macroprudential measures in the real estate sectors announced by the government, which included a relaxation of the “three red lines” policy restricting borrowing by property developers. Technology, travel and consumer stocks posted strong gains. South Korea and Taiwan benefited from the recovery of semiconductor stocks. Conversely, Japan was the worst performing region. Finally, The MSCI World Growth Index recorded its 9<sup>th</sup> largest monthly outperformance ever vis-à-vis the MSCI World Value. All in all, the MSCI AC World Daily TR was up +7.17% in USD terms and +3.67% in AUD terms.

#### **Australian Equities**

The S&P/ASX 300 TR rallied +6.29% in January with every sector except utilities up. Consumer discretionary were the best performing group, led higher by retailers. A-REITs outperformed on expectations of interest rates having reached their peak. Materials continued to benefit from the reopening in China and from the prospects of upcoming fiscal and monetary stimulus. Smaller companies outperformed the Top 20, while mid-caps lagged. Finally, the MSCI Daily TR Net Australia outperformed the MSCI AC World Daily TR for the third consecutive month.

#### **International Fixed Income**

On January 4<sup>th</sup>, the FED released the minutes from its meeting held on December 14<sup>th</sup>. At that time the FED downshifted to a 50 Bps hike following 3 consecutive increases of 75 Bps, cementing market expectations for a slower pace of tightening in 2023. However, the minutes showed that the central bank remains committed to bringing inflation back to target and it is prepared to maintain higher interest rates until more progress is made. In particular, it was noted that no member of the committee was expecting rate cuts in 2023 and there was unanimous consensus that restrictive conditions should be maintained until 2024. On January 18<sup>th</sup>, the Bank of Japan (BOJ) kept its monetary stance unchanged, leaving its key policy rate at a negative -0.1% and the target for the 10 year yield under its yield curve control (YCC) program around 0%. It also confirmed that it will continue with its large scale purchases of government bonds to defend its stimulus framework. Two days later, the domestic inflation number for December came out and exhibited a further acceleration to +4.0% YoY.

On January 25<sup>th</sup>, the Bank of Canada (BOC) increased its policy rate by 25 Bps to 4.5%, the highest level in 15 years and became the first major central bank to declare that it would hold off on further increases. Following a cumulative 425 Bps of tightening in the space of 10 months Governor Tiff Macklem finally announced that the central bank was pivoting to a “conditional pause” to “assess whether monetary policy is sufficiently restrictive to bring inflation back to its 2% target”. As a reference, inflation in Canada has declined to +6.3% in December from a peak of +8.1% in June.

European government bonds recorded their 9<sup>th</sup> best month ever, up +2.35% in EUR terms. Credit spreads tightened across the board, leading corporate investment grade, high yield, emerging markets and leveraged loans to outperform government bonds. All in all, the Bloomberg Barclays Global Aggregate Index hedged back to AUD recorded its best start of the year since 2015, up +2.10%.

#### **Australian Fixed Income**

Australian macroeconomic data painted a mixed picture in January. On the one hand, consumer confidence jumped +5%, its largest monthly increase since April 2021 and consumer sentiment inflected higher, though from very depressed levels consistent with a recession. On the other hand, employment fell unexpectedly in December, its first decline in 5 months, missing expectations for a modest rise. The unemployment rate held steady at 3.5%. Finally, domestic inflation accelerated to +7.8% YoY, its highest level since March 1990, exceeding expectations for a +7.6% increase. More worryingly, the Australia Monthly CPI Trimmed Mean, the measure preferred by the RBA, quickened to +6.9% YoY, its highest level since December 1988, exceeding forecasts of +6.5%. The Australian yield curve transposed lower, with the 2, 5 and 10 year yields dropping by the most since July 2022, down 28 Bps, 39 Bps and 50 Bps to 3.12%, 3.29% and 3.55% respectively. As a result, the Bloomberg AusBond Composite 0+ Yr recorded its best start of the year ever, up +2.76%. Finally, the Australian dollar strengthened across the board, appreciating vis-à-vis all major developed and emerging currencies. The domestic currency ended the month above 70 cents against the greenback for the first time since May 2022.

#### **Real Assets**

Global property rallied +8.42% in USD terms and +4.88% in AUD terms for the month. Europe was the best performing region for the second consecutive month, driven higher by the German residential subsector. US outperformed on the back of the strength in the industrial and office segments. Asia lagged the general index as Hong Kong consolidated gains following the reopening rally while Japan came last for the second month in a row.

Global infrastructure rose +4.45% in USD terms and +1.04% in AUD terms in January. Transportation stocks delivered solid gains, but the general index was held back by the poor returns of utilities. Following 5 consecutive months of outperformance, global infrastructure ended its winning streak against global property as in January the latter recorded its 10<sup>th</sup> best relative month ever vis-à-vis the former.

#### **Market Outlook**

2022 ended with economists placing a 70% chance of a US recession in 2023 and with the bond market pricing in an upcoming dovish pivot by the FED. One month into the new year and the data released so far points to a US economy on the verge of reaccelerating and to a central bank holding a monetary posture not restrictive enough. The jobs report published on February 3<sup>rd</sup> was a blockbuster as it showed that nonfarm payrolls (NFP) rose by 517,000, far exceeding expectations for an increase of 187,000. In addition, the unemployment rate declined to 3.4%, its lowest level since May 1969. To provide some context, in the US a “normal” economy tends to add around 200,000 NFPs per month, while a very “hot” economy like the one experienced in 2021 added an average of 600,000 NFPs per month. Labour is admittedly one of the most if not the most lagging indicator, that is, when people start to lose their jobs, the economic decline has already been underway for some time, but as Treasury Secretary Janet Yellen (correctly in our opinion) remarked “you don’t have a recession when you have 500,000 jobs and the lowest unemployment rate in more than 50 years”. She went on to say that she sees “a path in which inflation is declining significantly and the economy is remaining strong”. GDPNow, a “nowcasting” model created by the Federal Reserve Bank of Atlanta to provide a running estimate of the real US GDP growth based on available economic data for the current measured quarter, supports her view. At the time of writing of this note (February 16<sup>th</sup>), GDP growth for Q1 as projected by the model is tracking at +2.4% QoQ annualized. By comparison, market consensus is expecting the US economy to sequentially contract in both Q1 and Q2 and to rebound in Q3 and Q4 of this year.

On February 15<sup>th</sup>, the resiliency of US consumers was confirmed by the release of the retail sales figures for January, which rose +3.0%, handily beating expectations of an increase of +1.9%. More importantly, the number was significantly higher than the inflation reported for the same month (+0.5%), implying that the disinflation experienced in H2 2022, when US CPI declined from +9.1% to +6.4% YoY, has been boosting real disposable income and that consumption is now starting to respond accordingly. Higher spending has also been encouraged by the easing of financial conditions since October 2022. In fact, at the end of January the Goldman Sachs US Financial Conditions Index was at the same level it was back in June 2022 courtesy of the recovery in stock markets, tightening credit spreads and a weakening US Dollar. However, at that time the FED target rate was at 1.50%-1.75%, while today it is at 4.50%-4.75%. As the US economy is highly financialized, any easing of financial conditions tends to flow through to consumers pretty quickly. The US government has also done its part to push back against the efforts of its own central bank to combat inflation and slow down the economy. In fact, the US budget deficit expanded to 5.5% of GDP in December, a level historically consistent with an economy on the mend or in need of stimulus following a recession, as spending grew and revenue fell. As a result, during the full calendar year the US government added 1.4 Tril USD more to the economy than it took, that is, it ran a fiscal deficit as large as the one it ran at the height of the Global Financial Crisis (GFC) back in 2009. Finally, the two largest central banks by assets in Asia have recently restarted to increase their balance sheets, injecting new liquidity into the global financial system at the same time the FED, the European Central Bank (ECB) and the Bank of England (BOE) are withdrawing it. On the one hand, in the past two months the Bank of Japan (BOJ) has been forced to buy government bonds to defend the 0.5% cap on the 10 year yield set under its yield curve control (YCC) targets. On the other hand, the strengthening of the Renminbi that has followed the reopening of China is providing



the People's Bank of China (PBOC) with a window to loosen its monetary stance and support the recovery of the domestic economy.

All the dynamics detailed above point to the “soft landing” narrative continuing to prevail in H1 2023 and to a FED being nowhere near done. When it released its Dot Plot on December 14<sup>th</sup>, the central bank was projecting the so-called “terminal rate” to peak at a range of 5%-5.25% in 2023, before easing back to 4%-4.25% in 2024. However, we think it may have to go higher than that. Neel Kashkari, the president of the Federal Reserve Bank of Minneapolis, penned an article at the beginning of January in which he stated that he sees the FED “pausing at 5.4%” to ascertain “the full effects of the tightened policy” and then assess whether “to go higher or simply remain at that peak level for longer”. He concluded by saying that “any sign of slow progress that keeps inflation elevated for longer will warrant, in my view, taking the policy rate potentially much higher”. It seems to us that the scenario described by Kashkari is becoming more likely by the day. In other words, not only is there no “dovish pivot” coming any time soon, but the central bank may have to continue to hike rates for the rest of 2023, albeit at a much slower pace compared to 2022. In summary, the increased probability of a “soft landing” in the first half of the year may prompt the central bank to harden its monetary stance, increasing the probability of a “hard landing”, a.k.a. a recession, at the back end of the year.

For the above reasons, we think that the S&P 500 will continue to be stuck in a trading range between the current levels (4,200) which, in our opinion, fully discount the rosier scenario for the economy and corporate profits, and the lows of October 2022 (3,500). We will continue to participate in the stock market with a selective approach, favouring Australian equities over international equities and defensive sectors which offer income and dividends. The renewed geopolitical tension between US and China may provide us with an opportunity to increase our exposure to Asian ex. Japan equities in the context of attractive valuations and of a clearly positive macroeconomic (accelerating growth) and fundamental (increasing earnings) backdrop. In the fixed income space, we will continue to favour credit risk over interest rate risk in H1-23 as we think that the US 10 year yield is more likely to go back to 4.5% rather than to fall to 2.5%. Finally, we expect the Australian dollar to continue to trade around 70 cents vis-à-vis the US dollar despite an improved global risk appetite, which normally is conducive to a softening greenback. In fact, the recent stabilisation of the Dollar Index (DXY) points to the US economy outperforming that of the rest of the developed world in 2023, a condition sufficient to arrest the decline of the US dollar, but not to reverse it on its own.

#### **AZ SESTANTE**

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