CFS Sestante
Dynamic Diversified Portfolio
Super & Pension

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Monthly Performance Report
As of 31/03/2023

MARKET REVIEW

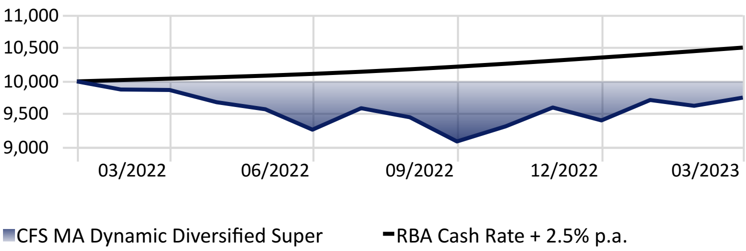
Three regional banks in the US and one global systemically important bank (G-SIB) in Switzerland went under in March, causing widespread volatility across asset classes. On March 9th, California-based, publicly listed Silvergate announced its intention to proceed with "an orderly wind down of Bank operations and a voluntary liquidation of the Bank" and to fully repay all deposits. Founded in 1988, Silvergate started to provide traditional banking services to crypto companies in the early 2010's and in 2018 it launched the Silvergate Exchange Network (SEN), a real-time payment platform used by its clients, primarily institutions, to seamlessly convert fiat into crypto and vice versa 24/7. (...Continues on page 4).

Latest performance*

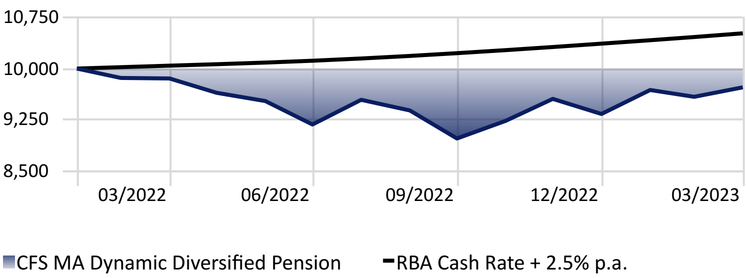
	1-mth	3-mths	6-mths	1-yr	Inception
CFS MA Dyn Div Super	1.29	3.66	7.29	-1.17	-2.45
CFS MA Dyn Div Pension	1.43	4.13	8.25	-1.31	-2.72
RBA Cash Rate + 2.5% p.a.	0.52	1.45	2.82	4.67	5.11
Morningstar AUS Balance Tgt Alloc NR AUD	1.62	4.22	8.07	-1.53	-2.47

*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 21/2/2022 and represents modelled performance only and assumes income received is reinvested.

$10,000 invested over time - Super



$10,000 invested over time - Pension

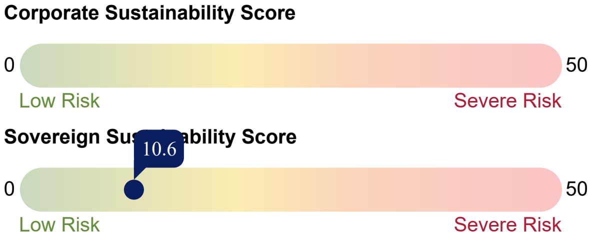


Portfolio information

- Investment Objective:
  target RBA cash rate +2.5% per annum over rolling 5-year periods after fees.
- Asset Class: Diversified
- 50% Growth / 50% Defensive Split
- Portfolio Inception Date: 21 February 2022
- Estimated Total Cost[1]:
  Super: 0.94%
  Pension: 0.94%

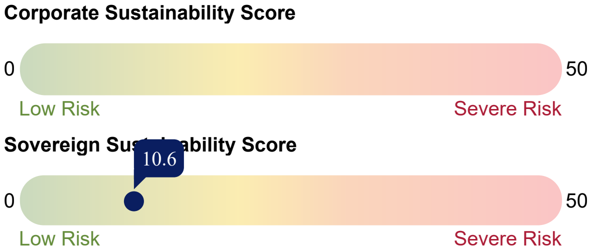
[1] Estimated total cost includes administration, investment and performance fees.

Sustainability Score - Super



● CFS MA Dynamic Diversified Super

Sustainability Score - Pension



● CFS MA Dynamic Diversified Pension

ESG Pillar Score - Super

Not Available

ESG Pillar Score - Pension

Not Available

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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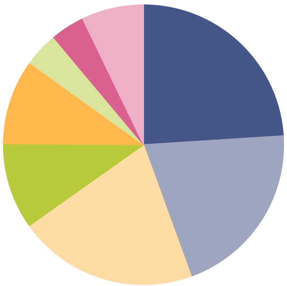
Current Asset Allocation - Super



	%
International Equity	23.98
Australian Bond	20.48
Australian Equity	20.72
International Bond	9.94
Cash	9.83
Global Infrastructure	3.97
Global Property	3.92
Australian Fixed Income	7.15
Total	**100.00**

Where your funds are invested

International Equity	**23.98**
CFS FC W PSup-Ironbark RL W Con Gb Share	7.24
CFS FC W PSup-CFS W Index Global Shr-Hgd	5.84
CFS FC W PSup-Stewart Inv W Wldwide Sus	5.08
CFS FC W PSup-Fidelity W Asia	4.23
CFS FC W PSup-Janus Henderson Glb Nat Re	1.59
Australian Equity	**20.72**
CFS FC W PSup-Schroder W Aus Equity	8.53
CFS FC W PSup-Fidelity W Aus Equities	6.55
CFS FC W PSup-Bennelong ex-20 W Aus Eq	5.64
Australian Bond	**20.48**
CFS FC W PSup-Franklin W Aus Abs Rtn Bnd	7.97
CFS FC W PSup-Pendal W Sust Au Fix Int	7.03
CFS FC W PSup-Macquarie W Income Opps	5.48
International Bond	**9.94**
CFS FC W PSup-Colchester W Glb Gov Bnd	4.98
CFS FC W PSup-PIMCO W Global Bond	4.97
Cash	**9.83**
CFS FC W PSup-FSI W Strategic Cash	9.83
Australian Fixed Income	**7.15**
CFS FC W PSup-CFS W Index Aus Bond	7.15
Global Infrastructure	**3.97**
CFS FC W PSup-FSI Gbl Listed Infrastruct	3.97
Global Property	**3.92**
CFS FC W PSup-Legg Mason M Curr Real Inc	3.92
	100.00

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.

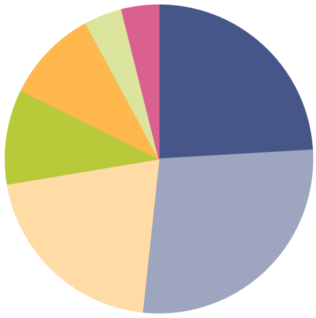
Portfolio changes

No changes this month

Major Index Returns

	1 Month	3 Months	6 Months	1 Year	3 Years
S&P/ASX 200 TR AUD	-0.16	3.46	13.19	0.10	16.52
MSCI World Ex Australia GR AUD	3.96	9.35	13.79	4.86	13.42
Bloomberg AusBond Composite 0+Y TR AUD	3.16	4.60	4.99	0.35	-2.37
Bloomberg Global Aggregate TR Hdg AUD	2.11	2.38	3.04	-5.48	-2.82
S&P Global Infrastructure NR AUD	3.01	5.03	10.36	7.35	11.30

Current Asset Allocation - Pension



	%
International Equity	24.07
Australian Bonds	27.64
Australian Equity	20.66
International Bonds	9.93
Cash	9.82
Global Infrastructure	3.97
Global Property	3.91
Total	**100.00**

Where your funds are invested

Australian Bonds	**27.64**
CFS FC W Pen-Franklin W Aus Abs Rtn Bond	7.96
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CFS FC W Pen-Janus Henderson Glb Nat Res	1.57
Australian Equity	**20.66**
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CFS FC W Pen-Bennelong ex-20 W Aus Eq	5.62
International Bonds	**9.93**
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Cash	**9.82**
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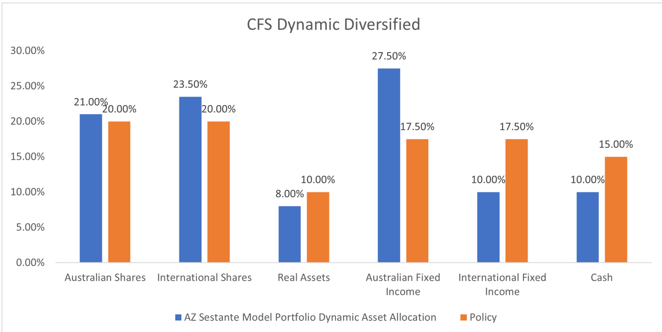
Portfolio changes

No changes this month

Active Asset Allocation: AZ Sestante Model Portfolio vs Investment Policy Target



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In particular, the network allowed some of the largest, participating crypto exchanges in the world to instantly move funds among each other. Following the collapse of FTX in November 2022, the second largest player in that space, customers withdrew more than 8 billion USD of deposits from Silvergate, which at their peak had reached 14 billion USD, causing the bank to sell assets on its balance sheet at a loss in order to meet outflows, effectively facing insolvency.

On March 10th, California-based, publicly listed Silicon Valley Bank (SVB) was taken over by the Federal Deposit Insurance Corporation (FDIC). Two days later, on March 12th, New York-based, publicly listed Signature Bank was seized by the state regulator and placed into an FDIC receivership as well. On the same day, the Treasury, the FED and the FDIC issued a joint statement in which they announced a "systemic risk exception" to make whole all depositors of those two institutions, and not just those holding up to 250,000 USD in their account ("insured depositors"). With 209 billion USD and 110 billion USD in assets respectively, the two collapses were the second and the third largest bank failures in US history, only topped by the demise of Washington Mutual Bank back in September 2008 (307 billion USD). That year saw the closure of 25 banks in total. According to data from S&P Global Market Intelligence, "the total assets of the two failures in 2023 amount to 87.6% of the total assets from the 25 failures of 2008".

As in the Silvergate case, a bank run was the proximate cause of the collapse of the two institutions. SVB grew rapidly during the pandemic era on the back of the boom in venture capital funding. Between the end of 2019 and the first quarter of 2022 it tripled its deposits. Flush with cash, it invested in high quality assets like government bonds and mortgage-backed securities (MBS), locking in a yield below 2% with a duration above 6 years. As the FED started to raise rates aggressively, SVB's portfolio suffered severe losses. On March 9th, panicked customers tried to pull 42 billion USD from the bank in a single day, an amount equivalent to almost 25% of its total deposits. Unable to meet outflows without selling assets at a loss, the bank became technically insolvent and had to be shut down. The plights of SVB were compounded by the fact that 93.8% of its total deposits were uninsured, hence more prone to become flighty, with the ten largest accounts holding 13.3 billion USD in aggregate. Signature Bank had the same issue, as 89.3% of its deposits were uninsured. A crypto-friendly bank owing to its Signet blockchain-based payment system, it had more than 20% in crypto-related client deposits, including 240 million USD from Coinbase, the US's biggest crypto exchange. The bank was hit by a "crisis of confidence" after the fall of SVB, as customers withdrew about 20% of its total deposits on March 10th, resulting in it being seized by the government.

On March 16th, 167-year-old Credit Suisse, the second largest lender in Switzerland, announced that it had secured a 54 billion USD lifeline from the Swiss National Bank (SNB), becoming the first G-SIB to receive emergency lending since the 2008 financial crisis. However, unbeknownst to the market, the so-called Swiss "trinity" of the SNB, regulator Finma and the minister of finance were orchestrating the merger of the bank with UBS, the largest lender in Switzerland. A deal to be finalized by Sunday, March 19th, "before Asia opens". In fact, scandal-ridden Credit Suisse was haemorrhaging more than 10 billion CHF of wealthy clients' money on a daily basis. The Swiss government had to pass two emergency laws to make the deal possible, the first suppressing the rights of the shareholders of the two banks to approve the merger and the second fully writing off the additional equity capital (AT1) of Credit Suisse in the amount of 16 billion CHF. The latter decision deviated from the norm, as, under the terms of the final agreement, Credit Suisse's shareholders received 3.25 billion USD, around 40% of the value of the company at its last closing price on March 17th, while the holders of the bank's AT1 bonds were completely wiped out. AT1 bonds, also known as Contingent Convertible (CoCo) bonds, are issued by major banks around the world and are an asset class worth 275 billion USD. They are the riskiest type of debt, designed to be converted into equity or cancelled if the lender runs into trouble. They ordinarily rank senior to equity in a bank's capital structure. The unusual decision of FINMA to write them off before the shares of Credit Suisse prompted an abrupt repricing of the entire sector, with yields exploding into double digit territory and prices sinking. In the aftermath of the merger, European and Asian regulators were forced to issue statements confirming that equity holders will absorb losses before holders of AT1 to calm the market rout.

International Equities
US equities ended a tumultuous March in the black. The S&P 500 (+3.51% in USD terms) and the Nasdaq 100 (+9.46%) outperformed the "Old economy" heavy Dow Jones Industrial (+1.89%) for the third month in a row, as investors sought refuge in the perceived safety of the so called "Big Tech" group of companies. The Nasdaq 100 was up +20.49% for the first three months of the year, its best quarter since Q2 2020. Investors continued to rotate aggressively from value to growth and from cyclicals to defensives. Technology, communication services, utilities and consumer staples were the best performing sectors, while financials, real estate, materials and energy declined over the month. As a result, the S&P 500, which is highly concentrated in the former sectors, recorded its 3rd best relative monthly return vis-à-vis the more diversified S&P 500 Equal Weight Index. The S&P Regional Banks Select Industry Index TR crashed -28.16%, its 3rd worst month ever. Before its collapse, Silicon Valley Bank was its largest holding at 2.3%. The weakness in financials dragged the Russell 2000 (-4.98%) lower. As a result, the benchmark for the performance of smaller companies recorded its 3rd worst relative monthly return vis-à-vis the Nasdaq 100. US equities outperformed the rest of the world (as exemplified by the MSCI AC World Index ex USA TR Index) for the second consecutive month despite a softening Dollar Index (DXY). Japan was the best performing region, ending a two-months losing streak, while Europe and emerging markets underperformed the general index. All in all, the MSCI AC World Daily TR was up +3.08% in USD terms and +3.90% in AUD terms as the Australian Dollar depreciated against all major developed and emerging currencies. Within the benchmark, sectors and factors saw a wide range of return dispersion. The MSCI World Growth Index recorded its largest monthly outperformance ever vis-à-vis the MSCI World Value Index. The MSCI ACWI Large Cap TR Index recorded its 2nd largest monthly outperformance ever vis-à-vis the MSCI ACWI Small Cap TR Index. Finally, the MSCI World Financials TR recorded its largest monthly underperformance ever vis-à-vis the general index.

Australian Equities
The S&P/ASX 300 TR fell hard between the second and the third week of March, at one time erasing all its gains since the beginning of the year; after staging a recovery during the last week of the month. It ended March down -0.24%. Domestic banks followed global financials lower, as investors fretted over the quality of balance sheets and the outlook for net interest margins. A-REITs sold off sharply as well, while insurers curbed losses. Conversely, miners rallied smartly, as the sector continued to be supported by M&A news. On March 28th, Perth-based Liontown Resources rejected a 3.7 billion USD cash offer from Albemarle Corp., the world's top lithium producer, valuing the company at a 64% premium above its last closing price. Utilities, telecom, consumer staples and consumer discretionary bucked the trend on expectations of interest rates having reached their peak, while energy and healthcare were mostly unchanged. Smaller companies and mid-caps underperformed the Top 20, while value stocks underperformed growth stocks despite the resilience of defensives. Finally, the MSCI Daily TR Net Australia underperformed the MSCI AC World Daily TR for the second month in a row.

International Fixed Income
On March 16th, the European Central Bank (ECB) delivered its third consecutive 50 Bps increase, lifting its policy interest rate from 2.5% to 3%, its highest level since October 2008. On March 22nd, the FED increased its target rate by a widely expected 25 Bps to a range of 4.75%-5%, its highest level since September 2007, for a cumulative 475 Bps of tightening in a year. The Bloomberg Barclays Global Aggregate rallied +2.11% in March as government bond yields were generally lower. In the US, the 10 year yield shed 45 Bps while the 2 year yield recorded its steepest decline since January 2008, falling 79 Bps. As a result, the differential between the former and the latter increased to -56 Bps (from -90 Bps), lessening the inversion of the yield curve. Credit spreads were generally wider owing to the uncertainty generated by FINMA's decision to fully write off Credit Suisse AT1 notes without imposing full losses on its equity. The Bloomberg Global CoCo Banking Statistics Index, which tracks the performance of that specific debt segment, recorded its 2nd worst month in history, down -8.96% in USD terms.

Australian Fixed Income
On March 7th, the RBA delivered a "dovish hike" as it increased the cash rate by a widely expected 25 Bps to 3.60%, its highest level since May 2012, and signalled a pause in its tightening cycle. In the accompanying statement, Governor Lowe reiterated that "further tightening of monetary policy will be needed to ensure that inflation returns to target" but affirmed that the central bank will be data-dependent "in assessing when and how much further interest rates need to increase". The Australian yield curve transposed lower and steepened. The 2 and 5 year yield recorded their sharpest decline since May 2012, down 64 Bps and 63 Bps to 2.95% and 3.04% respectively, while the 10 year yield dropped 55 Bps to 3.30%. As a result, the Bloomberg AusBond Composite 0+ Yr recorded its 8th best month in history, up +3.18%.

Real Assets
Global property fell -3.36% in USD terms and -2.59% in AUD terms for the month. Europe was the worst performing region as a number of highly levered REITs announced dividend reductions or suspensions. Asia curbed losses on the back of the strength of Hong Kong, which saw a sharp rebound in travel and consumption. The office sector bore the brunt of the concerns about commercial real estate (CRE).

Global infrastructure rose +2.20% in USD terms and +3.01% in AUD terms in March, recording its 8th best relative monthly return ever vis-à-vis global property. The S&P Global Infrastructure TR ended the month at its highest level in history.

Alternatives
Alternatives declined -1.31% in March, dragged lower by managed futures and trend following strategies. The SG CTA Index fell the most since November 2001 as quantitative programs were caught short bonds at a time investors pulled back their expectations of further rate hikes following the banking tremors, prompting a strong rally in fixed income.

Market Outlook
When the FED initiated its "Quantitative Easing" (QE) policy for the first time back in November 2008, US commercial banks were operating on a system of "scarce reserves". The action of the central bank de-facto changed that system to one of "ample reserves", which was formally adopted only a decade later, in March 2019. In the new system banks do not have to borrow reserves from each other because those are plentiful owing to the FED's expansion of its balance sheet. If anything, they may want to hold less of them because the more reserves they hold, the more equity they need to have in order to comply with the leverage ratio, a regulatory measure calculated by dividing equity by assets. For that reason, the central bank started to remunerate the banks with an Interest Rate on Reserve Balances (IORB), in such a way as to encourage banks to hold reserves. However, when the pandemic hit and the government and the FED responded with a massive, coordinated fiscal and monetary stimulus, banks were inundated by close to 3 trillion USD in additional reserves between March 2020 and March 2021, maxing out their capacity of absorption, or at least at the interest rate paid to them by the FED at that time (10 Bps). Thus, the central bank decided to authorize money market funds (MMFs) to depositors to park their cash directly at the FED through the so called Overnight Reverse Repo Facility (ON RRP), and to remunerate them with 5 Bps. As a result, in just 2 months, 1 trillion USD flew out of banks and into money market funds, and from there directly back to the FED, helping banks to comply with their leverage ratio without having to raise capital.

Then, in 2022 the central bank embarked on its most aggressive tightening cycle in decades to combat inflation by simultaneously hiking rates and shrinking its balance sheet. A direct effect of the latter operation, known as Quantitative Tightening (QT), is to reduce the amount of reserves in the banking system. In August 2022, John Williams, the President of the Federal Reserve of New York, stated that he expected to see going forward “reductions in the balances both of reserves and ON RRP”. In other words, the central bank was anticipating the cash to flow out of MMFs and back into the banks, where the FED could drain it. However, the opposite occurred; MMFs continued to receive inflows and tap the ON RRP, whose balance grew to more than 2 trillion USD. As a result, banks had to face the double whammy of losing reserves because of QT and because of money market funds. In fact, the ON RRP is a very attractive investment for MMFs, as they can get a 4.80% annualized yield, which is superior even to that provided by T-Bills issued by the government, and without any credit risk. Not surprisingly, 40% of the aggregate portfolio of MMFs at the end of March was allocated to ON RRP. Clearly, that cash is no longer unwanted and the banks would like to have it back as, among other things, the FED remunerates them for holding reserves with a 4.90% annualized yield, an income that currently they are not passing to their depositors. In fact, at the end of February, the average rate on savings deposits paid by US banks was only 0.35%. However, MMFs have become extremely popular as depositors have woken up to the fact that they can earn a decent return by shifting their balances out of the banks, and the recent regional banks crisis has just added fuel to the fire.

US banks are still swimming in an ocean of reserves, although their level is down from the 4.3 trillion USD peak reached in December 2021. At the end of March, reserves amounted to 3.4 trillion USD, equivalent to roughly 12.7% of the total assets held by the US banking system. However, the devil is in detail. The system is flush with liquidity, but as economists would say, it is “unevenly distributed”. Large, systemic banks the like Citigroup and JPMorgan Chase hold on average 15% of “cash on hand”, while the number for regional banks at the beginning of the year was only 7%. To add insult to injury, those smaller players are losing deposits to the megabanks, as the 25 biggest banks in US gained 120 billion USD in deposits in the days after SVB collapsed. At the end of 2022, there were “4,706 commercial banks and savings institutions insured by the Federal Deposit Insurance Corporation (FDIC)” in US. That means regional and community banks play an essential role in the economy given their capillarity on the territory. According to FED data, banks smaller than the top 25 accounted for around 38% of all outstanding loans and for 67% of commercial real estate (CRE) lending. In addition, those entities have become more levered in the past year, as they have increased their lending by +14.4% YoY, purchased 59 billion USD worth of bonds at a time when the FED was hiking rates (causing prices to drop), and lost an estimated 1 trillion USD of deposits. As those outflows continue, smaller banks cannot increase their loans further, while the banks that are receiving those deposits are likely to tighten their lending standards as a precaution for (potential) future haemorrhages. In short, the “marginal propensity to lend” is going down, and if that trend persists, it could give rise to a full-blown credit crunch.

According to the International Monetary Fund (IMF), the “banking volatility” detailed above will cause a -1% decline in lending capacity this year, resulting in a 44 Bps subtraction from US GDP. However, we do not think that its effects will be felt immediately. The reason why the US economy remains resilient, which also explains why the FED has been struggling in cooling it off with rate increases, is that in this cycle economic activity has been primarily fuelled by excess savings and income growth rather than by credit expansion. To (over)simplify, the US government has injected a ton of money into the economy (deficit spending), providing Americans with fresh cash to spend at a time of supply constraints, bringing about inflation, which has resulted in wage growth. That process is now getting close to its end. Excess savings are expected to run out by the middle of the year and, as the economy slows down, companies are unlikely to continue to hold on to their employees for fear of not being able to hire them back at the next upturn. In other words, we agree that some sort of credit crunch will materialize in the second half of the year, concurrently with the recession that we expect to start in Q4 2023. It will not cause it, but it has the potential to make it quite severe. Until that time, the FED will continue to maintain a tight monetary policy. We anticipate one final, 25 Bps hike at the next FOMC meeting (May 2-3), followed by a long pause. In the absence of a “credit event”, cuts are not an option this year in our opinion. Also, it is plausible that the central bank will continue to drain reserves from the system via QT, only to provide (part of) them back to the banks in need via the Bank Term Funding Program (BTFP), essentially executing a “blanket draining” / “targeted lending” program. For the above reasons, 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, as the S&P 500 will continue to be stuck in a trading range between the highs of January (4,200) and the lows of October 2022 (3,500). The good news is that bonds are back providing positive returns to investors, and we expect that they will continue to do so.

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AZ Sestante is a specialist investment consultant focused on designing and managing a range of multi-manager model portfolios via SMAs, MDAs, and fund of funds. Our parent company Azimut is Italy’s largest independent asset manager listed on the Italian stock exchange. The group manages over AU$55 billion in assets globally including over AU$6 billion in multi-manager solutions.
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