

# Sestante Moderately Conservative Index Portfolio

## Monthly Investment Report As of 30/04/2023

### MARKET REVIEW

In 2021, legendary Hedge Fund manager Ray Dalio published a book in which he posited that the world order as we have come to know it during our lifetime is changing. Two years later, two of the most preeminent global policymakers provided a glimpse into what is shaping up to be the new geopolitical reality of the 2020s.

(Continues on page 3)

### Latest performance\*

	1-mth	3-mths	1-yr	3-yr	Inception
Sestante Mod Conservative Index	1.16	1.69	1.00	3.32	3.72
RBA Cash Rate + 2% p.a.	0.46	1.35	4.47	2.91	2.93

\*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 Moderately Conservative Index    — RBA Cash Rate + 2% p.a.



### Portfolio information

- Investment Objective: target RBA cash rate +2.0% per annum over rolling 5-year periods after fees.
- Asset Class: Diversified
- 45% Growth / 55% Defensive
- Portfolio Inception Date: 7 February 2019

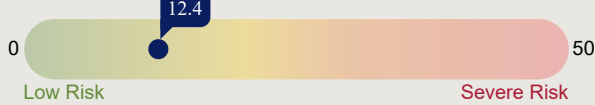
## Sustainability Score

● Sestante Moderately Conservative Index

### Corporate Sustainability Score



### Sovereign Sustainability Score



## ESG Pillar Score



5.5

Environmental



8.8

Social



6.6

Governance



1.2

Unallocated

## Major Index Returns

	1 Month	3 Months	6 Months	1 Year	3 Years
S&P/ASX 200 TR AUD	1.85	-0.80	8.71	2.83	13.99
MSCI World Ex Australia GR AUD	3.21	9.58	8.91	11.71	13.26
Bloomberg AusBond Composite 0+Y TR AUD	0.19	1.99	4.23	2.06	-2.28
Bloomberg Global Aggregate TR Hdg AUD	0.41	0.69	3.86	-2.28	-3.17
S&P Global Infrastructure NR AUD	3.95	8.06	8.64	9.22	11.90

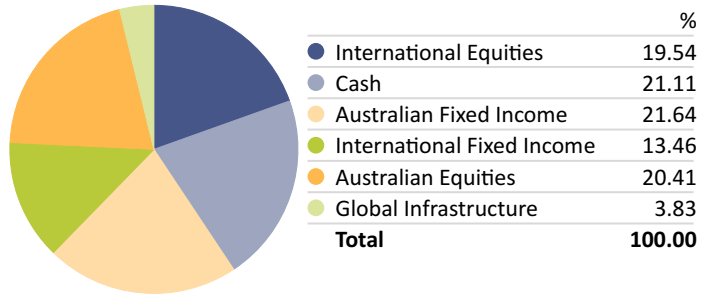
### Important information

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 Fixed Income</b>	<b>21.64</b>	—
iShares Australian Bond Index	21.64	🌐🌐🌐
<b>Cash</b>	<b>21.11</b>	—
iShares Core Cash ETF	12.95	—
BetaShares Aus High Interest Cash ETF	5.28	—
RBA Cash Rate Target	2.88	—
<b>Australian Equities</b>	<b>20.41</b>	—
iShares Core S&P/ASX 200 ETF	20.41	🌐🌐🌐
<b>International Equities</b>	<b>19.54</b>	—
Vanguard All-World ex-US Shares ETF	9.25	🌐🌐🌐
iShares S&P 500 AUD Hedged ETF	6.99	🌐🌐🌐
iShares S&P 500 ETF	3.30	🌐🌐🌐
<b>International Fixed Income</b>	<b>13.46</b>	—
iShares Global Bond Index	13.46	🌐🌐🌐
<b>Global Infrastructure</b>	<b>3.83</b>	—
VanEck FTSE Gbl Infrs(Hdg)ETF	2.87	🌐🌐🌐
Vanguard Global Infrastructure Index	0.96	🌐🌐
	<b>100.00</b>	

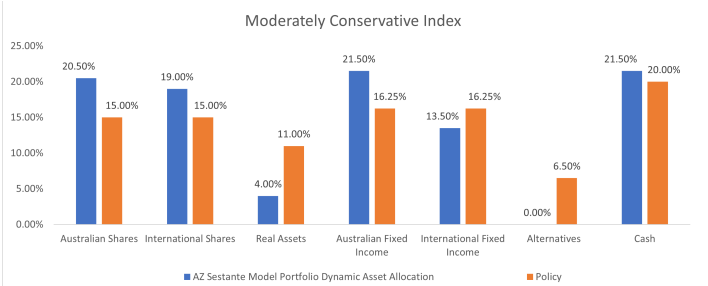
**Morningstar's Globe Ratings** are just one tool that can help investors work out a fund's ESG credentials. A 5 Globe Rating indicates a fund is at the top end of its peer group in terms of sustainability, while a 1 Globe Rating shows it is underperforming on sustainability issues.

## Portfolio changes

There are no portfolio changes this month

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

As of 30/04/2023



On April 17th, Christine Lagarde, President of the European Central Bank (ECB), gave a speech at the Council on Foreign Relations (CFR) aptly titled “Central banks in a fragmenting world”. She started by observing that the global economy is fragmenting “into competing blocs”, and that “this fragmentation may well coalesce around two blocs led respectively by the two largest economies in the world”, that is, USA and China. This “new global map” could give rise to a period of “lasting instability resulting in lower growth, higher costs and more uncertain trade partnerships” coupled with “more multipolarity as geopolitical tensions continue to mount.” The US dollar and the Euro are not at risk of “any imminent loss of dominance” however, “international currency status should no longer be taken for granted”. In that environment, “independent central banks can and will go ahead with ensuring price stability” but to achieve that “at a lower cost”, closer coordination between monetary policy and fiscal policy will be required. For that reason, President Lagarde called for “greater policy cohesion” and “not compromising independence, but recognising interdependence between policies”. Accordingly, much will depend on the fiscal and structural policies pursued by the government. If those policies “focus on removing supply constraints created by the new geopolitics – such as securing resilient supply chains or diversifying energy production – we could then see a virtuous circle of lower volatility, lower inflation, higher investment, and higher growth”. Conversely, if they centre on “supporting incomes to offset cost pressures that will tend to raise inflation, increase borrowing costs and lower investment in new supply”. Finally, during the Q&A session, she opened up to the idea of changing the ECB’s 2% inflation target (presumably to a higher level), but only after “we get there” and “we are confident that it stays there”.

On April 20th, Janet Yellen, the US Secretary of the Treasury, gave her remarks on “the US - China Economic Relationship” at the Johns Hopkins University School of Advanced International Studies. In her speech, she stressed that the US is not seeking to “decouple” its economy from China’s, as a “full separation of our economies would be disastrous for both countries” and “destabilizing for the rest of the world”. However, she made clear that “the United States will assert ourselves when our vital interests are at stake” by taking actions directed at China in the form of, among others, “export controls” and restrictions of “US outbound investments in specific sensitive technologies with significant national security implications.” Most importantly, the US “will not compromise” on its national security concerns “even when they force trade-offs with our economic interests.” Since 2021, the US government has been pursuing an agenda of “modern supply-side economics” to “expand the productive capacity of its economy” through the passing of the Bipartisan Infrastructure Law, the CHIPS and Science Act and the Inflation Reduction Act. In addition, it has been working on “friend shoring”, a strategy aimed at “mitigating vulnerabilities that can lead to supply disruptions” by creating “redundancies in our critical supply chains with the large number of trading partners that we can count on”.

In summary, gone seem to be the days of cheap Chinese goods, laissez-faire economy, just-in-time production and almighty central banks. A government directed, more localized economy backed by public investments and an acquiescent monetary policy may be the future, a scenario with potentially profound, long-term ramifications for growth, inflation and financial returns for investors.

### International Equities

US equities rose modestly in April. The “Old economy” heavy Dow Jones Industrial (+1.89% in USD terms) outperformed the S&P 500 (+1.46%) and the Nasdaq 100 (+0.49%) for the first time in 2023 as consumer discretionary and technology declined while energy and financials rebounded. However, within the latter sector, the S&P Regional Banks Select Industry Index TR ended the month in the red, dragging the Russell 2000 (-1.86%) lower once again. Market breadth deteriorated further during the month, with the rally in the major averages becoming narrower and narrower. At the end of April, the NYSE FANG+ Index, which tracks the performance of “10 highly-traded growth stocks of technology and tech-enabled companies”, was up +37.62% since the beginning of the year. However, restricting the investment universe even further shows that only 7 stocks out of those 10, that is, Apple, Microsoft, Nvidia, Meta (Facebook), Amazon, Alphabet (Google) and Tesla, accounted for more than the totality of the positive returns generated by the S&P 500 YTD. In other words, the remaining 493 constituents of the index exhibited a negative contribution in aggregate for the first 4 months of the year. 2 stocks in particular, Apple and Microsoft, added more than 1 trillion USD in combined market capitalization over that period of time, nearly half of the gains for the entire S&P 500, and saw their combined weightings in the benchmark jump to a record 14% on the back of a strong earnings report. The concentration of the Nasdaq 100 became even more extreme, with Apple and Microsoft accounting for 26% of the index. At the end of April, the 7 top-performing names listed above represented 25.5% of the S&P 500 and 52.7% of the Nasdaq 100. US equities performed in line with the rest of the world (as exemplified by the MSCI AC World Index ex USA TR Index). Europe was the best performing region as the Old Continent returned to positive GDP growth during the first quarter of the year, although at a slower pace than expected (+0.1% Vs 0.2% QoQ), and the Euro (EUR) rose to its highest level since May 2020 vis-à-vis the Australian Dollar. Conversely, the Japanese Yen (JPY) was the only major developed currency to weaken against the domestic currency, consequently, Japan underperformed the general index despite Warren Buffett disclosing an increased allocation to the stock market. Emerging markets were the worst performing region as China dropped sharply on renewed tensions with the US and despite reporting stronger than expected GDP and export growth for Q1. All in all, the MSCI AC World Daily TR was up +1.44% in USD terms and +2.69% in AUD terms as the Australian Dollar fell for the third consecutive month against the US Dollar.

### Australian Equities

The S&P/ASX 300 TR rallied +1.85% in April, led higher by interest rate sensitive sectors. A-REITs were the best performing group on the back of the recovery in residential property stocks. Banks and insurance posted strong gains as well. As a result, financials generated almost double the return of the general index. Technology, healthcare, telecom, industrials and consumer discretionary outperformed the benchmark while energy and utilities underperformed. Resources ended the month in the red, dragged lower by the large iron ore miners. Copper was also down for the month. Smaller companies and mid-caps strongly outperformed the Top 20, while value stocks outperformed growth stocks. Finally, the MSCI Daily TR Net Australia underperformed the MSCI AC World Daily TR for the third month in a row.

### International Fixed Income

On April 5th, the Reserve Bank of New Zealand (RBNZ) unexpectedly hiked the cash rate by 50 Bps to 5.25%, its highest level since December 2008. The tone of the accompanying statement was hawkish, as the central bank said that “inflation is still too high and persistent, and employment is beyond its maximum sustainable levels” and that “demand continues to outpace supply, and this continues to be reflected in persistently high domestic inflation.” Members of the Monetary Policy Committee also discussed the impact of the recent flooding and Cyclone Gabrielle, noting that “near-term inflationary pressures have increased, boosted by short-term price pressures resulting from recent severe weather events” and that they see “the risks to inflation pressure from fiscal policy as skewed to the upside.” The decision of the RBNZ came in the context of a contracting economy, as GDP declined -0.6% QoQ in Q4 2022, but still stubbornly high inflation, as CPI held steady at +7.2% YoY over the same period of time. Communications coming from the FED were mixed. Christopher Waller favoured more monetary policy tightening as “we haven’t made much progress on our inflation goal.” Conversely, Austan Goolsbee advocated for more caution on the part of the central bank, as “some mild recession is definitely on the table as a possibility.” Both are voting members of the FOMC in 2023. The Bloomberg Barclays Global Aggregate rose +0.41% in April as government bond yields were generally higher in Europe and lower in US, while most credit segments posted gains.

### Australian Fixed Income

On April 4th, the RBA kept the cash rate unchanged at 3.60%, pausing its almost yearlong tightening cycle. In the accompanying statement, Governor Lowe acknowledged that “monetary policy operates with a lag and that the full effect of this substantial increase in interest rates is yet to be felt” and thus the central bank is taking “additional time to assess the impact of the increase in interest rates to date and the economic outlook”. The reasons cited for the pause were an inflation rate that has peaked, the anticipation of below trend economic growth “over the next couple of years” and the evidence of “a substantial slowing in household spending” on the back of a “painful squeeze” on finances. However, Governor Lowe maintained a hawkish bias, reiterating that “the labour market remains very tight” and that “wages growth is continuing to increase.” He also left the door open for further hikes by concluding that “further tightening of monetary policy may well be needed to ensure that inflation returns to target”. Australian macroeconomic data released in April indicated that the so-called “soft landing” sought by the RBA may be achievable. On the one hand, employers added more than double the jobs forecasted by economists while the jobless rate held steady at 3.5%, missing expectations of an increase to 3.6%. On the other hand, the Australia Monthly CPI Trimmed Mean, the inflation measure preferred by the RBA, decelerated to +1.2% QoQ and +6.6% YoY, missing expectations of +1.4% and +6.7% respectively. The Australian yield curve transposed higher and flattened modestly. The 2, 5 and 10 year yield rose 9 Bps, 4 Bps and 4 Bps to 3.04%, 3.08% and 3.34% respectively. As a result, the Bloomberg AusBond Composite 0+ Yr was up +0.19% for the month.

### Real Assets

Global property added +2.00% in USD terms and +3.26% in AUD terms for the month. Europe was the best performing region as German residential companies caught a bid after a prolonged period of weakness. Australia outperformed the general index as 10 year inflation expectations remained relatively flat at 2.36% on the assumption that the RBA had reached its terminal rate. Asia was a mixed bag, with Japan benefiting from the BOJ’s renewed commitment to its ultra-accommodative monetary policy stance and Hong Kong hindered by a slower than expected recovery in China.

Global infrastructure rose +2.67% in USD terms and +3.95% in AUD terms in April. Transportation stocks in Europe, primarily airports and toll roads, were among the strongest performers. Utilities from the same region outperformed the general index, while their US peers lagged.

### Alternatives

Returns for Alternatives (+0.24%) were generally positive across strategic mandates in April. However, managed futures and trend following programs ended the month lower following a deleveraging of their short positions.

### MARKET OUTLOOK

Several commentators have pointed out how the current debt ceiling standoff is reminiscent of the two crises that unfolded in 1995 and in 2011, in that it was preceded by an election that flipped the House majority from Democrats to Republicans and it is happening in the year prior to a presidential election. In 1995, the US government shut down for 5 days, from November 14th to November 19th, resulting in the furloughing of about 800,000 federal workers and employees. In 2011, a deal was reached with only 72 hours left before the US would have defaulted on its debts and raised the debt ceiling by 900 Billion USD, but reduced deficit spending by nearly the same amount over the following decade. Today, negotiations are occurring in the context of a US economy starting to exhibit its first cracks after having been surprisingly resilient since the beginning of the year. In fact, we interpret the most recent bout of softer macroeconomic data, such as weaker than expected retail sales, sharply rising continuing jobless claims and declining consumer sentiment, as suggestive of a recession on track to materialize in Q4 2023, in line with our expectations. If the US government were to partially or totally shut down, as it did back in 1995, that event would clearly have a negative impact and exercise further downward pressure on growth in the immediate term, potentially bringing forward the start of the economic contraction. That is not our base case though. Assuming that a bill is passed in time, we are more interested in exploring its consequences on future government spending and on financial system liquidity.

Similar to 2011, we think that any agreement will involve the raising of the debt ceiling in exchange for some sort of deficit reduction over the following years. This is significant because the current (long) economic cycle has been primarily fuelled by excess savings and income growth stemming from government largesse rather than by credit expansion. The numbers are staggering. At end of April, the US government had collected 1.66 trillion USD in receipts during the first 4 months of the year, the second largest amount in history. Despite that record inflow, it was recording a deficit, that is a negative difference between the collection and the spending, equal to -503 Bil USD. As a comparison, in April 2022 the US government had collected a record 1.93 trillion USD in receipts during the first 4 months of the year and it was recording a surplus, that is a positive difference between the collection and the spending, equal to 17.7 Billion USD. According to the most updated projections by the Congressional Budget Office (CBO), the federal budget deficit is estimated to increase to 1.5 trillion USD in 2023, as "revenue collections through April were less than the agency expected". Budget deficits in the trillions used to be emergency tools to combat major crises such as the GFC and the COVID-19 pandemic, but in recent years they have become the new normal. At the end of April, the US government was running a budget deficit equal to -7.33% of its GDP, a number consistent with an economy on the mend and in need of stimulus, despite the US economy having entirely recovered the loss of output suffered in 2020 already by the end of Q1 2021, that is, more than 2 years ago. In short, after an agreement on the debt ceiling is reached, we expect the most significant driver of the "resilient US economy" to start to fade exactly at the time it would be most needed as economic activity starts to falter. That is relevant for stock markets as US equities have been following a path of "good news is good news" of late, rallying after the release of positive macroeconomic data and vice versa. The S&P 500 is not priced for a recession in our opinion and thus we do not expect it to take the potentially upcoming bad news lightly.

The debt ceiling resolution will also have important ramifications for the amount of liquidity in the financial system. In order to be able to spend money in the economy, the US government maintains an operating account at the FED, the so-called "Treasury General Account" (TGA). Since January 19th, the US Treasury has been using "extraordinary measures" to keep paying the country's bills without breaching the debt ceiling. Cutting through the jargon, what has essentially happened since then is that the US government has spent almost all the cash it had in the TGA without issuing new debt. In fact, on May 10th the balance of the TGA was 154.8 Billion USD after having been drawn down by Janet Yellen from a value of 572.6 Billion USD at the end of January. When the limit is raised, the US Treasury will finally be able to issue new debt to replenish the dwindling TGA, however, in doing so, it will temporarily drain liquidity out of the financial system. In fact, at present the FED is not expanding its balance sheet via a quantitative easing (QE) program, hence those fresh T-Bills and Treasuries will have to be absorbed by real buyers in the economy. According to the latest Quarterly Refunding Announcement (QRA), the US government intends to issue up to 600 Billion USD by the end of Q3. The increased offer of paper on the market may have the effect of crowding out other investments and/or exert upward pressure on yields, causing fixed income to experience volatility in the short term. The US Treasury may decide to mitigate the effect of its replenishing of the TGA by choosing to issue primarily T-Bills. In fact, the latter are in high demand by money market funds (MMFs), whose assets have just skyrocketed to a record 5.33 trillion USD on May 11th. In addition, once the TGA is replenished, starting from Q4 the US government should start to draw it down once again, returning to the system the liquidity it took away. However, all things being equal, liquidity dynamics for the next three months will be materially different from those of the first half of the year. Up until today, the FED has drained bank reserves via its quantitative tightening (QT) program while the US government has injected bank reserves in the system by drawing down the TGA, de facto sterilizing the actions of the central bank. Going forward, and if the FED stays the course, bank reserves will fall as a result of QT and of the US government replenishing the TGA, that is, the monetary tightening administered by the central bank will be magnified rather than sterilized. Again, that will happen in the context of an economy slowing down at a faster pace.

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. We are starting to see harbingers of the recession on the horizon, but we do not have particular reasons to reduce our exposure to growth assets too far ahead of time. In our opinion, the S&P 500 will continue to be stuck in a trading range as liquidity is withdrawn and then reinjected in the financial system. Our macro outlook calls for an increased allocation to bonds, and we intend to make use of any potential (temporary) spike in yields to lengthen the duration of our portfolios.

#### **AZ SESTANTE**

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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