

Sestante ESG Focus Dynamic Conservative Portfolio



Monthly Investment Report
As of 31/05/2023

MARKET REVIEW

Mr. Market's mood swung wildly in May, as concerns about a potential banking crisis in US at the beginning of the month gave way to enthusiasm for Artificial Intelligence (AI) rapid adoption just a few weeks later.

On May 1st, California-based, publicly listed First Republic Bank (FRC) was taken over by the Federal Deposit Insurance Corporation (FDIC). On the same day, the government struck a deal with JPMorgan Chase & Co. (JPM), with the latter agreeing to take over the failed regional bank's assets, including 173 billion of USD loans and 30 billion of USD of securities, as well as 92 billion USD in deposits.

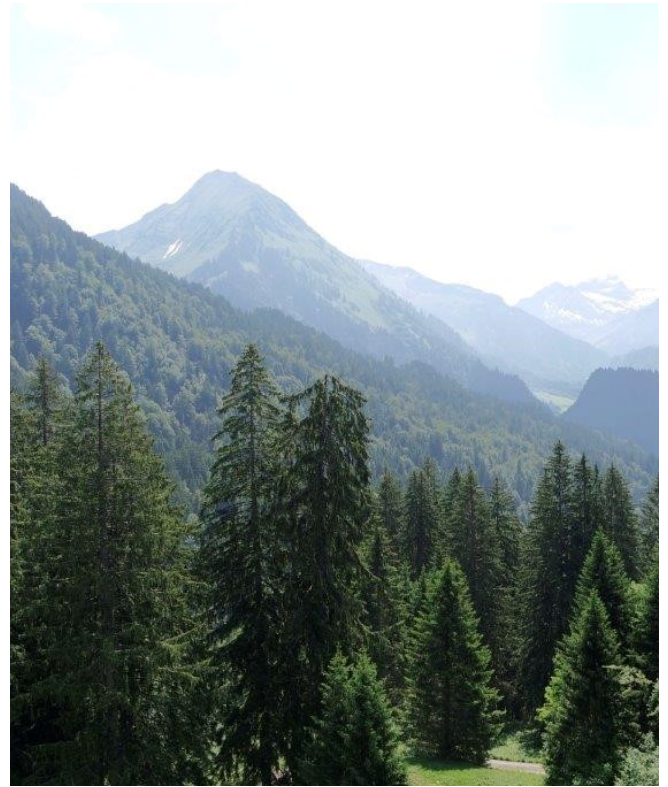
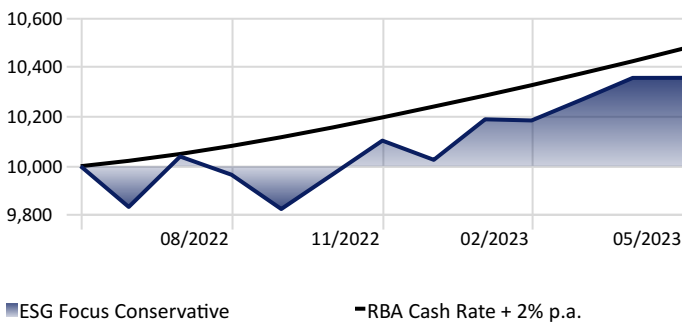
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Latest performance*

	1-mth	3-mths	1-yr	3-yr	Inception
ESG Focus Conservative	0.00	1.70	—	—	—
RBA Cash Rate + 2% p.a.	0.50	1.44	4.78	3.02	4.78

*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 1/6/2022 and represents modelled performance only and assumes income received is reinvested.

\$10,000 invested over time



Portfolio information

Investment Objective:

To delivery outperformance of RBA cash rate +2.0% per annum after fees over a rolling 3-year period.

Suggested minimum timeframe:

3 years

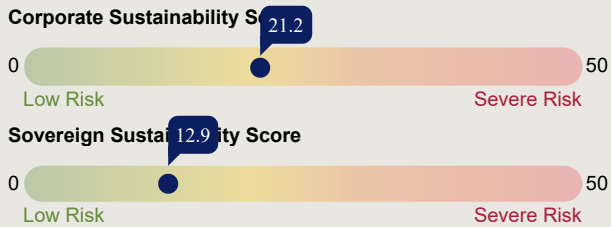
30% Growth / 70% Defensive

Portfolio Inception Date:

1 June 2022



Sustainability Score



● ESG Focus Conservative

ESG Pillar Score



Major Index Returns

	1 Month	3 Months	6 Months	1 Year	3 Years
S&P/ASX 200 TR AUD	-2.53	-0.89	-0.58	2.90	11.43
MSCI World Ex Australia GR AUD	1.26	8.65	8.05	13.98	12.45
Bloomberg AusBond Composite 0+Y TR AUD	-1.21	2.11	1.40	1.73	-2.77
Bloomberg Global Aggregate TR Hdg AUD	-0.54	1.97	0.90	-2.62	-3.43
FTSE EPRA Nareit Global REITs TR AUD	-1.72	-1.06	-0.56	-3.74	7.02
S&P Global Infrastructure NR AUD	-3.68	3.13	1.48	2.53	9.14
RBA Cash Rate Target	0.33	0.94	1.74	2.73	1.00
MSCI ACWI Ex USA NR USD	-3.64	0.43	3.99	-1.41	7.23

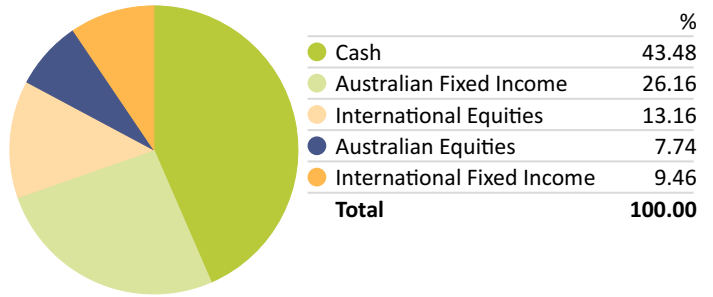
Important information

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.

The Portfolio Unallocated ESG Risk Score represents the unmanaged ESG risk exposure to companies assigned an ESG Risk Rating, but whose risk is not decomposed into environmental, social and governance components. Calculated as the asset-weighted average of the company ESG Risk scores for the covered holdings in a portfolio that do not have E/S/G risk scores, unallocated ESG risk is displayed as a number between 0 and 100, where lower is better. Together, the four portfolio pillar score data points- Environmental Risk Score, Social Risk Score, Governance Risk Score, and Unallocated ESG Risk Score- will add up to a portfolio's Sustainability Score.

Current Asset Allocation



Where your funds are invested

Cash	43.48	—
BetaShares Aus High Interest Cash ETF	27.52	—
Pendal Short Term Income Securities Fd	11.57	—
RBA Cash Rate Target	4.39	—
Australian Fixed Income	26.16	—
Janus Henderson Tactical Income	9.94	🌐🌐🌐
Pendal Sustainable Aust Fixed Interest	9.74	🌐🌐🌐🌐
Schroder Absolute Return Income Fund -WC	6.48	—
International Equities	13.16	—
Ironbark Royal London ConcentratedGlbShr	4.11	🌐🌐
Stewart Investors Worldwide Leaders Sust	3.06	🌐🌐🌐
VanEck MSCI Intl Sust Eq ETF	2.84	🌐🌐🌐🌐🌐
BetaShares Global Sstnbtby Ldrs ETF Ccy H	1.92	🌐🌐🌐🌐🌐
Janus Henderson Global Natural Resources	1.23	🌐🌐
International Fixed Income	9.46	—
FSI Wholesale Global Credit Income	4.77	🌐🌐🌐
PIMCO ESG Global Bond Fund - Wholesale	4.68	🌐🌐🌐🌐
Australian Equities	7.74	—
Schroder Australian Equity Fund - PC	3.17	🌐🌐🌐
VanEck MSCI AUS Sust Eq ETF	1.80	🌐🌐🌐🌐🌐
Alphinity Sustainable Share	1.62	🌐🌐🌐🌐
Australian Ethical Australian Shr WS	1.14	🌐🌐🌐
	100.00	

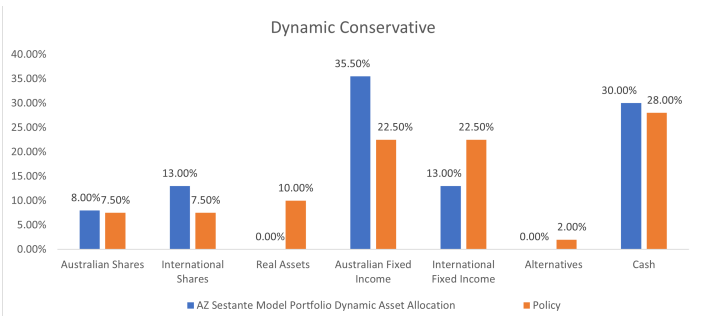
Morningstar's Globe Ratings are just one tool that can help investors work out a fund's ESG credentials. A 5 Globe Rating indicates a fund is at the top end of its peer group in terms of sustainability, while a 1 Globe Rating shows it is underperforming on sustainability issues.

Portfolio changes

There are no portfolio changes this month.

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

As of 31/05/2023



The FDIC agreed to provide Jamie Dimon's bank, the largest in the US, with 50 billion USD in financing and to share losses of up to 80% on single-family residential mortgages and commercial loans, including commercial real estate, which make up nearly 80% of FRC's loan book. With 229 billion USD of assets as of April 13th, the collapse of FRC was the second largest bank failure in US history, only topped by the demise of Washington Mutual Bank back in September 2008 (307 billion USD). FRC ranked as the 14th largest in the US at the end of Q1 according to the latest statistics released by the FED. It is the fourth regional lender to go under since early March. As in the Silvergate and Silicon Valley Bank (SVB) cases, a bank run was the proximate cause of its collapse. Founded in 1985, FRC specialized in high net-worth customers, whom it attracted by providing long-term mortgage loans at preferential rates. That strategy made the bank particularly vulnerable in the aftermath of the fastest hiking cycle in decades, as paper losses on its loan book and investment portfolio ballooned, while the focus on single-family residential mortgage loans (around 50% of the total) made it difficult to offload assets. In addition, about 70% of its total deposits were uninsured, hence more prone to become flighty. Following the closure of SVB, panicked depositors withdrew 100 billion USD from FRC, equivalent to around 40% of its total deposits, resulting in its seizing by the government. According to Bloomberg, the losses caused to investors by the demise of Silvergate, SVB, Signature Bank and FRC in just two months amounts to 54 billion USD, 49.7 billion USD in erased market capitalization and 7.5 billion USD in virtually defaulted bonds and preferred shares.

That sum is dwarfed by the 184 billion USD of market capitalization increase recorded by Nvidia on May 25th alone. On that day, the world's most valuable chipmaker revealed how much it expects to profit from the AI boom, as it forecasted that sales in the three months ending in July will be 50% higher than analysts' estimates (11 billion USD Vs 7.18 billion USD). During the company's earnings release, founder and CEO Jensen Huang said that "a trillion dollars of installed global data centre infrastructure will transition from general purpose to accelerated computing as companies race to apply generative AI into every product, service and business process". The stock jumped +24.37% on the news and its market capitalization rose to 940 billion USD. 184 billion USD is the third largest single day market cap gain in US stock market history, only topped by the 190.9 billion USD increase recorded by Apple on November 10th, 2022 and the 190.8 billion USD recorded by Amazon on February 4th, 2022. The positive momentum in the stock and in the technology sector continued in the following days and on May 30th Nvidia (briefly) joined the so called "Trillion Dollar Club" of companies, currently comprising Apple, Microsoft, Aramco (Saudi state-owned oil giant) Alphabet (Google), Amazon, Meta and Tesla.

International Equities

US equities rose in May. The S&P 500 (+0.25% in USD terms) and the Nasdaq 100 (+7.61%) outperformed the "Old economy" heavy Dow Jones Industrial (-3.49%), which ended the month in the red. As a result, the oldest benchmark for US stocks underperformed the Nasdaq 100 by the most since October 2001. The S&P 500 Equal Weight Index was also down for the month, recording its 4th worst relative monthly return vis-à-vis the more concentrated S&P 500. The S&P Regional Banks Select Industry Index TR shed another -8.84%, dragging the Russell 2000 (-1.09%) 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 May, the NYSE FANG+ Index, which tracks the performance of "10 highly-traded growth stocks of technology and tech-enabled companies", was up +61.27% since the beginning of the year. Investors continued to pile into the so-called "Magnificent Seven", that is, Apple, Microsoft, Nvidia, Meta (Facebook), Amazon, Alphabet (Google) and Tesla. As a result, the Nasdaq 100 recorded its 3rd best relative monthly return ever vis-à-vis the Nasdaq 100 Equal Weighted Index. Technology funds attracted record flows on the back of what Bank of America (BofA) termed a developing "baby bubble" in AI-related stocks. However, purchases were concentrated only in the megacap technology names, as the Nasdaq Next Generation 100, which tracks the performance of the largest 100 Nasdaq-listed companies outside of the Nasdaq 100, posted losses for the month. US equities outperformed the rest of the world (as exemplified by the MSCI AC World Index ex USA TR Index) by the largest amount since October 2022. Japan was the best performing region despite a weakening Japanese Yen (JPY), as foreign investors snapped up shares in domestic large cap growth names. Conversely, Europe was the worst performing region as revised figures showed that Germany officially slipped into recession in Q1 2023. Emerging markets underperformed the general index as Chinese stocks listed in Hong Kong entered into bear market territory on weak macro data while South Korea and Taiwan were driven higher by a sharp rally in semiconductors. All in all, the MSCI AC World Daily TR was down -1.07% in USD terms but up +1.25% in AUD terms as the Australian Dollar fell for the fourth consecutive month against the US Dollar. Within the benchmark, all major sectors, with the exception of technology and communication services, ended the month in the red. Finally, the MSCI World Growth Index recorded its 2nd largest monthly outperformance ever vis-à-vis the MSCI World Value Index.

Australian Equities

After a rangebound month, Australian equities broke down during the very last trading sessions on higher than expected domestic inflation and a faltering economic recovery in China. The S&P/ASX 300 TR dropped -2.53% in May, led lower by consumer related stocks and miners. Technology rose double digit on the back of the strength exhibited by the sector globally and of Xero beating earnings expectations. Utilities bucked the trend, boosted solely by the rally in AGL, while energy and healthcare were flat for the month. Financials were a mixed bag, with banks underperforming the general index, A-REITs curbing losses and insurance posting gains. Mid-caps strongly outperformed the Top 20, while smaller companies lagged. Value stocks outperformed growth stocks. Finally, the MSCI Daily TR Net Australia underperformed the MSCI AC World Daily TR for the fourth month in a row.

International Fixed Income

All major central banks that held a meeting during the month hiked rates. On May 4th, the FED increased its target rate by a widely expected 25 Bps to a range of 5%-5.25%, its highest level since August 2007, and signalled a potential pause. The decision was unanimous. During his press conference, Chairman Powell stated that "looking ahead, we'll take a data-dependent approach to determining the extent to which additional policy firming may be appropriate". On the same day, the European Central Bank (ECB) delivered a 25 Bps increase, lifting its deposit rate from 3.00% to 3.25%, its highest level since October 2008. The latest announcement slowed the pace of the tightening cycle, as it came after three consecutive 50 Bps increases, however, President Lagarde reiterated the hawkish message by stating that the central bank has "more ground to cover" and that "we are not pausing". On May 11th, the Bank of England's (BOE) Monetary Policy Committee (MPC) voted 7-2 to hike its official bank rate by 25 Bps to 4.25%. Governor Bailey stated that further tightening may be required to "stay the course" in the fight against inflation, which has recently surprised on the upside on the back of a more resilient than expected economy. On May 24th, the Reserve Bank of New Zealand (RBNZ) hiked the cash rate by 25 Bps to 5.50%, and released economic forecasts that showed that the monetary tightening cycle had reached its terminal rate. The Bank of Japan (BOJ) had no scheduled meeting for the month. However, speaking in parliament on May 9th, Governor Ueda stated that the central bank intends to scrap its Yield Curve Control (YCC) policy and shrink its balance sheet "once we have an inflation outlook indicating that sustainable and stable 2% inflation will be achieved". The Japanese CPI reaccelerated to +3.5% YoY at the end of April. The Bloomberg Barclays Global Aggregate dipped -0.54% in May as government bond yields were generally higher in the US and flat in Europe, while in the UK they broke out to their highest level since the September 2022 "mini-budget" crisis.

Australian Fixed Income

On May 2nd, the RBA unexpectedly increased the cash rate by 25 Bps to 3.85%, its highest level since April 2012, and signalled further policy tightening ahead. In the accompanying statement, Governor Lowe observed that "inflation has passed its peak in Australia but remains very high" and "a long way from the target range", and that "domestic demand pressures on inflation are at a high level". In addition, he pointed to unit labour costs rising at a fast pace and productivity remaining subdued. Finally, he made reference to housing prices, stating that, following the decision of the central bank to pause in April, they "have been responding to the expectation that interest rates may not increase". In other words, Governor Lowe singled out the nascent rebound in property prices as one of the reasons of the surprise hike. Australian macroeconomic data released in May indicated that the so-called "soft landing" sought by the RBA may be achievable. Salaries grew at around half the pace of inflation in Q1 2023, warding off the spectre of a wage-price spiral, as the Wage Price Index advanced +3.7% YoY, slightly above expectations of a +3.6% gain. In addition, the country posted a budget surplus of 4.2 billion USD for the year to June 2023, its first since the 2007-2008 fiscal year. The Australian yield curve transposed higher and flattened further. The 2, 5 and 10 year yield jumped 51 Bps, 30 Bps and 27 Bps to 3.55%, 3.38% and 3.61% respectively. As a result, the Bloomberg AusBond Composite 0+ Yr fell -1.21% for the month.

Real Assets

Global property dropped -4.69% in USD terms and -2.45% in AUD terms for the month. Europe was the worst performing region on deteriorating economic conditions and stickier inflation, as the European Union Harmonised Indices of Consumer Prices (EU HICP) and the UK CPI came out at +7.0% and +8.7% YoY respectively. Australia outperformed the benchmark despite the weakness in regional malls and shopping centres.

Global infrastructure fell -5.89% in USD terms and -3.68% in AUD terms in May. Regulated utilities, telecommunication infrastructure and renewables were all down for the month.

Market Outlook

On June 15th, the FED paused its tightening cycle but provided a hawkish guidance with the release of the new Dot Plot, which projected two more 25 Bps hikes to reach the so called "terminal rate" by the end of 2023 at a range of 5.50%-5.75%. The central bank expects to cut by 100 Bps in 2024 to a range of 4.50%-4.75% and by another 125 Bps in 2025 to a range of 3.25%-2.50%. Market consensus called the decision a "hawkish skip" as US cash futures projections continue to price in an additional 25 Bps hike in July with a 70%+ probability. Interestingly enough, during his press conference Chairman Powell pushed back against the idea of a "skip" as he corrected himself by saying that he should not have called it that way and that the FED has not made "any decision about going forward, including what would happen at the next meeting". So, which one is it, a pause or a skip? Let's review the evidence.

Firstly, as pointed out by several commentators, the FED has a history of pausing its hiking cycle while at the same time leaving the door open for additional increases that, in the end, it does not deliver. In fact, once the terminal rate has been reached, the modus operandi of the central bank has typically been to talk hawkish to push farther in the future the start of the countdown to rate cuts.

In our opinion, the collapse of SVB is more akin to the “Gilt moment” experienced in UK back in September 2022 than to the more (in) famous and consequential “Lehman moment” that precipitated the GFC in September 2008. In short, a public authority found out the hard way what was the limit of the policy that it was pursuing. In the UK, it was the government that tried to push a big package of (unfunded) tax cuts, necessitating the issuance of new government debt at a time the Bank of England (BOE) was increasing interest rates and planning to reduce its balance sheet by selling government bonds. In the US, it was the FED that pushed Quantitative Tightening (QT), reducing bank reserves in the system at a time banks needed them to accommodate customers moving their cash from checking accounts to money market funds, with the latter trend prompted by the FED increasing its target rate and aggravated by an inverted yield curve. In the UK, the BOE was forced to step in, temporarily restarting Quantitative Easing (QE) to essentially bailout the domestic pension fund system. However, following the dissipation of concerns, the central bank continued to hike rates. In fact, it added another 175 Bps between November 2022 and February 2023. It also stopped expanding its balance sheet and reverted back to its original plan of selling government bonds, although at a more conservative pace. We think that the FED may follow a similar playbook. Removing good quality assets from the banks’ balance sheet at par via the BTFP is not Quantitative Easing, as banks will be required to pay interest to the FED, but it will increase the amount of reserves in the banking system nevertheless, offsetting QT. However, on the interest rate front, we think that the FED will continue to increase its target rate, potentially diluting the hikes over a longer period of time and refraining from further 50-75 Bps moves, a possibility that the central bank was openly considering just one week ago. In fact, on March 7th, during his testimony in front of the Senate Banking Committee, Chairman Powell observed that “the latest economic data has come in stronger than expected, which suggests that the ultimate level of interest rates is likely to be higher than previously anticipated”, that is, he opened the door to a terminal rate higher than 5%-5.25%. In addition, he stated that “if the totality of the data were to indicate that faster tightening is warranted, we would be prepared to increase the pace of rate hikes.”

In conclusion, we think that the FED will make a differentiated use of its monetary tools going forward, (temporarily) expanding its balance sheet to alleviate the pressure on the banking system, while continuing to increase interest rates to combat an inflation problem, that, in our view, is getting more and not less entrenched in the US economy. If the SVB scare is quickly reabsorbed without long lasting, negative impacts on the aggregate demand coming from consumers and corporates, we may be back to a scenario in which the US economy remains more resilient than expected and the FED is not restrictive enough. In that context, a 25 Bps hike on March 22nd, our base case, may prove to be insufficient, that is, the central bank should do more, as hinted by Powell, but being unable to deliver a larger increase, it may find itself behind the curve once again if inflation remains stubbornly high or even reaccelerates in the following months. For the above reasons, we think that 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) and that the US 10 year yield is more likely to go back to 4.5% rather than to fall to 2.5%.

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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