Sestante Aggressive Index Portfolio

AZ SESTANTE
AZIMUT GROUP

Monthly Investment Report
As of 30/06/2023

MARKET REVIEW

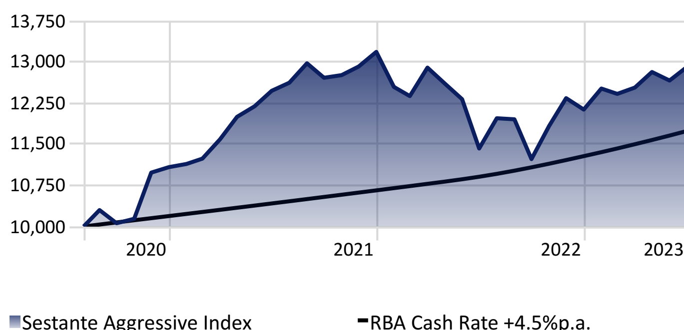
The UK is the first major country to introduce so-called “mortgage bailouts” to support homeowners struggling with their repayments following the fastest hiking cycle in decades. On June 23rd, the Chancellor of the Exchequer Jeremy Hunt announced that the government, the Financial Conduct Authority (FCA), the banks and the principal mortgage lenders, which cover 75% of the market, had agreed to a new mortgage charter designed to primarily help “people who are having to change their mortgage because their fixed rate comes to an end, and they’re worried about the impact on their family finances of higher mortgage rates” and those “who are at real risk of losing their homes because they fall behind in their mortgage payments”. (Continues on page 3...)

Latest performance*

	1-mth	3-mths	1-yr	3-yr	Inception
Sestante Aggressive Index	1.92	2.96	12.99	—	25.32
RBA Cash Rate +4.5%p.a.	0.70	2.09	7.65	5.65	17.00

*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



Portfolio information

- Investment Objective: target RBA cash rate +4.5% per annum over rolling 7-year periods after fees.
- Asset Class: Diversified
- 98% Growth / 2% Defensive
- Portfolio Inception Date: 8 August 2020

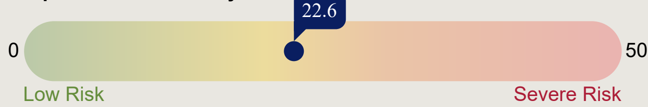
HELPING YOU TO NAVIGATE THE INVESTMENT LANDSCAPE.

Source: Morningstar Direct

Sustainability Score

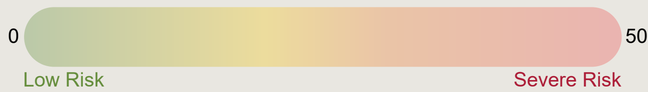
● Sestante Aggressive Index

Corporate Sustainability Score



Low Risk Severe Risk

Sovereign Sustainability Score



Low Risk Severe Risk

ESG Pillar Score

Major Index Returns

	1 Month	3 Months	6 Months	1 Year	3 Years
S&P/ASX 200 TR AUD	1.76	1.01	4.51	14.78	11.12
MSCI World Ex Australia GR AUD	3.16	7.81	17.89	23.24	14.03
Bloomberg AusBond Composite 0+Y TR AUD	-1.95	-2.95	1.51	1.24	-3.51
Bloomberg Global Aggregate TR Hdg AUD	-0.16	-0.30	2.07	-1.16	-3.64
S&P Global Infrastructure NR AUD	0.07	0.19	5.24	6.66	11.00

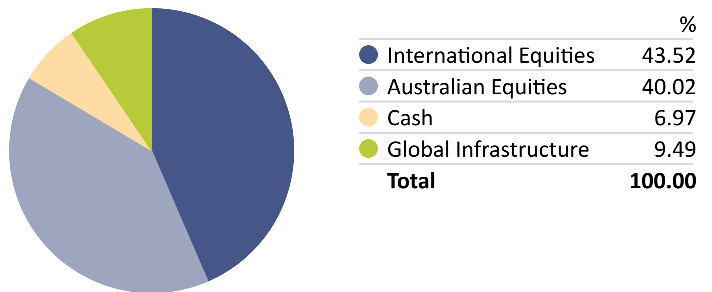
Important information

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.

This document has been prepared by AZ Sestante Limited, ABN 94 106 888 662, AFSL 284 442 (AZ Sestante). This document is not an offer of securities or financial products, nor is it financial product advice. As this document has been prepared without taking account of any investors' particular objectives, financial situation or needs, you should consider its appropriateness having regard to your objectives, financial situation and needs before taking any action. Past performance is not a reliable indicator of future results. Although specific information has been prepared from sources believed to be reliable, we offer no guarantees as to its accuracy or completeness. The information stated, opinions expressed and estimates given constitute best judgement at the time of publication and are subject to change without notice. Consequently, although this document is provided in good faith, it is not intended to create any legal liability on the part of any other entity and does not vary the terms of a relevant disclosure statement. All dollars are Australian unless otherwise specified.

Current Asset Allocation



	%
International Equities	43.52
Australian Equities	40.02
Cash	6.97
Global Infrastructure	9.49
Total	**100.00**

Where your funds are invested

International Equities	**43.52**	—
Vanguard All-World ex-US Shares ETF	21.54	
iShares S&P 500 AUD Hedged ETF	13.35	
iShares S&P 500 ETF	8.63	
Australian Equities	**40.02**	—
iShares Core S&P/ASX 200 ETF	26.60	
iShares Australian Equity Index	13.42	
Global Infrastructure	**9.49**	—
VanEck FTSE Glbl Infras(Hdg)ETF	7.77	
Vanguard Global Infrastructure Index	1.72	
Cash	**6.97**	—
BetaShares Aus High Interest Cash ETF	4.23	—
RBA Cash Rate Target	2.74	—
	100.00	

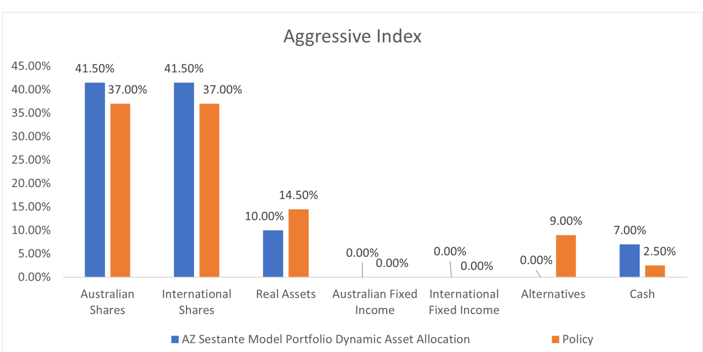
Morningstar's Globe Ratings are just one tool that can help investors work out a fund's ESG credentials. A 5 Globe Rating indicates a fund is at the top end of its peer group in terms of sustainability, while a 1 Globe Rating shows it is underperforming on sustainability issues.

Portfolio changes

There are no portfolio changes this month.

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

As of 30/06/2023



AZ SESTANTE AZIMUT GROUP

Source: Morningstar Direct

The former category is "encouraged" to call its lender for information and support without any impact on its credit score. In addition, it will be permitted to switch to an interest-only mortgage for six months, or extend its mortgage term to reduce the monthly payments, and then switch back to the original term within the first six months, if it chooses to. Both options can be taken without a new affordability check or impact on the credit score. The latter category won't be forced to have its home repossessed within 12 months from the first missed payments.

According to the FCA, at the end of Q1 residential mortgage arrears and defaults remained well below pre-pandemic levels, amounting to only 0.86% of the total. That figure favourably compares with 3.32% in 2009. Also, the proportion of disposable income spent on mortgage payments was at 5.4%, way lower than the roughly 10% recorded in the 1990s and prior to the GFC. However, according to a report published by the Resolution Foundation, an independent British think tank, total mortgage debt in the UK stood at 66% of GDP in 2022, up from under 45% throughout the 1990s. Over the past two decades, two-year and five-year fixed have become the most popular mortgages, delaying the pass through of a rise in interest rates in the short term. It is estimated that at the end of March, about half of the households (3.8 mil) that will eventually be impacted by higher rates saw their mortgage bills increase by 4.2 billion GBP per year, equivalent to an average increase of 1,100 GBP per household. The burden of mortgage repayments is projected to increase by another 8 billion GBP for the remaining half (3.7 mil households) between Q1 2023 and Q4 2026, but with a heavily front loaded schedule. In fact, 5.3 billion GBP of additional costs are already coming due by Q1 2024, equivalent to an average increase in the annual mortgage bill of 2,300 GBP per household should they re-fix. In addition, the Bank of England (BOE), may have to "take tougher action to bring inflation back down" in the words of former Governor Lord King. In April, employment hit a record high with more than 33 million in work, the unemployment rate notched down to 3.8% and private sector pays jumped +7.6% YoY, the fastest rate on record outside of the pandemic, when the furlough scheme distorted the data. In May, headline inflation remained stubbornly elevated at +8.7% YoY, while core inflation surprisingly accelerated to +7.1% YoY. As a result, UK cash futures moved to price in a terminal rate of 6.25%, prompting the 2 year yield to break out to 5.27%, its highest level since September 2007 and way above the (temporary) peak reached during the September 2022 "mini-budget" crisis. In summary, much of the "mortgage pain" in the UK is yet to come, and the BOE appears to be set to compound it with an additional 125 Bps in hikes in the next 12 months.

International Equities

US equities rose sharply for the month, with the S&P 500 (+6.47% in USD terms) and the Nasdaq 100 (+6.49%) recording their 9th and 7th best June ever respectively. The underperformance streak for the "Old economy" heavy Dow Jones Industrial (+4.56%) extended to 5 months out of 6 in 2023, although the oldest benchmark for US stocks posted solid gains for the month. The Nasdaq 100 capped its best first half of the year ever, up +38.75%. The S&P 500 Equal Weight Index and the Russell 2000 outperformed the major averages as the rally broadened out to materials, industrials and, to a lesser extent, energy and financials. Consumer discretionary was the best performing sector for the month, while technology, the best performing sector since the beginning of the year, confirmed its leadership by eking out another small outperformance vis-à-vis the general index. Consumer staples, utilities and healthcare lagged as liquidity chased riskier sectors and names, prompting the S&P 500 High Beta TR Index to extend its winning streak vis-à-vis the S&P 500 Low Volatility TR Index. US equities outperformed the rest of the world (as exemplified by the MSCI AC World Index ex USA TR Index) for the second month in a row. Europe, Japan and emerging markets all lagged the general index. The Nikkei 225 exploded to its highest level in 33 years, however, gains on the local stock market were almost entirely cancelled out by the weakening of the Japanese Yen (JPY), which closed at its lowest monthly level since December 2014 against the Australian Dollar. It was a volatile June for the domestic currency, which traded between 64 cents and 69 cents against the greenback in the first half of the month, before stabilizing just below 67 cents. All in all, the MSCI AC World Daily TR was up +5.81% in USD terms and +2.58% in AUD terms as the Australian Dollar strengthened vis-à-vis all major and developed currencies.

Australian Equities

After another roller coaster ride, Australian equities swung into the green during the very last trading sessions of the month. The S&P/ASX 300 TR rose +1.73% in June, led higher primarily by cyclicals. Miners were the best performing sector as iron ore and copper caught a bid on hopes of China stimulus. Energy shone as oil rose following the decision of OPEC+ to maintain its planned oil production cuts for this year. Banks and insurance posted solid gains, while A-REITs were mostly unchanged for the month. Defensives lagged, with healthcare sharply lower on the back of CSL reducing its profit forecast for FY 2023 due to higher than expected foreign currency headwinds. Telecom bucked the trend as well, while utilities and consumer staples outperformed the general index. Mid-caps and smaller companies were flat for the month, strongly underperforming the Top 20. Value stocks underperformed growth stocks. Finally, the MSCI Daily TR Net Australia underperformed the MSCI AC World Daily TR for the fifth month in a row.

International Fixed Income

On June 7th, the Bank of Canada (BOC) unexpectedly increased its policy rate by 25 Bps to 4.75%, its highest level since March 2001. The central bank had been on hold since January, but inflation figures ticking up for the first time in 10 months and GDP growing faster than expected prompted the governing council to return to hikes on the grounds of a monetary stance not sufficiently restrictive to curtail demand. On June 14th, the FED kept the target rate unchanged at a range of 5-5.25%, pausing its 15-month tightening cycle. However, it 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%. During his press conference, Chairman Powell made clear that the central bank expects the disinflation process to continue, but it intends to maintain real rates “meaningfully positive and significantly”. In fact, the FED is projecting 100 Bps in rate cuts in 2024, but it sees inflation declining by 130 Bps over the same period of time. As a result, the central bank expects the monetary stance to become progressively more restrictive in the next 18 months despite its latest “hawkish skip”. On June 15th, the European Central Bank (ECB) delivered a 25 Bps increase, lifting its deposit rate from 3.25% to 3.50%, its highest level since April 2001. During her press briefing, President Lagarde stated that “we are not thinking about pausing” despite inflation cooling off at a faster than expected pace in May and the European Union entering into a technical recession in Q1 2023. On June 22nd, the Bank of England’s (BOE) Monetary Policy Committee (MPC) voted 7-2 to hike its official bank rate by 50 Bps to 5%, its biggest move since February and the highest level since April 2008. Governor Bailey urged workers to stop demanding higher wages and companies to refrain from increasing prices to “rebuild profit margins” if inflation is to come down from the current “completely unsustainable” level. His comments echoed those of BOE Chief Economist Huw Pill, who, back in April, said that Britons “needs to accept that they’re worse off and stop trying to maintain their real spending power by bidding up prices”. The Bloomberg Barclays Global Aggregate Index hedged back to AUD declined -0.16% in June on the back of generally higher government bond yields but relatively tighter credit spreads as recessionary concerns receded.

Australian Fixed Income

On June 2nd, the Australia’s industrial relations umpire raised the national minimum wage by +5.75%, more than the +3.7% recorded in the annual wage price index for the first quarter but less than the March CPI print (+7%). On June 6th, the RBA increased the cash rate by 25 Bps to 4.10%, its highest level since April 2012. Australian macroeconomic data released in May showed that additional policy tightening may be required. In fact, employers added more than four times the jobs forecasted by economists, the participation rate rose to 66.9% and the employment to population ratio increased to a record high of 64.5%. However, the central bank is not considering reducing the size of its balance sheet via Quantitative Tightening (QT) to harden its monetary stance. According to documents released under a Freedom of Information Act request by Bloomberg News, the RBA is concerned that the stimulative effect of future Quantitative Easing (QE) programs could be lessened were the market “to anticipate sales of holdings next time around”. The Australian yield curve transposed higher and flattened further, with the 2 and the 5 year yield jumping by the most since April 2022, up 67 Bps and 57 Bps to 4.22% and 3.95% respectively, and the 10 year yield adding 42 Bps to 4.03%. As a result, the differential between the 10 year and the 2 year went into negative territory (-19 Bps) on a monthly basis for the first time since July 2008, that is, the yield curve inverted. The Bloomberg AusBond Composite 0+ Yr fell -1.95% for the month, giving back the entire outperformance accumulated over the Bloomberg Barclays Global Aggregate Index hedged back to AUD since the beginning of the year.

Real Assets

Global property was up +3.29% in USD terms but flat (+0.13%) in AUD terms for the month. Returns were primarily driven by central bank’s decisions. US topped the list as the FED paused its hiking cycle, while UK was the worst performing region as the BOE delivered a 50 Bps rate increase. Asia underperformed as the Bank of Japan (BOJ) maintained its ultra-accommodative monetary stance, prompting a record devaluation of the JPY.

Global infrastructure added +1.77% in USD terms, but it was mostly unchanged in AUD terms (+0.07%) in June. Utilities lagged the general index as risk appetite increased globally. In addition, Thames Water came under pressure in the UK, causing the entire subsector to fall sharply. Conversely, the Dow Jones Transportation Average recorded its 9th best month ever, up double digit.

Market Outlook

The inflation report released on July 12th saw the US CPI YoY for June softening more than expected to +3.0% (from +4.0%), its lowest level since March 2021. The headline number rose +0.2% MoM, compared to expectations of a +0.3% increase. The US CPI YoY Core, which excludes the more volatile food and energy components, decelerated to +4.8% (from +5.3%), while the MoM number, which is a leading indicator for future YoY figures, rose +0.2%, missing expectations of +0.3%. To put things into context, in the past 2 years the monthly increase of the US CPI Core had averaged +0.4%, which is consistent with a YoY figure stubbornly above +5%. In addition, the last (and only) MoM print of +0.2% had been recorded back in August 2021. Good news came also from the so called “Super Core CPI”, which is designed to provide a more accurate representation of service inflation by stripping away the housing component as well. According to Bloomberg’s calculations, it came out at +4.0% YoY and at +0.0% MoM.

Market consensus correctly called the June CPI report “pivotal”, in that it established that the disinflation process had gathered momentum and that the cleansing of the elements of inflation related to the supply side, already completed in the headline number, was finally moving to the Core CPI at an accelerated pace. The original “Team Transitory” took a victory lap, as his most notable proponent, the winner of the 2008 Nobel prize in Economics Paul Krugman, twitted that the proposition “that inflation would subside without the need for a big rise in unemployment” does not look “so wrong now”. He admitted that it “took much longer than expected”

Source: Morningstar Direct

but he then questioned the wisdom of the FED response by stating that the central bank "did raise rates a lot, although it's fairly unclear how that reduced inflation". Lael Brainard, former vice chair of the FED, where she was known to be a "dove" on monetary policy, and Director of the National Economic Council (NEC) under President Biden since February 2023, gave triumphant remarks at the Economic Club of New York. There, she declared that "the economy is defying predictions that inflation would not fall absent significant job destruction. Just today, we saw new and encouraging evidence that the U.S. economy is on the path to moderate inflation accompanied by a resilient jobs market." In summary, it seems that "inflation was transitory, after all", and that the US economy is headed for the much fabled, elusive "soft landing", whether engineered by the FED (as per Brainard) or naturally occurred despite the FED (as per Krugman).

We do not share such an optimistic outlook. In our opinion, the fact that the US CPI remains at +3.0% YoY following 500 Bps of rate increases over the past 15 months is indicative of excessive demand within the economy. That is, the government overstimulated through unprecedented fiscal stimulus, and the central bank obliged by maintaining its monetary stance ultra-accomodative way past its expiration date. The FED conducted its final bond purchase of up to 4.025 billion USD in Treasuries in March 2022, notwithstanding the fact that the economy had been growing at an annualized +7% in real terms for the previous 4 quarters and that inflation was already running above +5%. The fact is, it should have started to rein in its monetary largesse at least 6 months before. So where does this leave us? We see two possible scenarios going forward: either the FED has not been successful in suppressing demand, or the FED has done enough to damage it, but the extent of the demand destruction is not yet evident due to the "long and variable lags" of monetary policy. In the first case, we think that the inflation problem will resurface in Autumn, when the base effect becomes less favourable. At that point the central bank may have to shock the market with additional hikes, or get serious with reducing the size of its balance sheet. In other words, until an appropriately tight monetary stance is enforced by the FED, resilient demand will continue to prop up the US economy and keep inflation above the 2% target. In the second case, the monetary stance is already in restrictive territory, and holding rates at the current level in the context of declining expected and realized inflation will make it progressively more restrictive as real rates increase. As a result, the "resilient economy" narrative should start to give way to deteriorating macroeconomic data in the following months, until a sharp spike in unemployment puts an end to the cycle and the "recession that never came" finally materializes in Q4 2023. We lean towards the latter scenario. A tight labour market has so far masked the effects of the fastest tightening cycle in decades, as sustained wage growth has allowed companies to raise prices, inflating their profits. However, we expect those dynamics to reverse course as we progress into H2 2023. True, subsiding price pressures boost real income, (potentially) allowing for more spending on the part of consumers but as companies are less capable of protecting their margins, they will stop hoarding labour and start reducing headcounts. In the meantime, the differential between the FED target rate and the current level of headline inflation, which has recently surpassed 200 Bps, its highest since August 2007, will continue to head higher, further constraining economic activity.

We are approaching the moment of truth for markets. Bonds and long duration assets are mispriced if the economy, and inflation, are indeed resilient, while equities appear to us grossly overvalued if demand destruction is the real driver of the continued disinflation expected by investors. That said, we anticipate the "soft landing" chorus to grow louder and louder during the northern hemisphere summertime, supported by the declining rate of increase of the US CPI Core. As a result, the US Dollar should remain bid, with market participants throwing caution to the wind in the belief that the US economy has avoided a recession, or that it will only come in 2025. The Dollar Index (DXY) has recently dropped to its lowest level since April 2022. Cash futures are pricing in that the FED will hike less than its major central bank peers in the remainder of the year, and that it will cut more next year. A declining greenback vis-à-vis other major developed and emerging currencies tends to be positive for growth assets. For the above reasons, we will continue to participate in the stock market with a selective approach, favouring defensive sectors which offer income and dividends. In our opinion, the disinflation process is about to reach a tipping point and we are starting to see harbingers of the recession on the horizon, however, we do not have reason to reduce our exposure to growth assets too far ahead of the time. We think that market breadth will continue to improve as investors rotate into late cycle sectors and factors, such as energy and industrial metals, financials and small caps, when in fact the cycle may be already over. Our macro outlook identifies that bonds are currently overbought following the downgrading of the "higher for longer" narrative one notch lower to "high for longer". 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.
E: invest@azsestante.com
www.azsestante.com

Source: Morningstar Direct