CFS AZ Sestante Wholesale Conservative Fund

AZ SESTANTE
AZIMUT GROUP

Monthly Investment Report

As of 31/07/2022

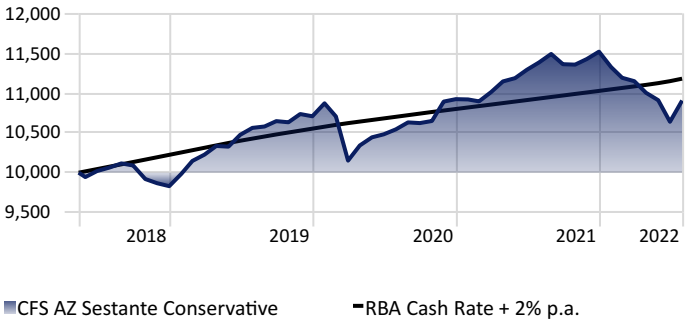
MARKET REVIEW

The US economy contracted for the second consecutive quarter from April to June, hitting a common rule of thumb for a recession. In fact, US GDP fell -0.2% QoQ for the period, after having shrunk -0.4% in Q1. Looking at the data on a yearly basis, US GDP reverted to its long term average trend of +1.5/ +2% as it grew +1.6% YoY in Q2, down from the +3.5% recorded in Q1. Following the publication of the data, Treasury Secretary Janet Yellen appeared in a news conference together with President Biden and pushed back against the claim of a "recession", stating that "the US economy is in a state of transition in which growth is slowing and that's necessary and appropriate" (as it comes from a very high level of activity).

(Continues on page 3…)

	1-mth	3-mths	6-mths	1-yr	3-yrs	5-yrs	Inception
Investment	2.48%	-0.94%	-3.73%	-4.36%	0.93%	2.71%	3.03%
Pension	2.48%	-0.89%	-3.67%	-4.23%	1.02%	2.82%	2.98%
Super	2.21%	-0.77%	-3.28%	-3.80%	0.89%	2.49%	2.66%

$10,000 invested over time



Portfolio information

- Investment Objective:
  target RBA cash rate +2.0% per annum over rolling 5-year periods after fees.
- Asset Class: Diversified
- Portfolio Inception Date:
  5 December 2016 (for investments only)
- Management Costs[1]:
  Investment: 0.79% p.a.
  Pers. Super: 0.83% p.a.
  Pension: 0.82% p.a.
- Buy/Sell Spreads: +/-0.10%

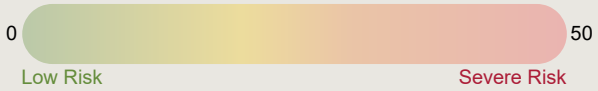
[1] Management Cost is the estimated current total fee before transaction costs and platform fees but after AZ Sestante manager discounts. Figures as at 30 June 2021.

HELPING YOU TO NAVIGATE THE INVESTMENT LANDSCAPE.

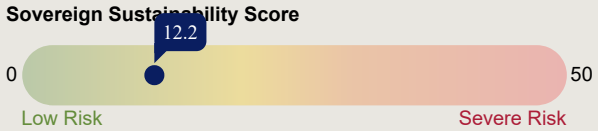
Sustainability Score

● CFS AZ Sestante Conservative

Corporate Sustainability Score



Sovereign Sustainability Score



ESG Pillar Score

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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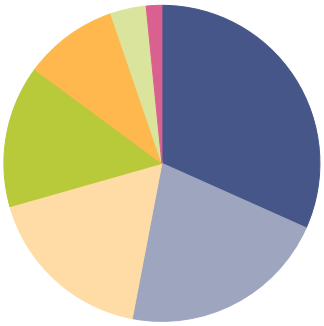
Current Asset Allocation



	%
Cash	31.69
Australian Fixed Income	21.32
International Equity	17.58
Global Fixed Income	14.53
Australian Equity	9.64
Global Infrastructure	3.66
Australian Real Assets	1.59
Total	**100.00**

Where your funds are invested

Cash	**31.69**	—
CFS FC Inv-FSI Strategic Cash	31.69	—
Australian Fixed Income	**21.32**	—
CFS Wholesale Indexed Australian Bond	15.83	
CFS FC W Inv-Kapstream W Absolute Ret	5.49	—
International Equity	**17.58**	—
CFS FC Inv-CFS Index Global Shr-Hgd	5.57	—
CFS FC Inv-CFS Index Global Share	3.62	
CFS FC Inv-IronBk Royal Lon Con Gb Shr	2.86	—
CFS FC-Janus Henderson W Glb Nat Res	2.78	—
CFS FC W Inv-Platinum Asia	2.75	—
Global Fixed Income	**14.53**	—
CFS FC W Inv-Macquarie Income Opps	5.17	—
Colchester Global Government Bond I	5.05	
CFS FC-PIMCO Wholesale Global Bond	4.31	—
Australian Equity	**9.64**	—
CFS FC W Inv-Bennelong ex-20 W Aus Eq	4.12	—
CFS FC W Inv-Schroder Australian Equity	3.61	—
CFS FC W Inv-Fidelity Aus Equities	1.91	—
Global Infrastructure	**3.66**	—
CFS FC Inv-FSI Glb Listed Infrastructure	3.66	
Australian Real Assets	**1.59**	—
CFS FC W Inv-Legg Mason M Curr Real Inc	1.59	—
	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	5.75	-6.04	1.71	-2.17	4.27
MSCI World Ex Australia GR AUD	6.43	0.77	-8.50	-3.94	9.78
Bloomberg AusBond Composite 0+Y TR AUD	3.36	0.93	-5.46	-9.10	-1.81
Bloomberg Global Aggregate TR Hdg AUD	2.49	0.61	-5.61	-8.23	-1.04
S&P Global Infrastructure NR AUD	2.43	1.10	5.06	13.67	4.30

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She also pointed out that "a recession is a broad-based contraction that affects many sectors of the economy" causing layoffs, business closures and strains in household finances, none of which are currently observable, and that two quarters of contraction "is not the technical definition of a recession". The Administration is correct in its assessment as in US there exists an entity in charge of declaring whether the economy is actually expanding or contracting, and its name is the National Bureau of Economic Research (NBER). The NBER is a nonpartisan organization created in 1920 to "conduct and disseminate economic research" without making policy recommendations or normative statements about policy. Its "Business Cycle Dating Committee" consisting of eight eminent economists has yet to make its judgement about the current economic predicament. Historically it has done so with a delay spanning from a few months to two years from the conclusion (not the beginning) of a recession.

The NBER's definition of a recession is the same one quoted by Janet Yellen and it does not involve GDP trends. To assess whether the decline in economic activity is significant enough, widespread enough and protracted enough to call it a recession (that is, meeting the three criteria of "depth, diffusion, and duration"), the committee looks at economic indicators which include, among others, real personal incomes and consumption expenditures, nonfarm payrolls, wholesale-retail sales and industrial production. Based on those, it seems unlikely the NBER will determine that the US economy was in a recession during H1-22, even after the fact.

However, the two quarters of contraction rule, while not determining a recession, has historically been a strong predictor of it. Gross Domestic Product (GDP) became the standard tool for sizing up a country's economy following the Bretton Woods conference held in July 1944. Official quarterly data for the US economy starts in 1947, and since then the US has experienced 12 NBER-defined recessions. In 83.3% of the cases (10 out of 12), the economy experienced two back-to-back quarters of negative GDP growth while being in a NBER-defined recession. In 16.7% of the cases (2 out of 12) the economy did not experience two back-to-back quarters of negative GDP growth despite being in a NBER-defined recession. To elaborate, in 1960 the economy peaked in Q1 and entered a 10-month recession, but it contracted only in Q2 and Q4. Similarly, in 2001 the economy was in a recession for 8 months, but it contracted only in Q1 and Q3.

There exists only one precedent for the economy experiencing two back-to-back quarters of negative GDP growth without being in a NBER-defined recession. That single instance happened in 1947, as the economy contracted in Q2 and Q3, but it subsequently expanded for an entire year before peaking in November 1948 and entering a 11-month recession. Back then the economy was coming out of a 8-month recession that occurred in 1945 following the end of WWII. Similarly, today's contraction follows the 2-month, COVID-19 recession that occurred in 2020. In 1947, the economy hit a "soft patch" 17 months after the previous recession, while in 2022 it is happening with a delay of 20 months. If the analogy is to hold, the US economy should start to accelerate in the following months, and indeed the Bloomberg consensus is currently projecting positive growth in Q3 and Q4 (+0.5% and +0.4% QoQ respectively). Those forecasts will put the current debate about recession to rest should they prove to be correct.

International Equities
The appetite for risk returned in July with investors rotating away from high dividend and low volatility stocks and into high beta stocks. The S&P 500, the Dow Jones Industrial and the Russell 2000 recorded their best month since November 2020, rising +9.11%, +6.73% and +10.38% respectively in USD terms. The Dow Jones Internet Composite Index recorded its 7th best month ever, leading the Nasdaq 100 (+12.35% in USD terms) to its best month since April 2020. In addition, the consumer discretionary sector recorded its 3rd largest monthly outperformance ever vis-à-vis the consumer staples sector. Consumer discretionary and technology were in fact the best performing groups for the month, posting double digit gains. The MSCI World Growth Index recorded its 6th best month ever and its 2nd largest monthly outperformance ever vis-à-vis the MSCI World Value. The US recorded its 2nd largest monthly outperformance ever vis-à-vis the rest of the world (as exemplified by the MSCI AC World Index ex USA TR Index). Japan and Europe underperformed the general index, while emerging markets bucked the trend as the CSI Overseas China Internet was down double digits for the month. All in all, the MSCI AC World Daily TR was up +6.98 % in USD terms and +5.96% in AUD terms.

Australian Equities
The MSCI Daily TR Net Australia underperformed the MSCI AC World Daily TR for the third month in a row in July. The S&P/ASX 300 TR rose +5.95%, led higher by technology, A-REITs, banks, consumer discretionary and healthcare. Resources fell for the second consecutive month as oil prices ended July below 100 USD per barrel and copper closed at its lowest monthly level since January 2021. Gains for insurance were muted with investors assessing the 4.9 Bil AUD bid for Suncorp's bank announced by ANZ. Finally, the Top 20 underperformed mid-caps and smaller companies, while growth stocks outperformed value stocks for the first time in four months.

International Fixed Income
On July 22nd, the European Central Bank (ECB) raised its policy interest for the first time in 11 years, from -0.50% to 0% (+50 Bps), officially ending an eight-year experiment with negative interest rates. On July 27th the FED enacted its second consecutive 75 Bps target rate increase following the one administered just one month before. Those two hikes came on top of the 50 Bps increase decided back in May, for a cumulative 200 Bps of tightening. The last time the target rate was increased by 200 Bps or more in the space of three months was in Q1 1982, as Paul Volcker hiked by 300 Bps over that period of time. During his press conference Chairman Powell stated that "we're at 2.25% to 2.5%, and that's right in the range of what we think is neutral" and that going forward the FED will have to "go to a meeting by meeting basis" given its inability to provide "the kind of clear guidance that we had provided on the way to neutral". Finally, he confirmed his commitment to continue to hike rates to "get to a moderately restrictive level by the end of this year, by which I mean somewhere between 3 and 3.5% percent" and that "the committee sees further rate increases in 2023".

Bond markets reacted by bringing forward to March 2023 their expectations for the first rate cut, in direct contradiction to the central bank's stated intentions for next year. The 5 and 10 year yields dropped by the most since March 2020, while the 2 year yield moved only marginally lower. As a result, the differential between the 10 year and the 2 year went into negative territory on a monthly basis for the first time since August 2019 and by the most (-24 Bps) since August 2000, that is, the yield curve inverted. Spreads tightened across the entire credit spectrum, with corporate investment grade and high yield, hard currency emerging markets and leveraged loans rebounding sharply. All in all, the Bloomberg Barclays Global Aggregate Index hedged back to AUD (+2.49%) recorded its 6th best month ever.

Australian Fixed Income
Domestic inflation accelerated to 6.1% in Q2, missing expectations for a 6.3% increase, while the unemployment rate declined to 3.5%, its lowest level since August 1974. The RBA enacted its second consecutive 50 Bps cash rate increase on July 5th following the one administered just one month before. Those two hikes came on top of the 25 Bps increase decided back in May, for a cumulative 125 Bps of tightening. The last time the target rate was increased by 125 Bps or more in the space of three months was when the RBA tightened by 200 Bps in Q4 1994. The Australian yield curve transposed lower and flattened. The 2 year yield dropped by the most since March 2020 while the 5 and the 10 year yield dropped by the most since May 2012. The Bloomberg AusBond Composite 0+ Yr (+3.35%) recorded its 5th best month ever. The Australian Dollar strengthened vis-à-vis most major developed and emerging currencies for the month.

Real Assets
Global property rose +7.41% in USD terms and +6.39% in AUD terms for the month. The MSCI World Real Estate Net TR recorded its 12th best month ever as financial conditions eased in July by the most since November 2020. Australia rallied double digits on a flattening yield curve and declining real yields. Residential, industrial and retail were the best performing sectors. US and Europe outperformed the general index, the former driven higher by industrial and storage, the latter buoyed by office, retail and industrial. Conversely, Asia underperformed, bringing to an end a three-month winning streak.

Global infrastructure rose +3.41% in USD terms and +2.43% in AUD terms for the month. After seven consecutive months of outperformance, global infrastructure recorded its 8th largest monthly underperformance ever vis-à-vis global property. Transportation stocks caught a bid after a challenging first half of the year, while infrastructure stocks active in the renewable and energy transition space outperformed the general index. On July 6th the European Parliament backed new rules enabling investors to label and market investments in gas and nuclear power plants as "green" starting from 2023. Electricity and gas prices continued to skyrocket in Europe as Russian energy giant Gazprom reduced its gas supplies via the Nord Stream 1 pipeline to only 20% of its full capacity due to maintenance.

Alternatives
Alternatives (+0.41%) were modestly up in July. Long/Short Equity managers outperformed the rest of the industry as the Goldman Sachs Hedge Fund VIP, which measures the performance of the most popular long positions, beat the Goldman Sachs Hedge Fund Very Important Shorts by the largest amount since February 2021. Risk Parity mandates rebounded sharply as both equities and bonds rallied. Conversely, CTA and managed futures suffered steep losses as commodity prices and government bond yields fell.

MARKET OUTLOOK
US equities continued their recovery in August as the VIX Index, the measure which estimates the expected volatility of the S&P 500, dropped below 20 for the first time since April after having been crushed in July. The "soft landing" narrative gathered momentum as investors started to anticipate a reacceleration of economic growth in the context of inflation rolling over and the FED pivoting to a dovish stance. Labour data firmly pushed back against the recession narrative, with the US economy adding more jobs than expected in July and the unemployment rate ticking lower to 3.5%. At the same time, inflation softened more than expected with the US CPI YoY decelerating to +8.5% in July from +9.1% in June and the so-called US CPI Core YoY, which excludes the more volatile food and energy components, remaining unchanged at +5.9%. It was the first step in the direction of the "clear and convincing evidence price pressures are abating" that the FED needs to see before it can alter its aggressively hawkish stance. Finally, with close to 95% of the companies in the S&P 500 having reported actual results, earnings for Q2 grew at +8.13% YoY. That is lower than the +9% recorded in Q1 and the lowest rate of growth since Q4 2020, but it is a number consistent with a robust, although slowing, economy.

The bond market provided another interesting statistics pointing to the worst being potentially behind us. The US 10-year real yield, that is, the return generated by government bonds once inflation expectations are taken into account and which had just turned positive back in May, dropped by -57 Bps, from 0.67% to 0.10%. That is its biggest monthly decline since March 2009. Back then, the economy was one quarter away from coming out of its longest Post War, NBER-defined recession and the stock market was bottoming after having more than halved from its peak. In short, financial assets appear to be pricing in that there is no longer a recession on the horizon in the US. At the time of writing of this note (August 19th), the S&P 500 and the Nasdaq 100 are up +17.79% and +22.37% in USD terms from their mid-June lows, and, in our opinion, fully discounting the "soft landing" scenario. While the latest macroeconomic releases have clearly increased the probability of such an outcome, we do not deem it likely.

The US economy has proven more resilient than expected thus far and continues to exhibit substantial inertia going forward. The tightening administered by the FED appears to have been largely insufficient to slow down a red-hot labour market, and, if anything, the recent bout of strength in financial markets seems to imply that the central bank may still be too accommodative. As a result, our base case remains that the FED will continue to hike its target rate until the end of the year and then it will pause for an extended period of time, that is, it will maintain interest rates "higher for longer". Minneapolis Federal Reserve Bank President Neel Kashkari

has recently declared that he thinks the central bank will need to raise the target rate to 3.9% by the end of 2022 and to 4.4% by the end of 2023 and that expectations for rate cuts to begin early next year are not realistic. While we think that the FED may not need to go that high, and that the market consensus is correct to price in a terminal rate between 3.5% and 3.75%, we wholeheartedly agree with the second part of his statement. There is no "dovish pivot" coming and in its absence, the economy will continue to slow down and potentially enter a recession sometime in the first half of next year.

The cooling off of US CPI observed in July could have been a warning sign in that regard. It was read positively by the markets, and rightly so, as it greatly reduced the probability of an out-of-control inflation. However, its magnitude was so large that it should raise, rather than dissipate, concerns about an upcoming recession. In fact, the Federal Reserve Bank of Cleveland 16 Trimmed-Mean declined to +0.45% MoM in July from +0.80% MoM in June, its biggest sequential drop since August 2008. While it is true that it was coming down from its highest print ever, a continuous decline at the same pace in the following months would be more consistent with economic growth falling off a cliff rather than just a resolution of supply chain issues.

Investors are currently anticipating the exact opposite scenario, namely that receding inflation will boost real incomes, allowing consumers to increase their spending and economic growth to accelerate. Even in that rosy scenario, we find it difficult to believe that companies will be able to sustain the current elevated level of profit margins. In fact, high inflation has meant high nominal GDP growth, which correlates with high revenues and potentially with high earnings for corporates. The last bit clearly depends on the single company's ability to manage its own input costs, so it cannot be a blanket statement. However, wages have, on average, risen less than inflation, so the bottom-line of companies have benefited from that effect. Said situation may reverse in the coming quarters, that is, the increases demanded by workers may start to exceed reported inflation. Hence, we maintain that a "profit recession" may be the most likely outcome for the second half of this year, whether the economy continues to slowdown and eventually enter a recession or does accelerate from here.

Despite our not so sanguine view of the US profit and economic cycles going forward, we think that the positive momentum in growth assets may persist in the short term. International equities are currently recovering part of the underperformance they suffered vis-à-vis Australian equities between March and April. For that reason, we are maintaining our overweight in the former and underweight in the latter over the summer, with the intention to reverse that stance before the start of Q4, when we foresee renewed downside risk for the stock market. We project the economic slowdown in Australia to be milder and to happen later than in US, however, we do not expect the domestic currency to strengthen vis-à-vis the greenback.

The Australian Dollar appears to have become overly cheap based on fundamentals, but the global slowdown and the aggressive FED will keep the US Dollar bid for the remainder of the year. In addition, historically the Dollar Index (DXY) has tended to appreciate during US recessions with investors pulling out money from higher growth and higher risks regions in search of a safe haven. We question that narrative as the past two years have seen massive capital inflows in the US given its superior economic growth compared to the rest of the world. A recession may be the catalyst for a reversal, rather than an intensification, of that dynamic. If our thesis is correct, investors may as well focus on income and dividends, of which there is no lack of in the Australian market.

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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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