

Sestante ESG Focus Dynamic Conservative Portfolio



Monthly Investment Report As of 31/08/2022

MARKET REVIEW

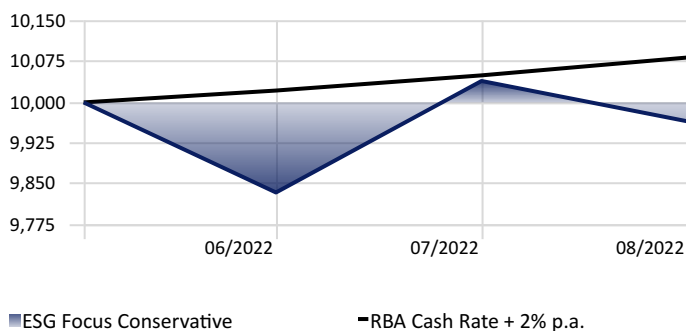
Prominent central bankers, finance ministers, academics and economists gathered together in Jackson Hole on August 25-27 for the annual economic policy symposium hosted by the Federal Reserve Bank of Kansas City. There FED Chairman Jerome Powell gave one of his shortest, yet most forceful and direct speeches on monetary policy and price stability to date. He started by stating that the central bank's "overarching focus right now is to bring inflation back down to the 2% goal". He called its responsibility to deliver price stability "unconditional". He acknowledged that the US economy "is clearly slowing from the historically high growth rates of 2021".

(Continues on page 3...)

Latest performance

	1-mth	3-mths	1-yr	3-yr	Inception
ESG Focus Conservative	-0.74	—	—	—	—
RBA Cash Rate + 2% p.a.	0.33	0.83	2.43	2.37	0.83

\$10,000 invested over time



Portfolio information

- Investment Objective:**

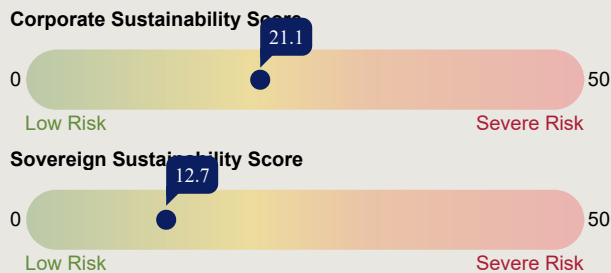
To delivery outperformance of RBA cash rate +2.0% per annum after fees over a rolling 3-year period.

- Suggested minimum timeframe:**
3 years

- 30% Growth / 70% Defensive**

- Portfolio Inception Date:**
1 June 2022

Sustainability Score



● ESG Focus Conservative

ESG Pillar Score



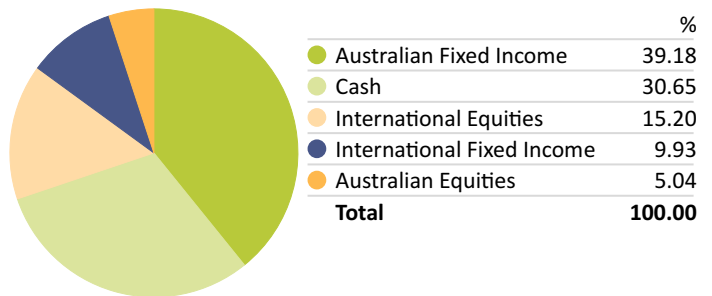
Major Index Returns

	1 Month	3 Months	6 Months	1 Year	3 Years
S&P/ASX 200 TR AUD	1.18	-2.39	0.75	-3.43	5.51
MSCI World Ex Australia GR AUD	-2.50	-1.00	-5.60	-9.18	8.75
Bloomberg AusBond Composite 0+Y TR AUD	-2.54	-0.76	-6.74	-11.50	-3.14
Bloomberg Global Aggregate TR Hdg AUD	-2.72	-1.93	-6.97	-10.53	-2.66
FTSE EPRA Nareit Global REITs TR AUD	-4.50	-2.43	-5.72	-7.97	-0.47
S&P Global Infrastructure NR AUD	0.18	-1.30	5.82	11.28	3.47
RBA Cash Rate Target	0.16	0.33	0.37	0.42	0.37
MSCI ACWI Ex USA NR USD	-3.22	-8.51	-13.51	-19.52	2.87

Important information

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Current Asset Allocation



Where your funds are invested

Australian Fixed Income	39.18	—
Pendal Short Term Income Securities Fd	12.26	—
Janus Henderson Tactical Income	10.31	●●●●
Pendal Sustainable Aust Fixed Interest	9.83	●●●●●
Schroder Absolute Return Income Fund -WC	6.78	—
Cash	30.65	—
RBA Cash Rate Target	30.65	—
International Equities	15.20	—
Stewart Investors Worldwide Leaders Sust	3.71	●●●●●
Ironbark Royal London Concentrated Gbl Shr	3.69	●●●●
VanEck MSCI Intl Sust Eq ETF	2.58	●●●●●
BetaShares Global Sstnbtty Ldrs ETF Ccy H	1.89	●●●●●
Janus Henderson Global Natural Resources	1.43	●●●●
Impax Sustainable Leaders Fund B	1.07	●●●●●
Robeco Emerging Conservative Eq AUD C	0.83	●●●●
International Fixed Income	9.93	—
iShares ESG Global Bond Index D	5.02	●●●●
PIMCO ESG Global Bond Fund - Wholesale	4.91	●●●●●
Australian Equities	5.04	—
VanEck MSCI AUS Sust Eq ETF	1.73	●●●●●
Schroder Australian Equity Fund - PC	1.35	●●●●●
Australian Ethical Australian Shr WS	1.26	●●●●
Alphinity Sustainable Share	0.70	●●●●
Total	100.00	

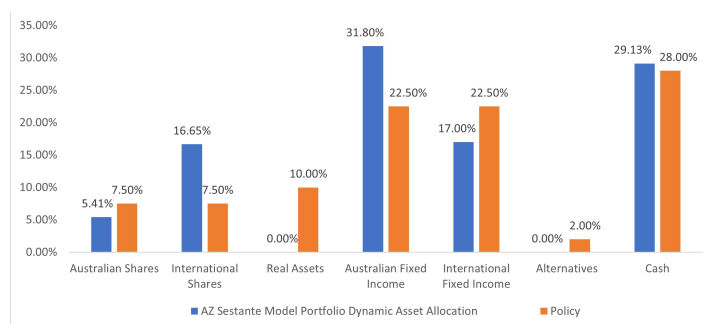
Morningstar's Globe Ratings are just one tool that can help investors work out a fund's ESG credentials. A 5 Globe Rating indicates a fund is at the top end of its peer group in terms of sustainability, while a 1 Globe Rating shows it is underperforming on sustainability issues.

Portfolio changes

There are no portfolio changes this month.

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

As of 31/08/2022



However, despite that deceleration the labour market remains “extremely tight” and “clearly out of balance, with demand for workers substantially exceeding the supply of available workers” while “high inflation has continued to spread through the economy”. To address such a predicament, the FED will have to use its monetary tools “forcefully” and cause “a sustained period of below-trend growth” and “softer labour market conditions”, even at the cost of bringing “some pain to households and businesses”. Finally, he pushed back against the bond market’s expectations of a dovish pivot in Q2 of next year by stressing that higher interest rates will have to be maintained “for some time” and that the most recent Dot Plot’s median estimate, which will be released in September, projects more hikes in 2023.

The policy papers and presentations discussed during the gathering added to the hawkish and sombre undertone of the 45th edition of the event. One paper in particular gave a negative assessment of quantitative easing (QE) and warned about the risks to financial stability posed by the FED’s decision to reverse its course by shrinking its balance sheet. In summary, the paper found that, in the end, the liquidity injected in the financial system by the central bank following the GFC and the pandemic did not flow to the real economy as commercial banks did not increase their lending. Instead, they expanded lines of credit to generate extra fees, essentially rendering themselves more vulnerable to the reduction of bank reserves caused by quantitative tightening (QT). The FED has just started the latter policy in June and intends to step up the pace of liquidity withdrawal to a 1 trillion USD a year from September. The strongest remarks were delivered by ECB Executive Board member Isabel Schnabel. Her lecture conveyed a sense of urgency by focusing on the present need for central banks to retain credibility and to act forcefully in an environment of elevated inflation. She proclaimed the end of the so-called “Great Moderation”, defined as “a period of prosperity and broad macroeconomic stability”, and the transition to a new era of “Great Volatility”. The latter is characterized by an “unprecedented increase in macroeconomic volatility” and by shocks that “are potentially larger, more persistent and more frequent” and “imply a trade-off for monetary policy, between inflation and output”; in other words, between the level of prices and that of economic growth. She stressed that the decisions central banks are taking today will be crucial to mitigate and limit the ultimate impact of these shocks on prosperity and stability. Accordingly, she urged fellow central bankers to choose the path of “determination” and “respond more forcefully to the current bout of inflation, even at the risk of lower growth and higher unemployment”. Even if the economy enters a recession, there is going to be “little choice” as normalizing monetary policy is necessary in order “to lean with determination against the risk of people starting to doubt the long-term stability of our fiat currencies”.

International Equities

US equities resumed their fall in August as investors lost their recently rediscovered appetite for risk after getting the Jackson Hole memo of “higher for longer”. The S&P 500, the Dow Jones Industrial and the Nasdaq 100 declined -4.24%, -4.06% and -5.22% respectively in USD terms for the month. Following the plunge, Minneapolis FED President Neel Kashkari commented that he was “happy to see how Chair Powell’s Jackson hole speech was received”. Healthcare was the worst performing sector. On August 16th President Joe Biden signed into law the Inflation Reduction Act of 2022 which, among other provisions, will make healthcare and prescription drugs more affordable for Americans. Real estate, technology and consumer discretionary experienced some of the sharpest declines. Semiconductor stocks fell hard during the month as major chipmakers reported ongoing supply-chain issues, shortages of certain components, rising inventories of chips and lowered their earnings and revenue guidance for Q3. Energy bucked the trend despite oil prices dropping close to double digits for the month. The US underperformed the rest of the world (as exemplified by the MSCI AC World Index ex USA TR Index) despite the Dollar Index (DXY) soaring to its highest level since May 2002. Japan outperformed the general index, while Europe dropped sharply on concerns about the stag-flationary shock caused by skyrocketing gas prices. Emerging markets were the best performing region as the CSI Overseas China Internet bucked the trend. However, Asia ex. Japan was a mixed bag, with Taiwan and South Korea declining and India and South East Asia rallying. Brazil ripped higher as consumer price inflation continued to ease from its April peak and opinion polls narrowed ahead of October’s presidential election. Turkey posted double digit gains after its central bank cut rates by 100 Bps to 13% despite inflation topping +80% and become the best performing emerging market since the beginning of the year. All in all, the MSCI AC World Daily TR was down -3.68% in USD terms and -1.97% in AUD terms.

Australian Equities

The MSCI Daily TR Net Australia outperformed the MSCI AC World Daily TR in August, bringing to an end a three month relative losing streak. The S&P/ASX 300 TR rose +1.18%, led higher by resources, as major miners resumed their M&A activity. On August 7th, BHP Group offered 8.4 Bil AUD to takeover OZ Minerals with the intent of increasing its exposure toward commodities critical to electric transport and clean energy, particularly copper needed for renewables and nickel required for lithium-ion batteries. The proposal of the world’s top miner was rejected despite valuing the Adelaide-based company at a premium of 32% over its last closing price. On August 24th, Rio Tinto submitted an improved non-binding proposal to acquire full ownership of Turquoise Hill with the intent of assuming greater control of the Oyu Tolgoi project in Mongolia. The latter is expected to become the world’s fourth-largest copper mine once completed. Financials fell in August, dragged lower by banks and A-REITs. Conversely, insurance outperformed the general index together with energy and telecom. Technology, consumer staples and utilities ended the month in the red. Finally, mid-caps strongly outperformed the Top 20, while smaller companies lagged.

International Fixed Income

On August 4th, the Bank of England (BOE) hiked its official bank rate by 50 Bps, its largest single increase since February 1995 and

its sixth consecutive since December 2021. On August 17th, the Reserve Bank of New Zealand (RBNZ) delivered its seventh straight official cash rate hike, bringing its benchmark to 3%. The European Union Harmonised Indices of Consumer Prices (EU HICP) accelerated to +9.1% in August, its highest reading ever. The German yield curve transposed higher with the 2 and the 5 year yield spiking by the most in history, up 92 Bps and 86 Bps, to 1.20% and 1.39% respectively. The last time they were trading around those levels was between June and July of 2011. The 10 year yield recorded its second largest monthly increase in history, up 72 Bps to 1.54%, its highest level since March 2014. As a result, European government bonds recorded their worst month ever in August, down -5.16% in EUR terms. In the US, yields rose by the most since March, while the differential between the 10 year and the 2 year sank further into negative territory, ending the month at -30 Bps. The yield curve inverted also in the segment between the very long end and the so-called “belly” as the differential between the 30 year and the 5 year dropped to -6 Bps. Speaking with the Wall Street Journal on August 25th, Raphael Bostic, Atlanta FED governor, acknowledged that some weakening of the US economy is to be expected, but given the fact that “monetary policy starts to bite somewhere six to 18 months after it starts”, the central bank should “resist the temptation to be too reactionary” and avoid taking a more accommodative stance next year. Spreads widened for corporate investment grade and high yield and tightened for emerging markets hard currency and local currency. As a result, the former group underperformed global government bonds, while the latter outperformed. Leveraged loans posted gains. All in all, the Bloomberg Barclays Global Aggregate Index hedged back to AUD (-2.72%) recorded its 2nd worst month ever.

Australian Fixed Income

The RBA enacted its third consecutive 50 Bps cash rate increase on August 2nd, for a cumulative 175 Bps in the space of four months, its fastest pace of tightening since 1994. At the end of the month investors were pricing in close to 6 additional 25 Bps hikes for the remainder of the year, on top of the 7 already delivered, for a total of 325 Bps. The Australian yield curve transposed higher, with the 2, 5 and 10 year yields rising 56 Bps, 54 Bps and 54 Bps to 2.99%, 3.32% and 3.60% respectively. The Bloomberg AusBond Composite 0+ Yr (-2.54%) recorded its 6th worst month ever. The Australian Dollar strengthened vis-à-vis most major developed and emerging currencies in August but fell against the greenback.

Real Assets

Global property fell -6.48% in USD terms and -4.82% in AUD terms for the month. Europe plummeted, dragged lower by residential, industrial and office. Conversely, Asia ex. Japan was the best performing region given its relative insulation from the inflation concerns gripping the rest of the world. Australia marginally outperformed the general index on the back of a solid semi-annual reporting season, with retail producing the strongest relative returns. The Australia CoreLogic - Median City Values fell for the third consecutive month in July, down -1.4% MoM. As a result, its YoY rate of appreciation decelerated to +2.16%.

Global infrastructure fell -1.57% in USD terms but rose +0.18% in AUD terms in August. The sector outperformed global property by the most since May, recording its 9th best month ever in terms of relative return. The MSCI World Utilities TR Index was dragged lower by Europe. As the Old Continent grapples with an energy crisis, its electricity generators that have hedged their power sales on the future market are facing spiralling collateral requirements. As a result, they are running out of cash despite selling electricity at record prices.

Alternatives

Alternatives (+0.99%) posted gains in August, driven higher by a recovery in Macro strategies and CTA and managed futures programs. Conversely, Long/Short Equities declined, underperforming the rest of the industry, while Risk Parity mandates dropped sharply as both equities and bonds fell.

Market Outlook

The US CPI YoY for August softened less than expected to +8.3% as the headline number rose +0.1% MoM compared to expectations of a -0.1% decline. More concerning, the US CPI YoY Core, which excludes the more volatile food and energy components, showed an unexpected reacceleration in inflation as it hit +6.3%, its highest level since March, with shelter, medical and transportation the largest contributors. The MoM number, which is a leading indicator for future YoY figures, rose +0.6%, doubling expectations of +0.3% and signalling firming and broadening inflation pressures. In addition, the Bank of Cleveland 16 Trimmed-Mean CPI rose +0.62% MoM and +7.22% YoY, its highest annual reading ever. In short, the report published on September 13th seems to suggest that headline inflation in US has been moderating/stabilizing, although at a slower pace than expected, on the back of the easing of supply chain disruptions and the drop in oil (and gasoline) prices recorded in the last three months. Conversely, the stickiness of core inflation points to persistent excessive demand caused by a resilient US economy and a labour market that, while no longer red-hot, continues to remain extremely tight.

Following the publication of the data, the US cash futures projections moved to price in a terminal rate just shy of 4.5% in March 2023, that is, the bond market is incorporating an additional 200 Bps of tightening in the following 6 months on top of the 225 Bps already delivered. At the next four meetings the FED will have to hike by another 75 Bps twice and then by further 25 Bps twice, in that order, to realize what has been already built in the yield curve. We agree with those expectations. We think that the central bank will continue

to deliver outsized hikes to take advantage of an expanding economy. That has been the story so far for this tightening cycle. In fact, the FED has been frontloading its rate increases in response to elevated inflation but also because it could afford to do that as growth was coming down from a record level of economic activity.

We think that the real test for monetary policy will come in 2023, as we see the US economy slowing down further and potentially entering a recession in the first half of the year. Historically, the central bank has never pivoted until its target rate had exceeded the level of CPI and, according to the current Bloomberg consensus estimates for inflation, that is only going to occur in June 2023, when the headline number is projected to be at +3.9%. That is the reason why the bond market continues to see rate cuts in the second half of next year, albeit from a higher terminal rate of 4.5%. However, we consider it unlikely that this “dovish pivot” will materialize as soon as currently implied by the futures. To begin with, in our opinion it would not prevent the US economy from falling into a recession even if it were to happen. In fact, in normal times the FED should cut rates today if it wanted to stave off the risk of a downturn, but clearly it is not interested in prolonging this cycle. More importantly, the central bank has been adamant that it wants to bring inflation back to +2%. It also has made clear that it does not want to repeat the policy errors it committed back in the 70s, when it failed to lower inflation for a decade as, after increasing rates in multiple instances, it reversed course too early.

Our thesis is that a mild, technical recession next year will not be sufficient to achieve the FED’s stated goal as the labour market is simply too tight. As pointed out by several economists, during the last three official recessions (Q1 to Q3 2001, Q4 2007 to Q2 2009 and Q4 2019 to Q1 2020), total job openings fell by 2.5 million on average. However, at the end of July, total job openings were still 4 million above their pre-covid peak, that is, even if the economy were to suffer a run-of-the-mill downturn in 2023, at its trough the labour market would still be stronger than it was at the end of previous expansions. In addition, the government is still running an expansionary fiscal policy with a projected budget deficit of 1.032 trillion in 2022 and may decide to increase spending to combat the downturn. In fact, we do not think that there is much political will for a severe recession in the US that brings the unemployment rate from the current level of 3.7% to the 5-6% required to cool down wage pressures. In summary, our base case remains that the FED, after reaching its terminal rate, will maintain interest rates “higher for longer” to generate a prolonged period of subdued growth. That, we think, is the only option it has to try and bring inflation back to +2% in the absence of a deep recession. In other words, it will have to substitute duration for magnitude.

The scenario for Australia appears to be more constructive. Here the probability of a “soft landing” is higher than that of a recession. The RBA wants to keep the economy on an “even keel” and that implies, in our opinion, that it does not intend to bring its cash rate into highly restrictive territory. The central bank may return to smaller hikes once it reaches its estimate of neutral rate at 2.5% in September. Also, the urgency of normalizing the monetary policy stance may dissipate, allowing for meetings with no rate increases or even for an extended pause. Governor Lowe has recently pushed back against the latter possibility, stating that a few more hikes would be needed to tame inflation. However, with a decline in house prices gathering momentum and the first cracks emerging in the employment market, the central bank may not need to reach the 3.9% terminal rate currently priced in by cash futures. Finally, Australia is a commodity powerhouse with an undervalued currency, and that will sustain its terms of trade with the rest of the world as the global slowdown and the aggressive FED will continue to keep the US Dollar bid for the remainder of the year. For the above reasons, the risk/reward for domestic equities appears to be superior to that of international equities going into Q4, when we foresee renewed downside risk for the stock market. As a result, we are reducing our multiyear overweight in the latter and tilting the portfolio back into the former by buying primarily into large caps, which offer income and dividends. Also, we are rotating our international equities exposure further away from growth stocks into more defensive sectors and into energy. In fact, we do not expect the economic deterioration to push the price of oil much lower from this level. Since April, the Biden Administration has embarked upon the largest-ever emergency release of oil from the Strategic Petroleum Reserve (SPR) in order to mitigate prices. If anything, we consider more probable a renewed bull trend in crude once the historic release is over at the end of October, and that may further complicate the task for the FED.

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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