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Half Yearly Investment Update Seminar

May 2022

Presented by Chris Molloy

Your financial future, tailored your way

Disclosure

General Advice Disclaimer

The purpose of this presentation is to provide you general advice and insight into MPW's current market outlook and investment philosophy.

Where our presentation provides general advice, we must explain that this advice has been prepared at this time without taking into account your individual personal needs, objectives, or financial situation, and the personal information we hold about you has not specifically been considered in forming our views.

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Outlook: A Mid-Cycle Slowdown Or A Recession?

1. Where we are in the cycle
2. The case for a mid-cycle slowdown
3. The case for a recession in 2023
4. MPW view and portfolio positioning
5. MPW asset class strategies
6. Future Return Expectations
7. Conclusion & Questions

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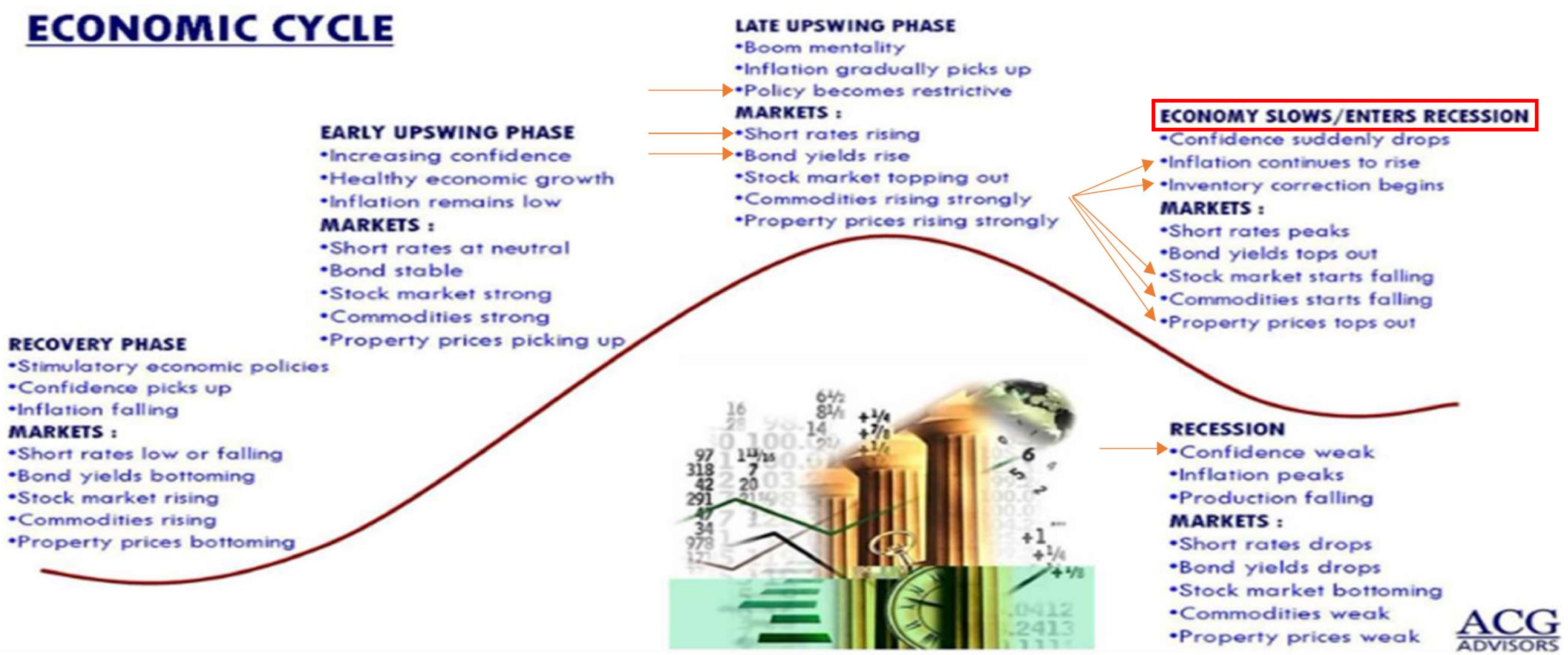
Where Are We In The Economic Cycle?



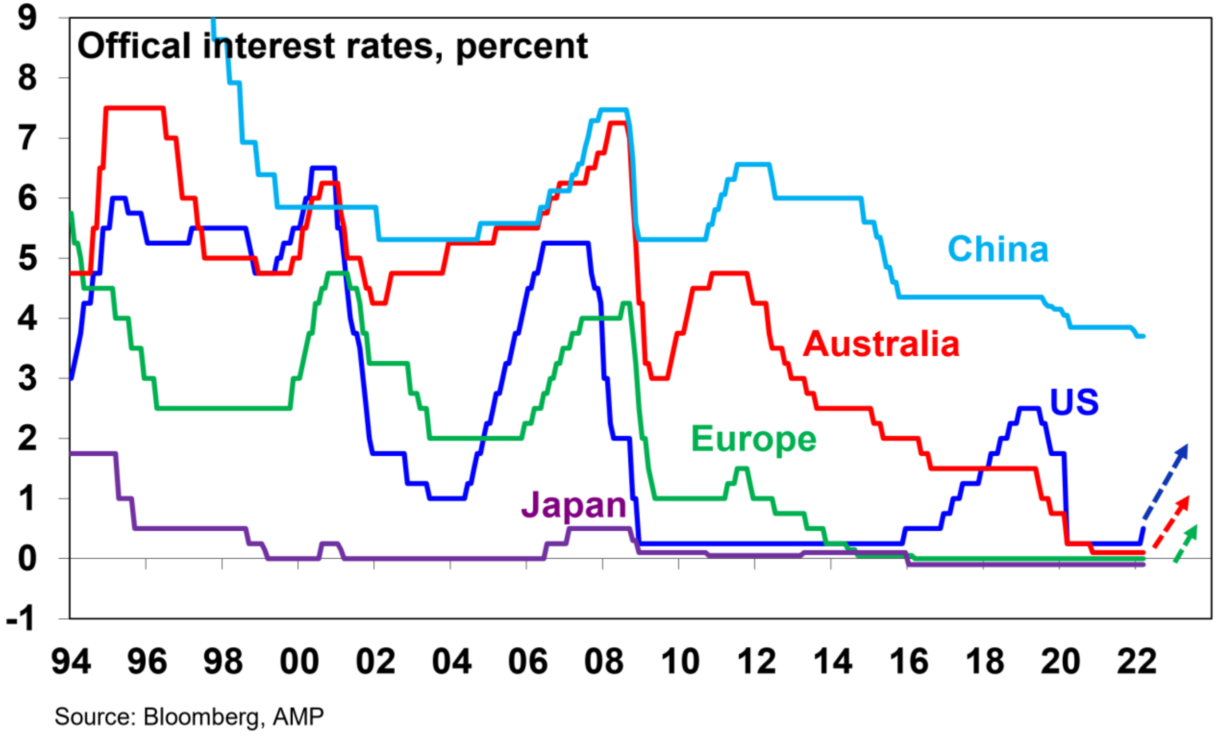
The Case For A Mid-Cycle Slowdown

The following factors support the ability for central banks to facilitate a mid-cycle slowdown:

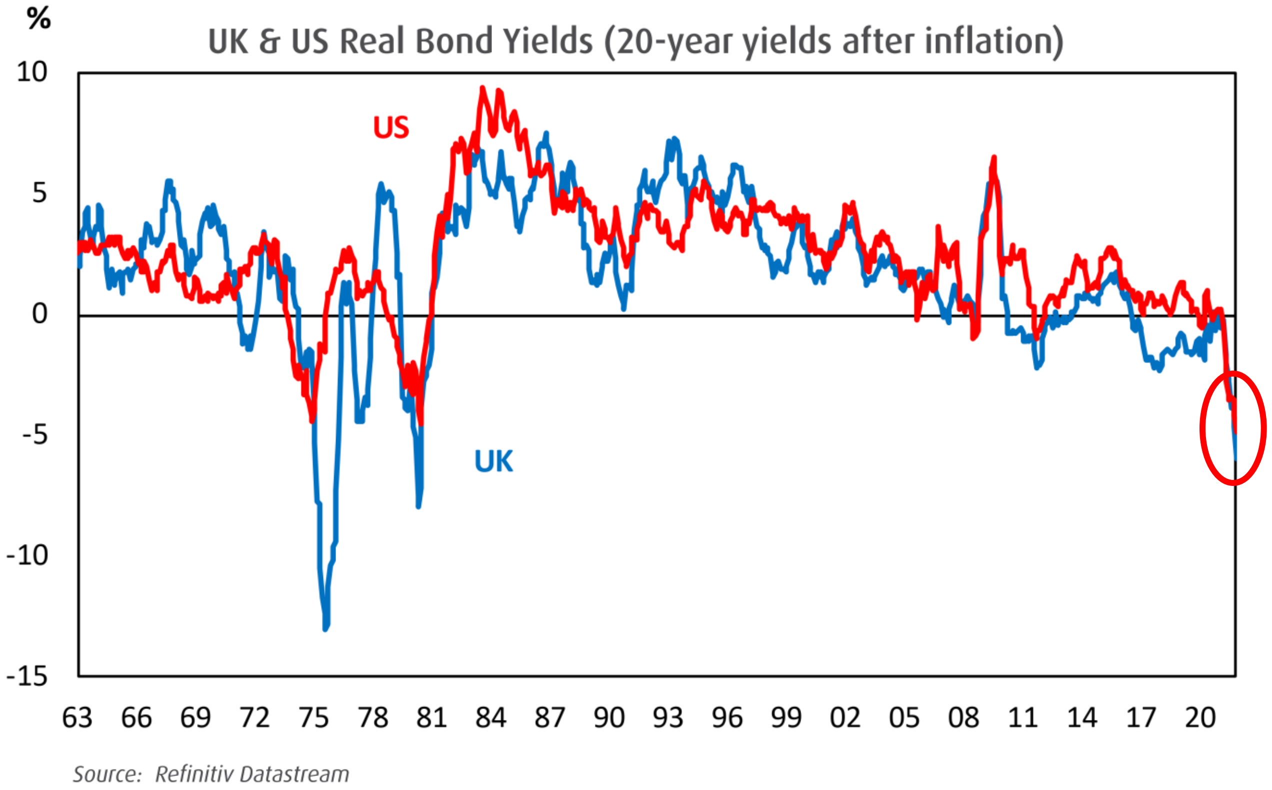
1. **Low Interest Rates** – Real interest rates are low despite Central bank tightening ahead
2. **Financial Conditions** – Liquidity is abundant and financial conditions remain accommodative now
3. **Consumers** – Record savings levels, rising wages, and deleveraging puts consumers in good shape
4. **Corporates** – Earnings remain strong and should support higher equity prices
5. **Investment Liquidity** – There is record cash and 'dry powder' ready to 'buy the market dips'

Interest Rates To Rise Off A Record Low Base

Interest rates will rise but will remain historically low.



Real-yields (inflation adjusted) are the lowest in 40 years, so any tightening begins off of a tremendously low base.



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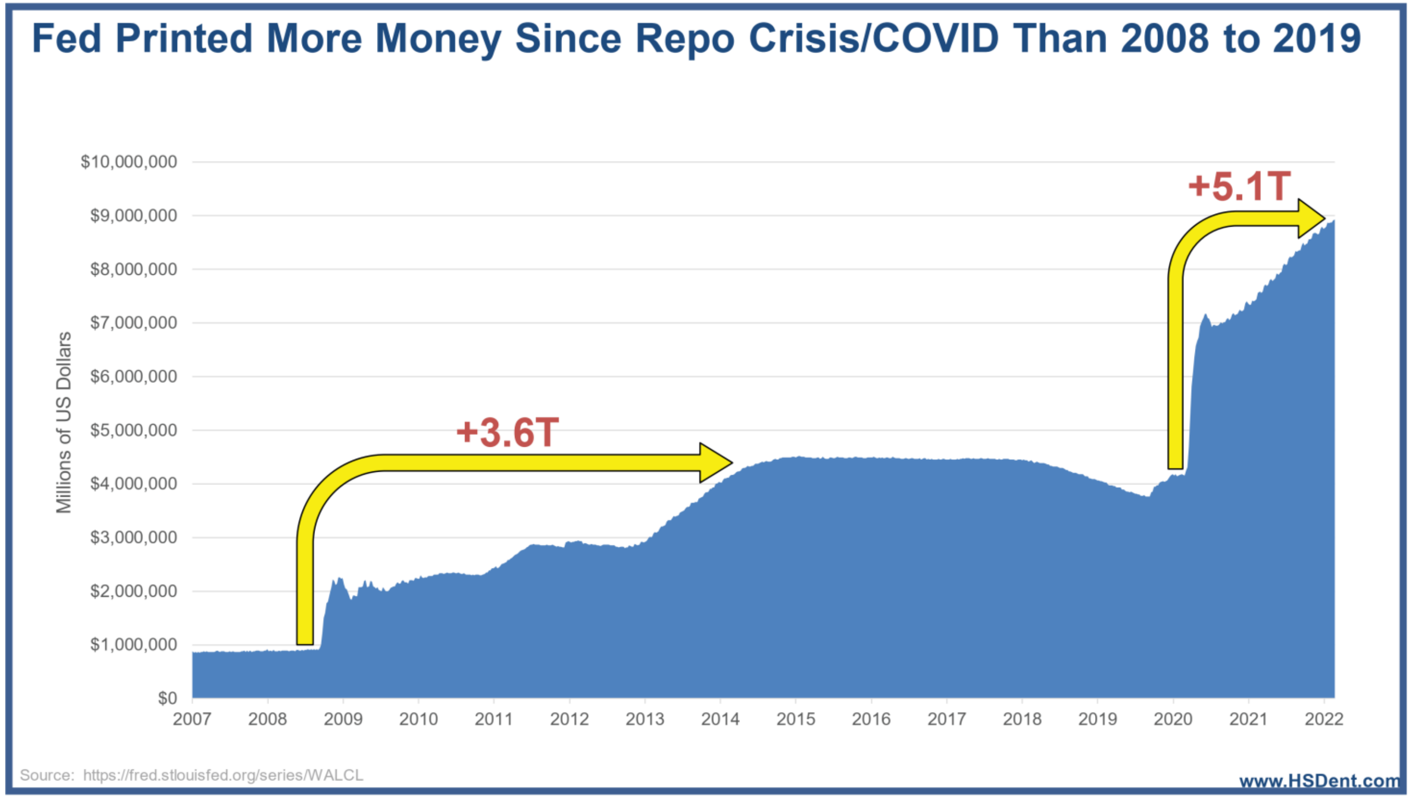
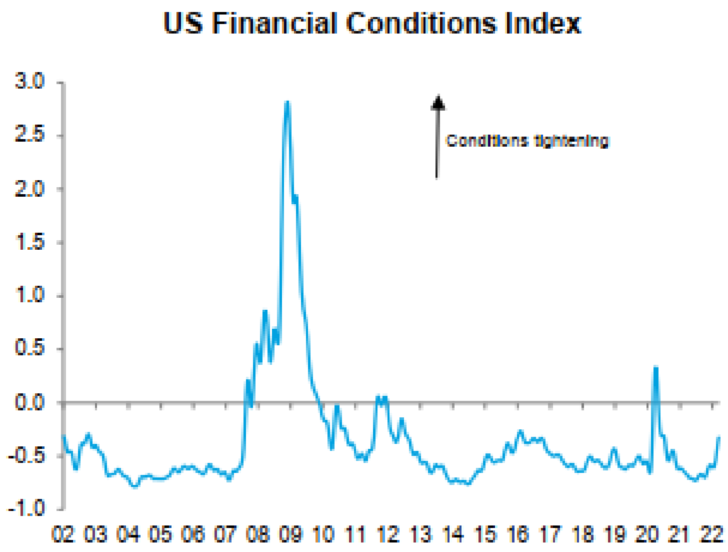
Financial Conditions Remain Accommodative

We have witnessed the largest central bank balance sheet expansion in history. The US Fed is about to raise interest rates and unwind its balance sheet by ~$95 billion per month, but financial conditions remain accommodative, at least for now.



Financial conditions are tightening but remain very accommodative



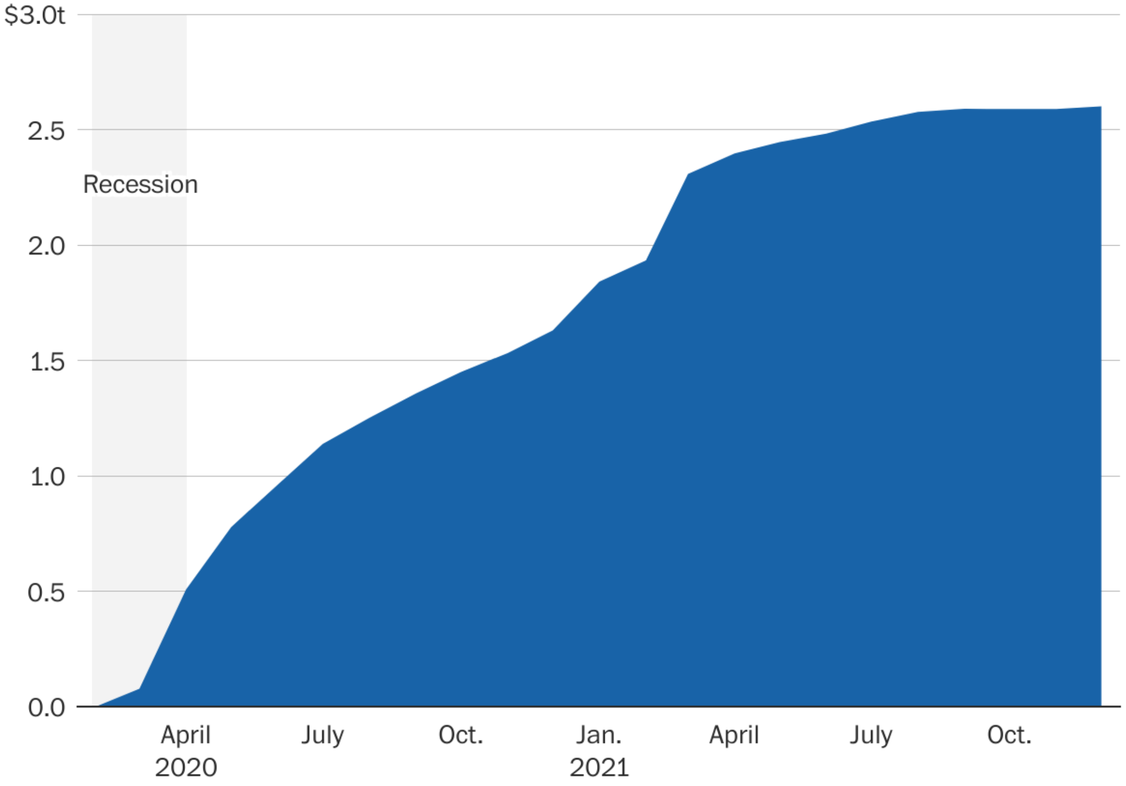
Source: Factset, MWM Research, March 2022

Consumers Are Cashed-Up

The covid-19 pandemic has spurred global cash savings

More than $2.5 trillion waiting on the sidelines (US)

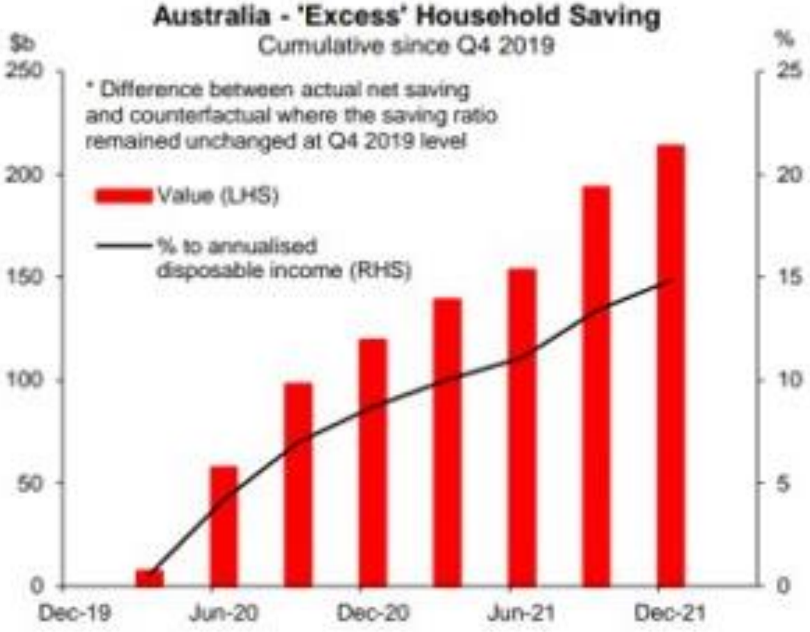
Cumulative excess savings by U.S. households since the pandemic began



Source: Bureau of Economic Analysis

THE WASHINGTON POST

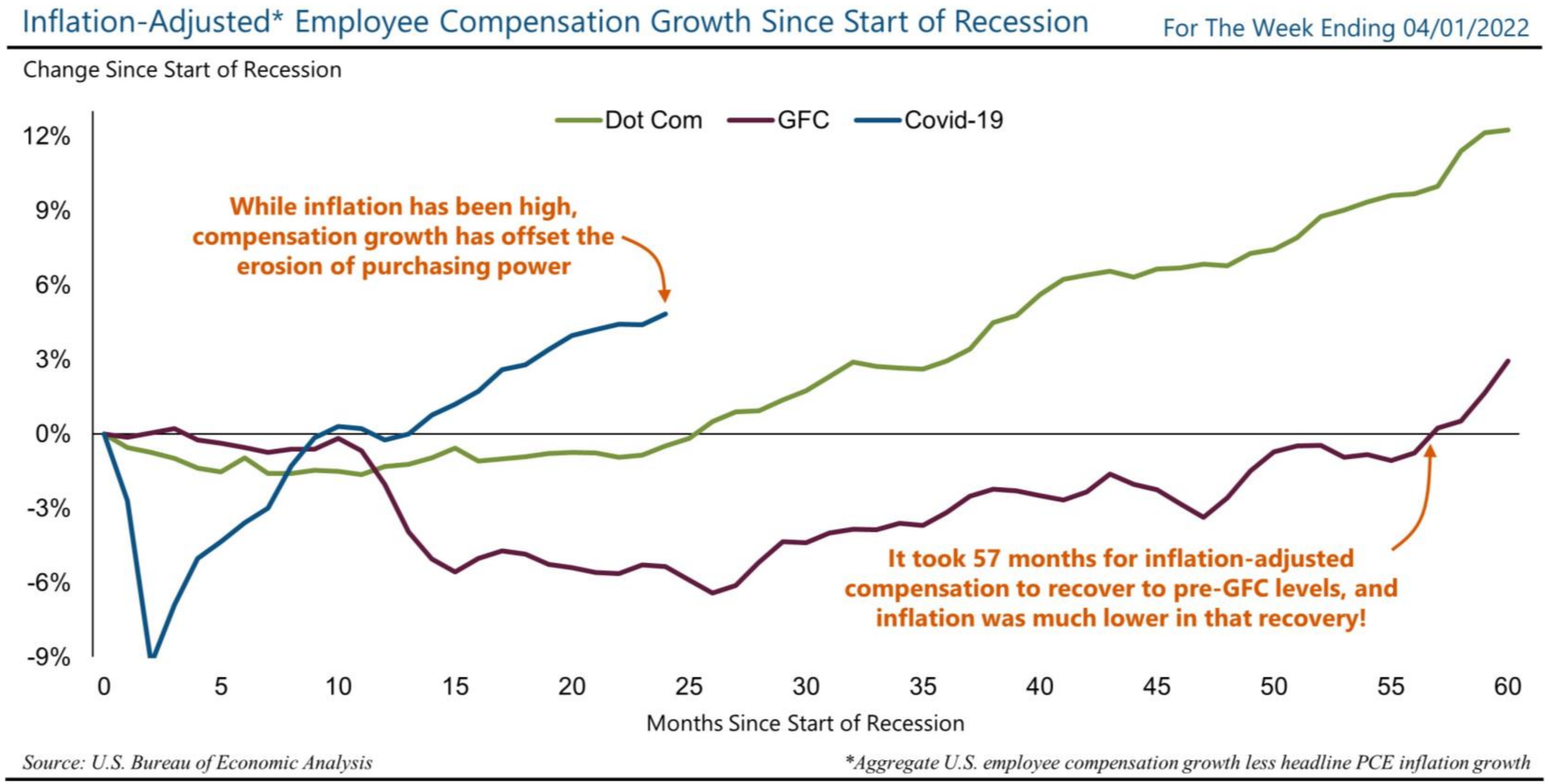
Strong consumption to be underpinned by $200bn in household 'excess savings'

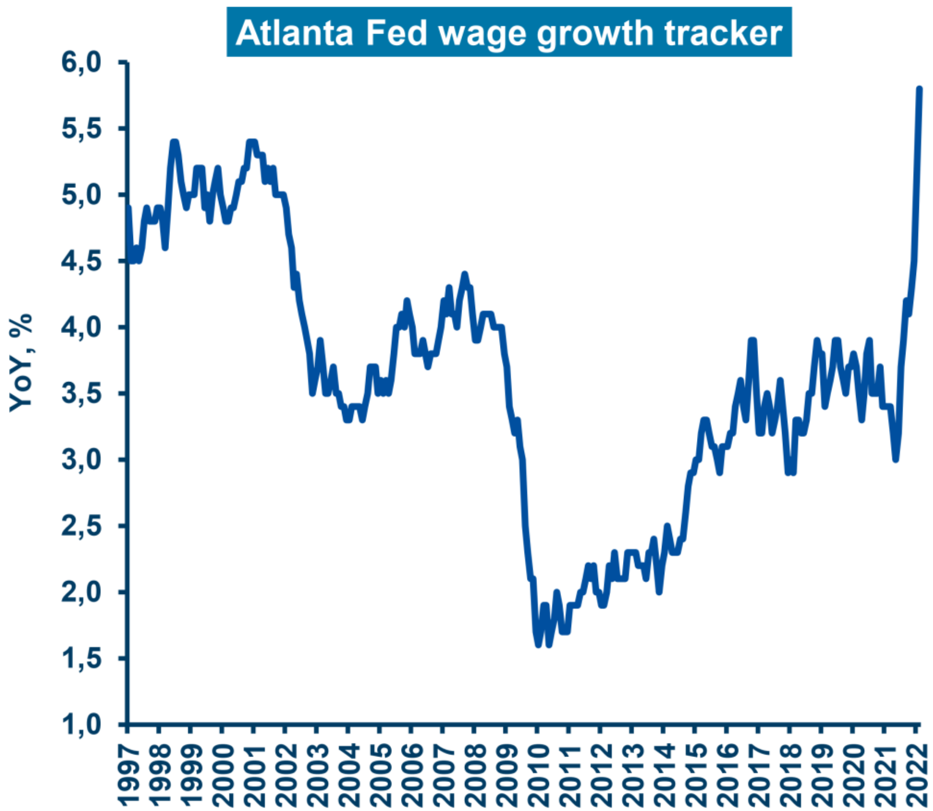


Source: ABS, Macquarie Macro Strategy, March 2022

Wages Growth Is Compensating For Inflation

US consumers have more purchasing power now than they did in February 2020.





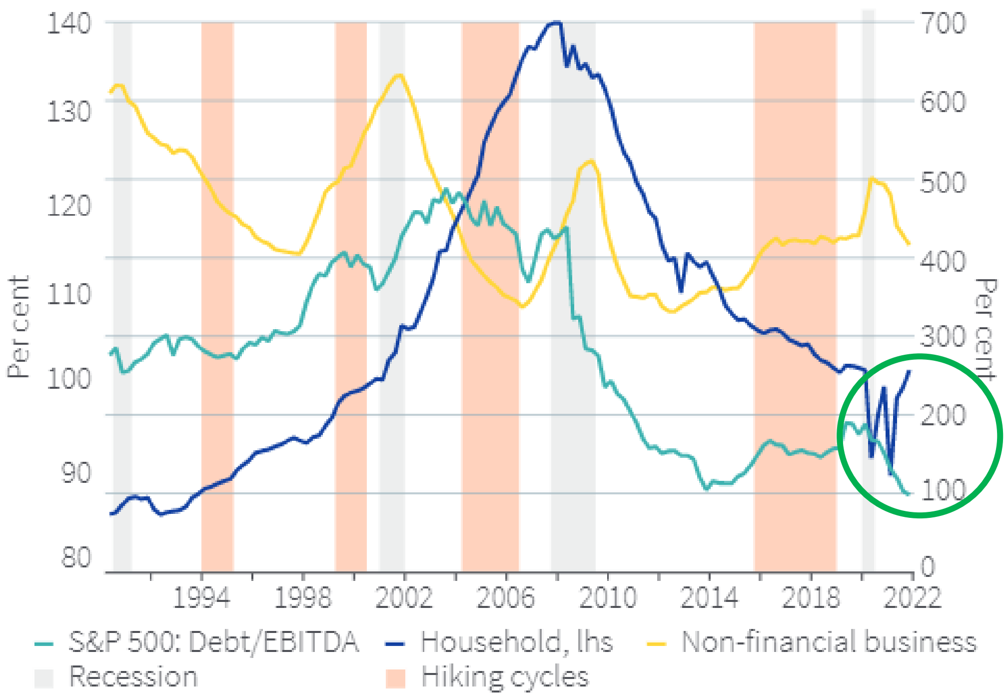
Consumer & Corporate Balance Sheets Are Strong

US consumers and corporates have de-leveraged significantly

Australian consumers are highly leveraged, but household debt service ratios are at record lows

Figure 36. **U.S. Household and Corporate balance sheets in good shape**

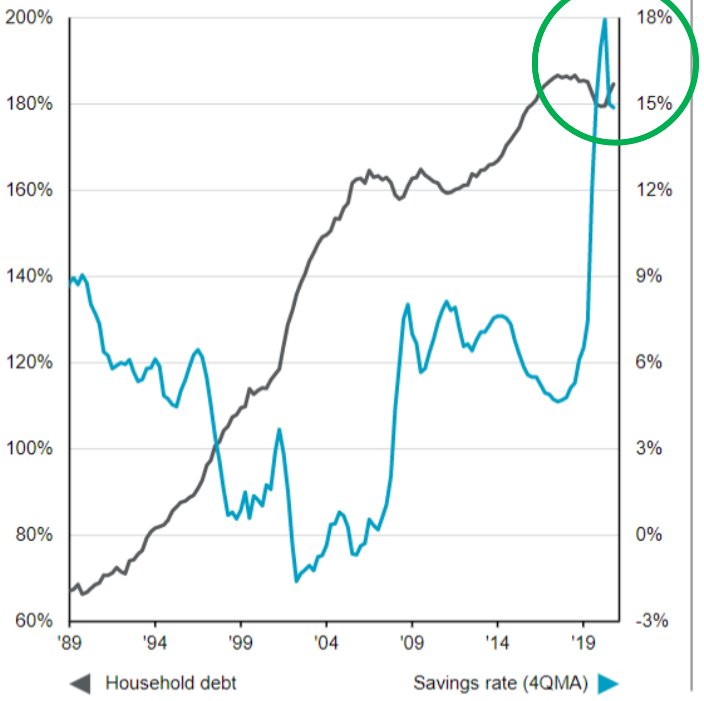
US: household and corporate debt to income



Source: Aviva Investors, Macrobond, Bloomberg as at 24 March 2022

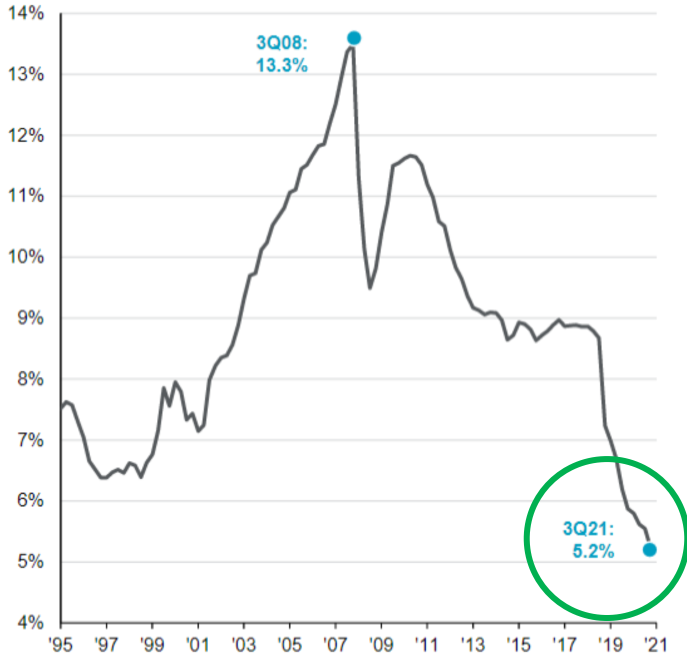
Household debt and savings rate

Percent of annualised household disposable income



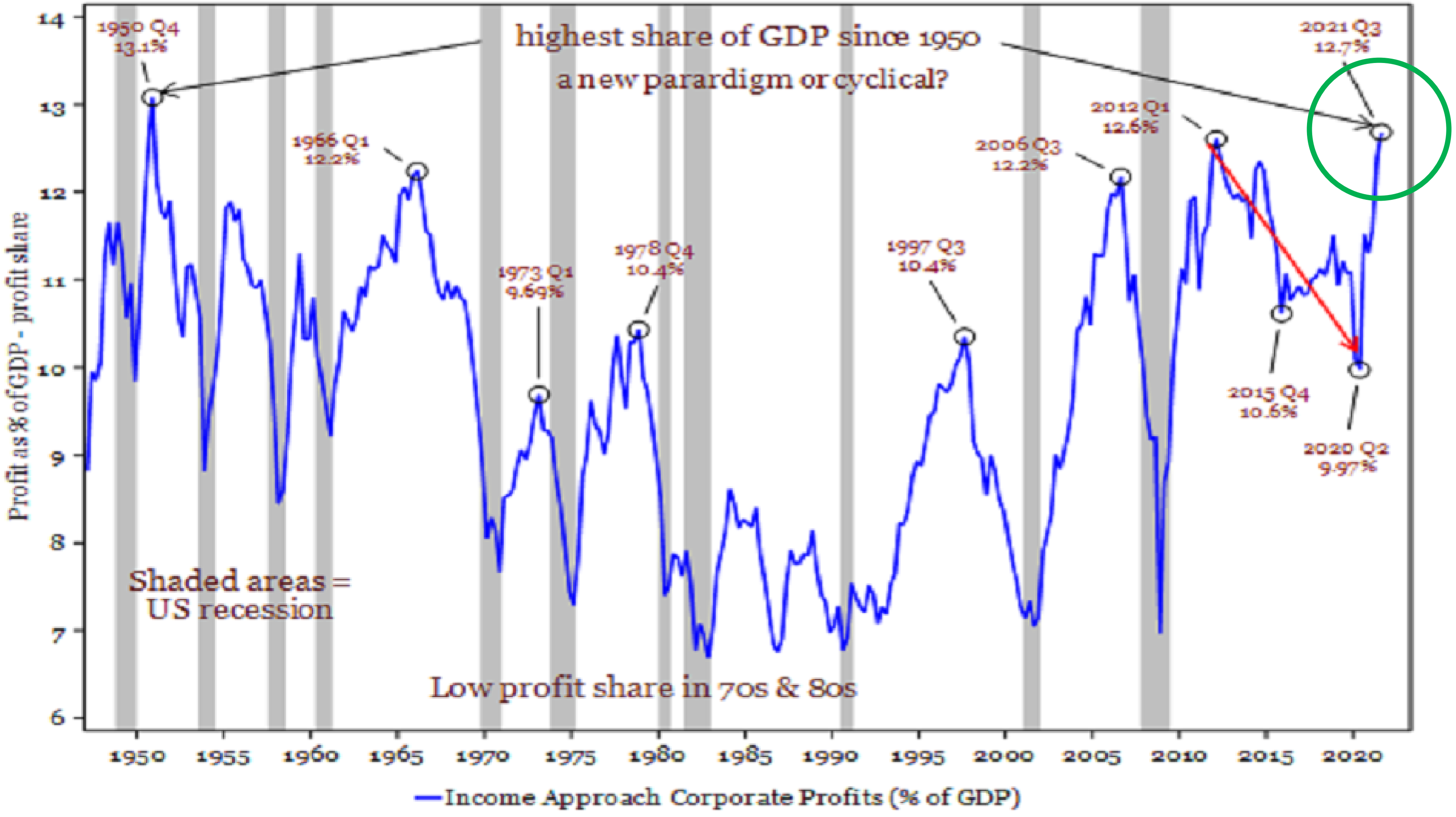
Household debt service ratio

Interest payments to household disposable income, seasonally adjusted



Corporate Profits Are High, But Likely Peaked

As we move through 2022 corporate profit margins are likely to be squeezed by higher rates and inflation

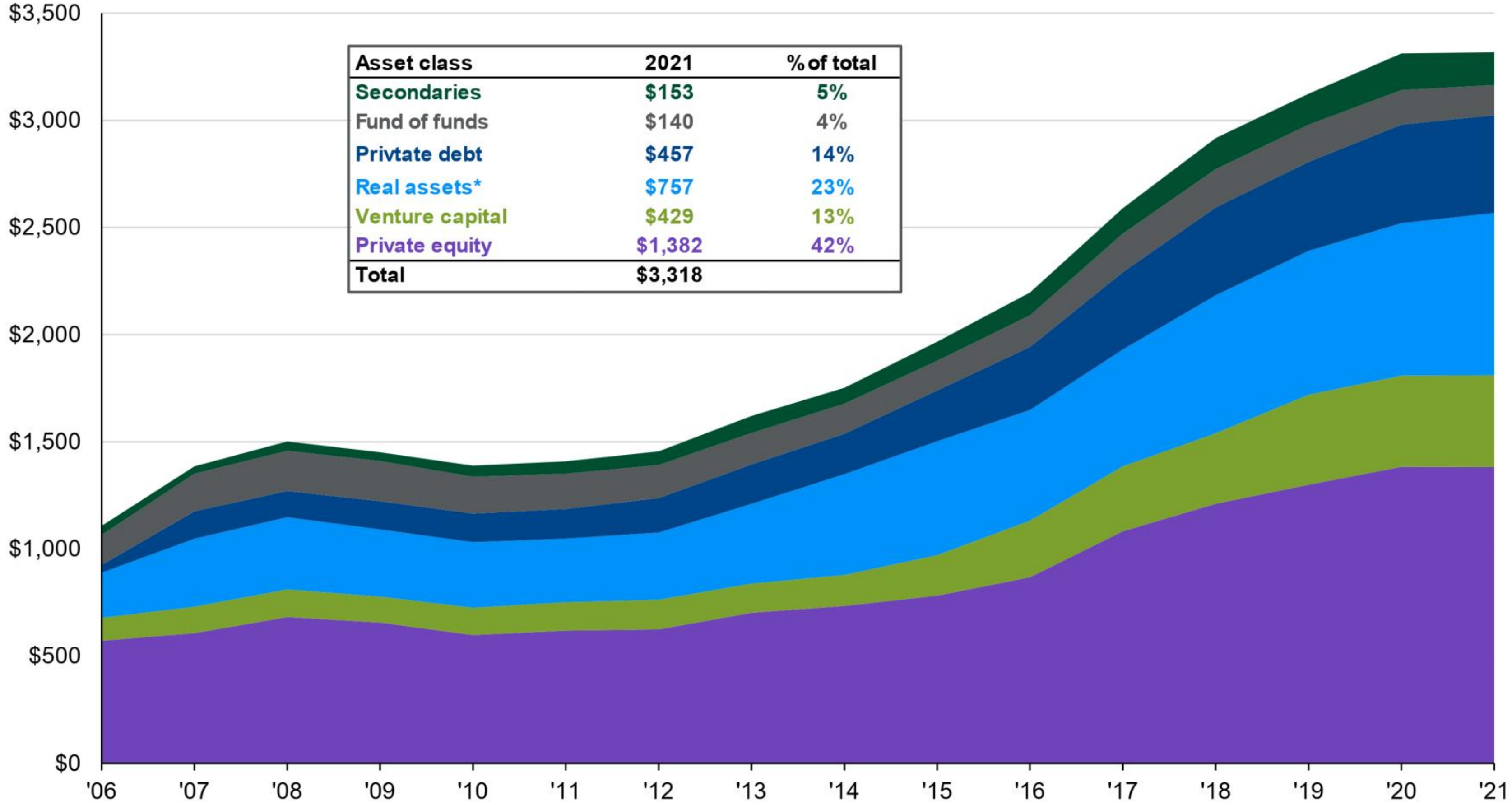


Source: Longview Economics, Macrobond

Private Equity Fund ‘Dry Powder’

Private Equity Funds are waiting to deploy surplus cash of more than $3.3 trillion, which could underpin markets

Dry powder by asset class
Cumulative dry powder, USD billions



Asset class	2021	% of total
Secondaries	$153	5%
Fund of funds	$140	4%
Privtate debt	$457	14%
Real assets*	$757	23%
Venture capital	$429	13%
Private equity	$1,382	42%
Total	$3,318	

Source: Pitchbook, J.P. Morgan Asset Management. Dry powder data is as of December 31, 2021. Percentages may not sum to 100 due to rounding.

The Case For A Global Recession

Central bankers have a choice: Bring on a sharp recession or live with high inflation, what will they choose?

1. **Geopolitical Risks –** The longer the war in Ukraine persists the more likely a recession ensues
2. **Supply Chains & China** – Supply chains are already under pressure, now magnified by China's lockdown
3. **Demand Brought Forward** – Reversal of massive overspending could leave the economy vulnerable to a downturn
4. **Consumer and Investor Sentiment** – Collapsing confidence is akin to 2008-09 GFC levels
5. **Inflation & Rising Bond Yields** – Out of control inflation will see the central banks playing catch-up with rates
6. **Rising Rates and QT** – Aggressive interest rate increases and quantitative tightening will impact market liquidity
7. **Recession Risks High** – History suggests that current market forces indicate we will be in recession in 2023

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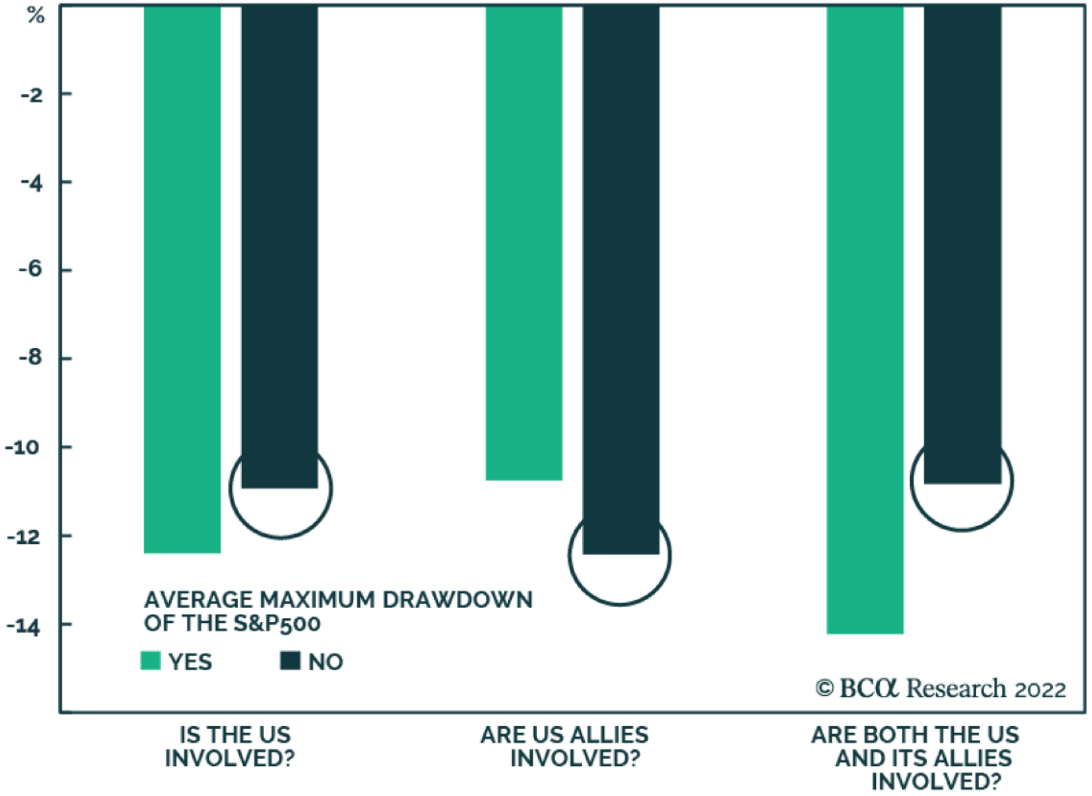
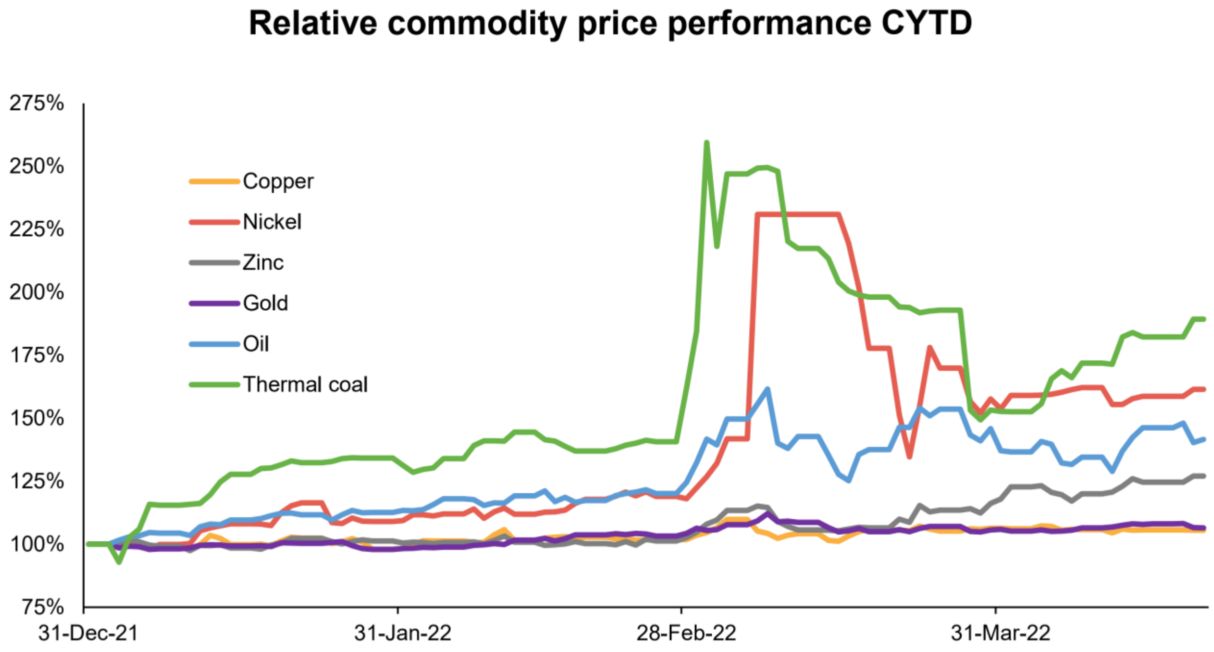
Russia and Ukraine Implications

The peak-to-trough equity drawdowns amid major geopolitical crises range from 11-15%. Markets have already fallen this far, but a prolonged war is not priced



Russia's invasion of Ukraine saw many commodity prices spike upwards of 100% in a matter of days! This adds to the inflation and supply chain issues

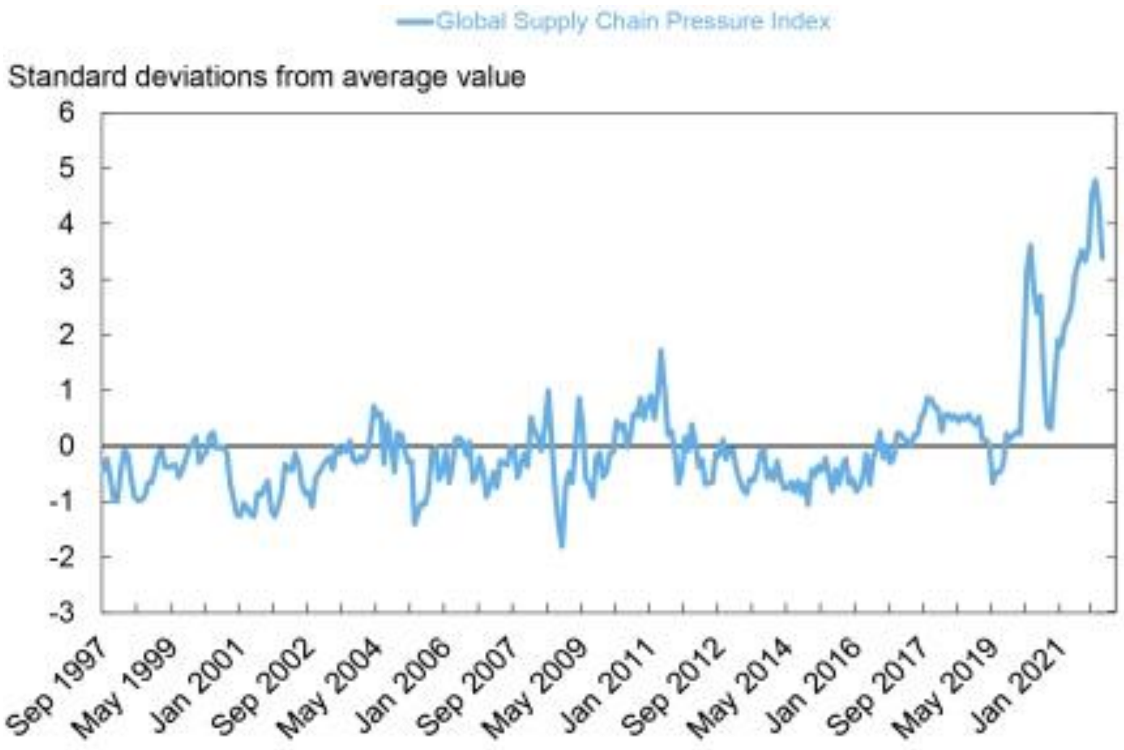
Chart 2: Price shock across the commodity complex from the war



Source: Ausbil, Bloomberg

Supply Chain Pressure Remains High

While global supply chain pressure was decreasing early this year, pressure still remains high and China's lockdown will only exacerbates this alongside higher inflation



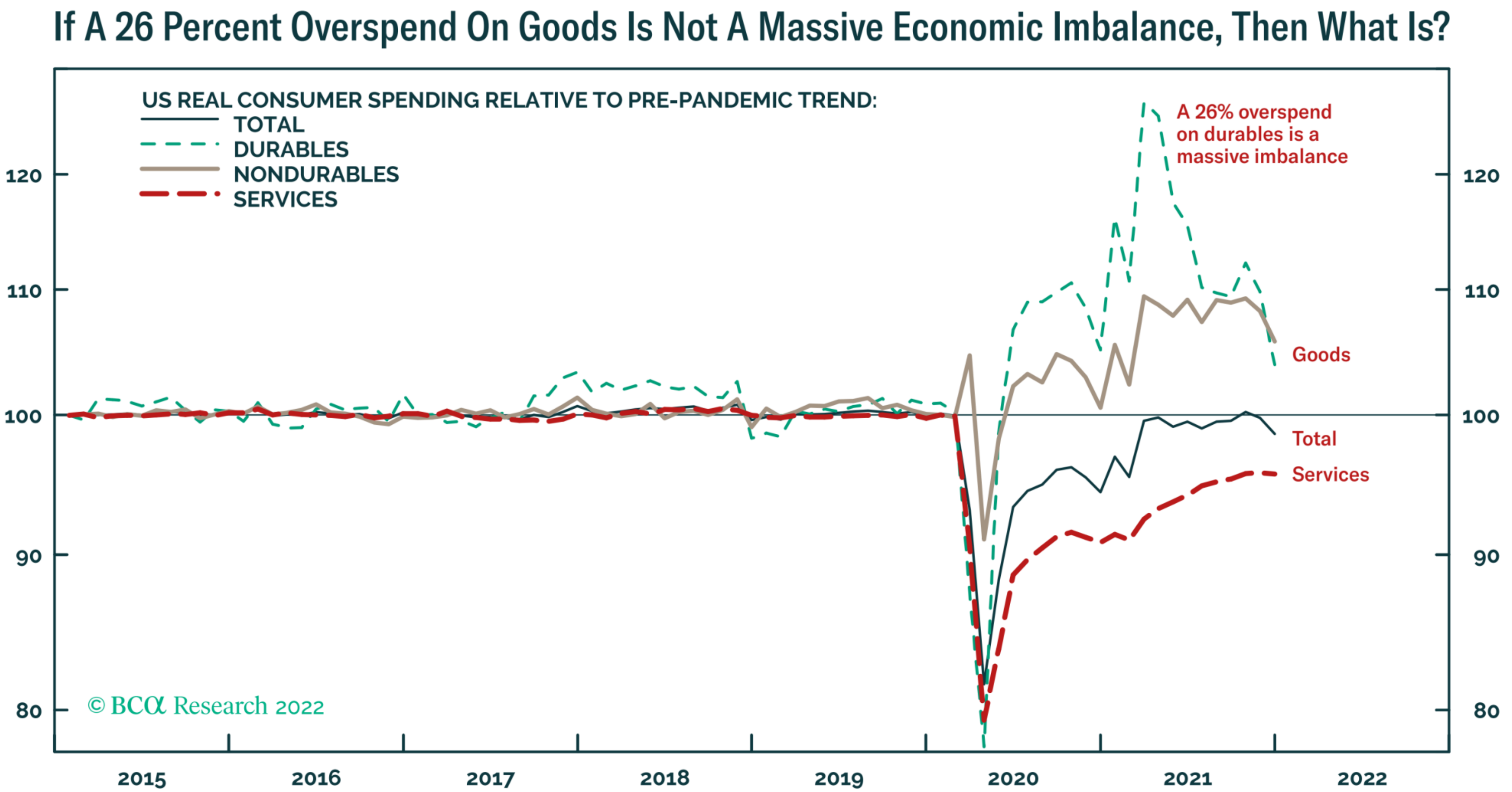
Sources: Bureau of Labor Statistics; Harper Petersen Holding GmbH; Baltic Exchange; IHS Markit; Institute for Supply Management; Haver Analytics; Bloomberg L.P.
Note: Each index is scaled by its standard deviation.

Impact of China Covid Lockdowns

As growth in China slows and recession probabilities increase, authorities will aggressively stimulate

Is It A Supply Or Demand Issue, Or Both?

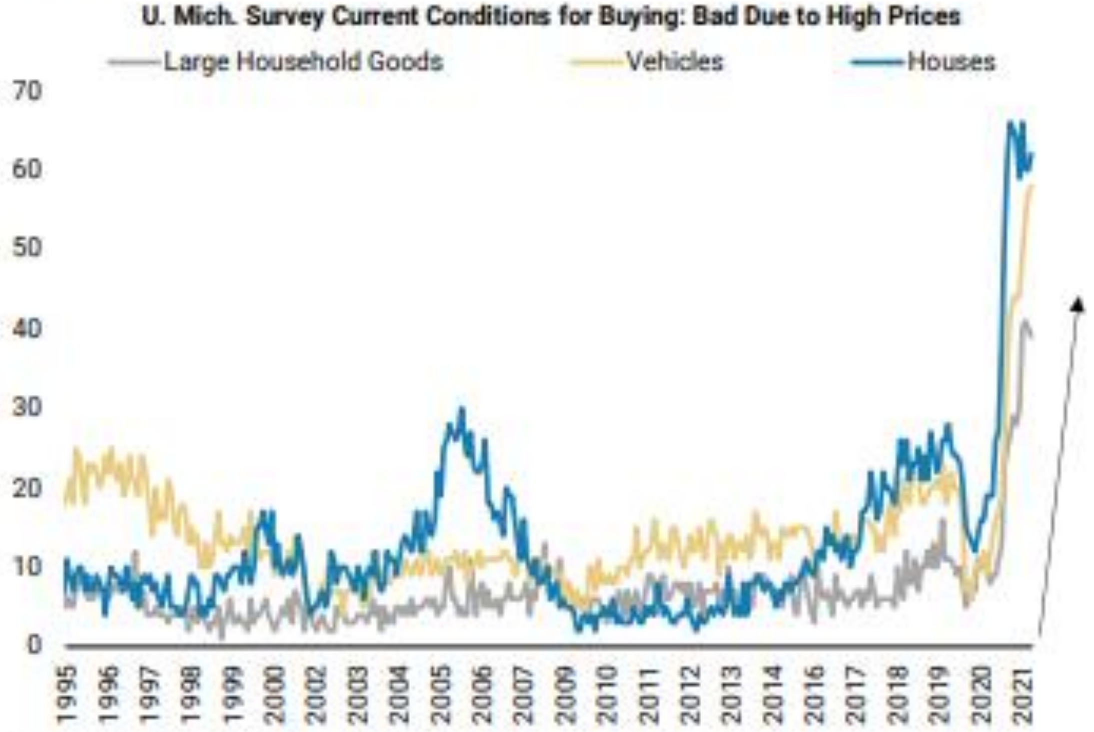
There is a massive demand imbalance that makes the economy vulnerable to a downturn.



Consumer Confidence Has Collapsed

This is the worst time in decades to purchase assets

Exhibit 50: ...High Prices Are Likely to Become Demand Destructive...



Source: Haver Analytics, Morgan Stanley Research

US Consumer sentiment is near 2009 GFC levels

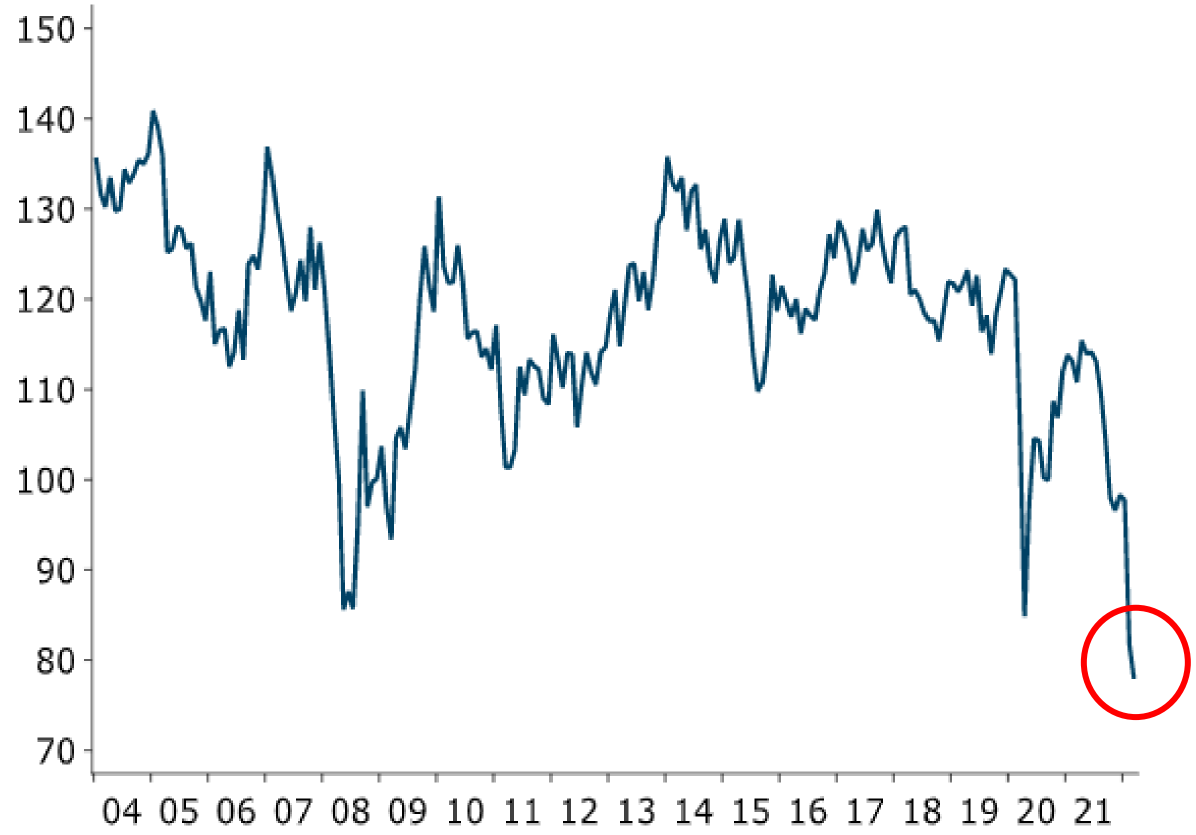
Exhibit 51: ...And Consumer Sentiment Is Near Historical Lows..

Source: Haver Analytics, Morgan Stanley Research

NZ and Australian Sentiment Is Following Suit

New Zealand consumer confidence has fallen below GFC levels and Australia is following this trajectory

Figure 1. ANZ-Roy Morgan Consumer Confidence



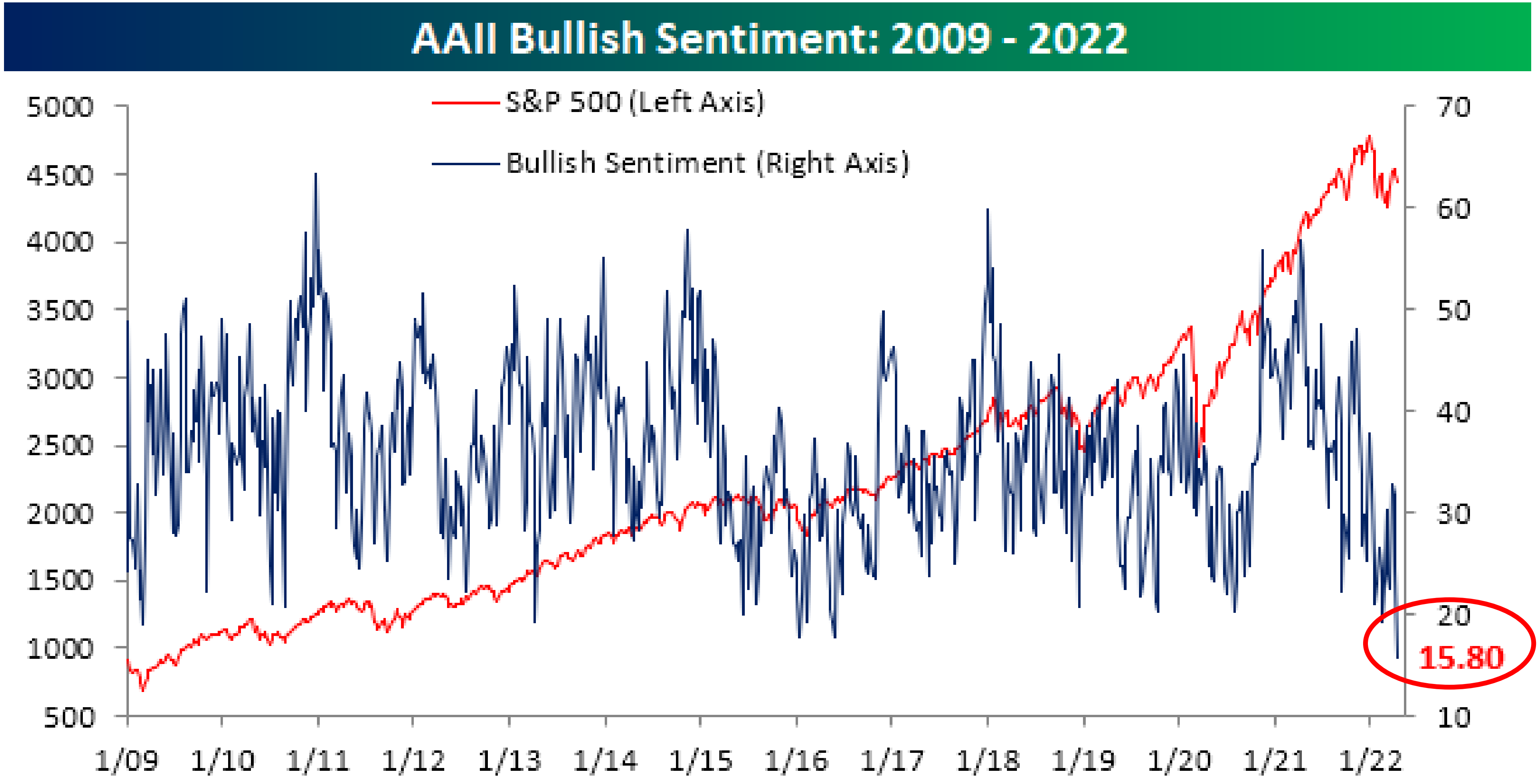
Source: Roy Morgan, Macrobond, ANZ Research

Figure 4. Australia and NZ consumer confidence

Source: Roy Morgan, Statistics NZ, Macrobond, ANZ Research

US Investor Sentiment Is Very Bearish

Investors haven't been this bearish since the GFC in 2009



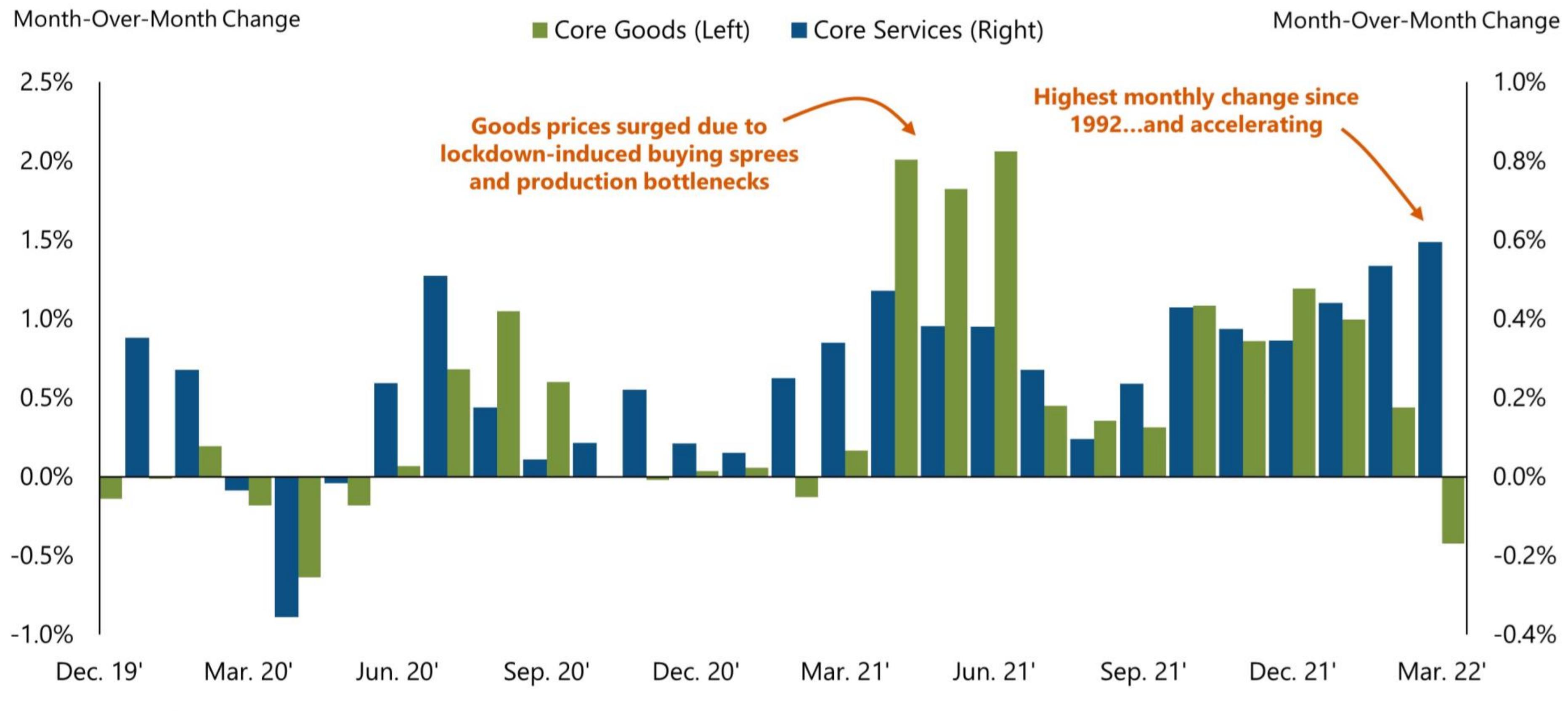
US Inflation Is At 40-Year Highs & Recession Looms

US core inflation rose to 6.5% in March, a 40 year high, with headline inflation (including food and energy) rising to 8.5% and potentially on track for 10% by mid-year.

Peak Inflation? Goods vs Services Inflation

Core services CPI (which excludes energy but includes housing) makes up 72% of core CPI, so even if goods prices recede, services prices may continue to rise as wage growth increases. We may not have seen peak inflation?

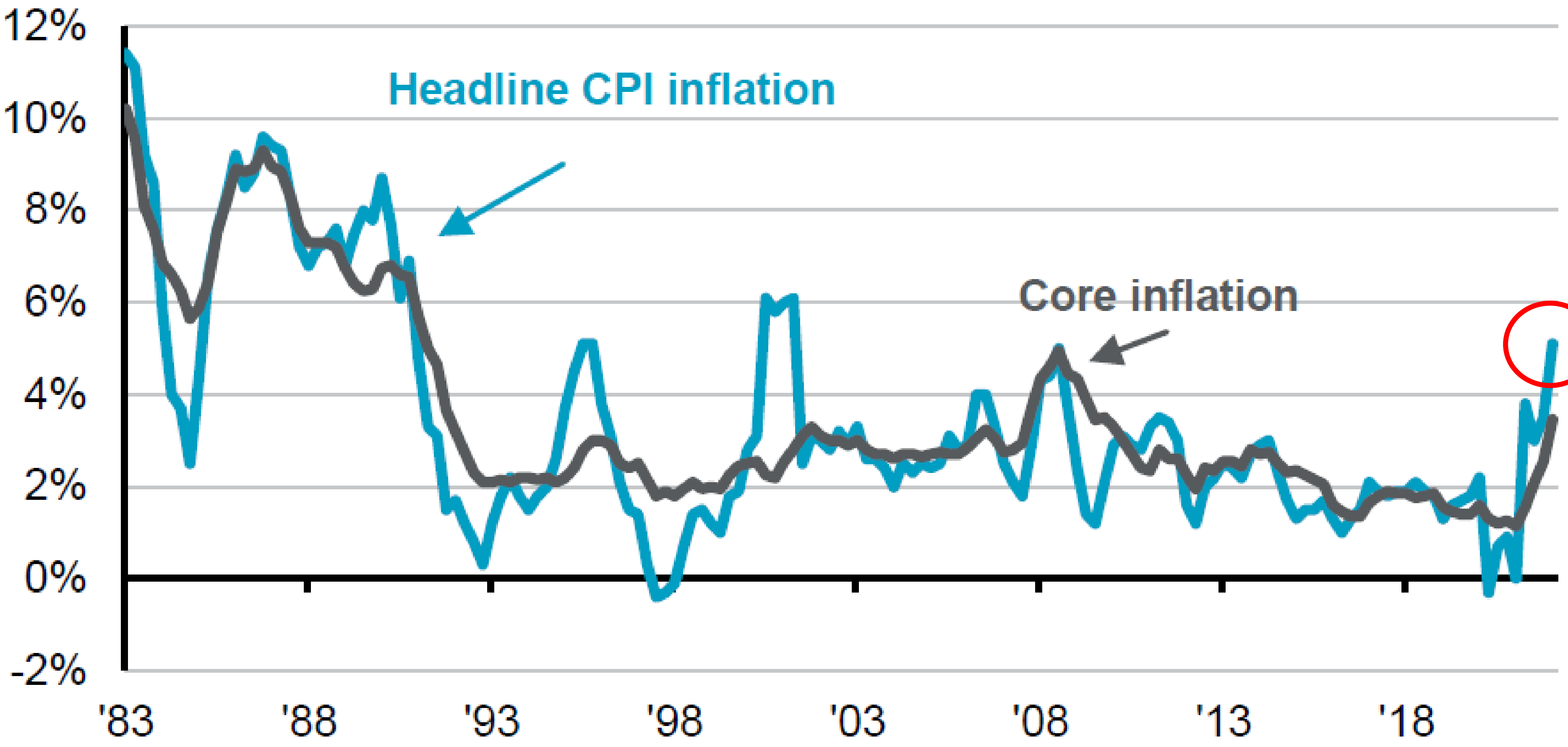
US Core Goods CPI versus Core Services CPI



Source: Bureau of Labor Statistics

Inflation In Australia Is Rising, But Lagging US

Australian headline inflation hit 5.1% in the March quarter and is expected to rise further in the June quarter



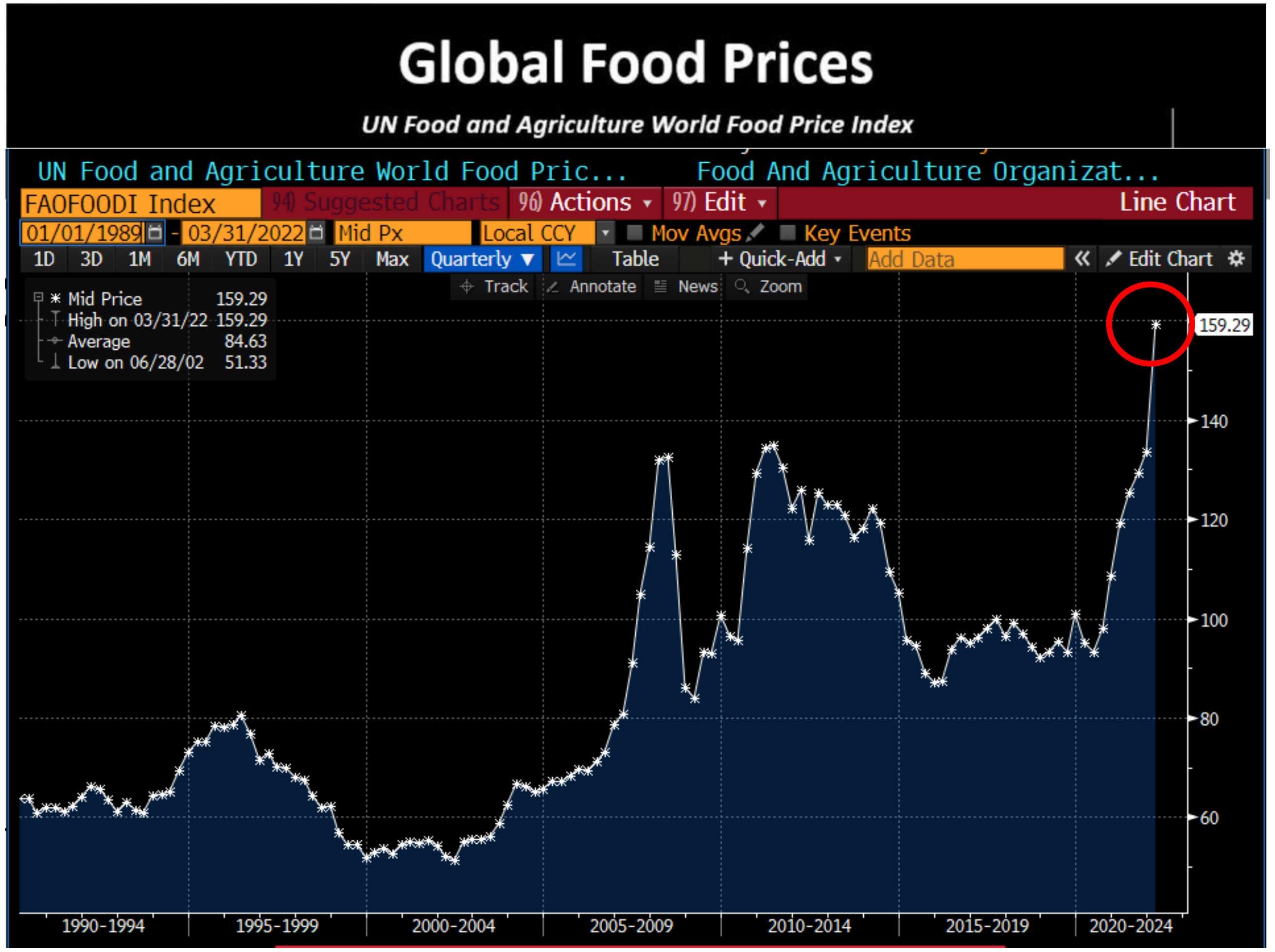
Source: ABS, FactSet, J.P. Morgan Asset Management.

Inflation Is A Tax On Consumers

True US inflation rates are significantly higher than the printed CPI number, as shown in the table below

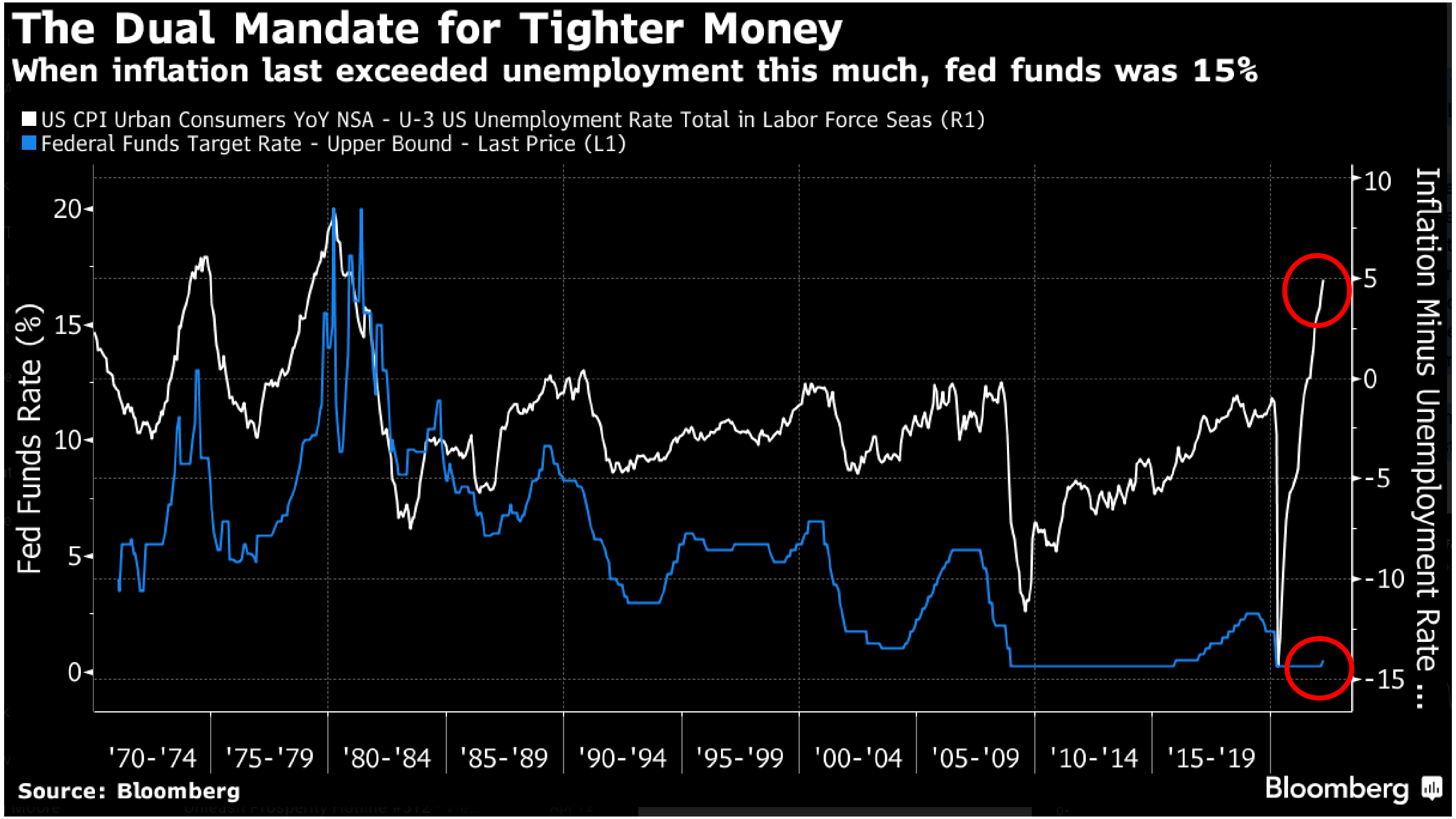
These are true price changes having a material impact on household budgets and the cost of living

Price Changes Since January 2021	
Coffee	92%
Natural Gas	81%
Crude Oil WTI	66%
Used Cars	45%
Hotel Prices	37%
Gasoline	36%
Agricultural Commodities	25%
Lumber	21%
Rent	13%
CPI	7.5%
Source: Bloomberg	©2022 Crescat Capital LLC



The US Fed’s Dilemma

The Fed’s Choice: Destroy demand or live with persistently high inflation (option 2 is the least favourable)



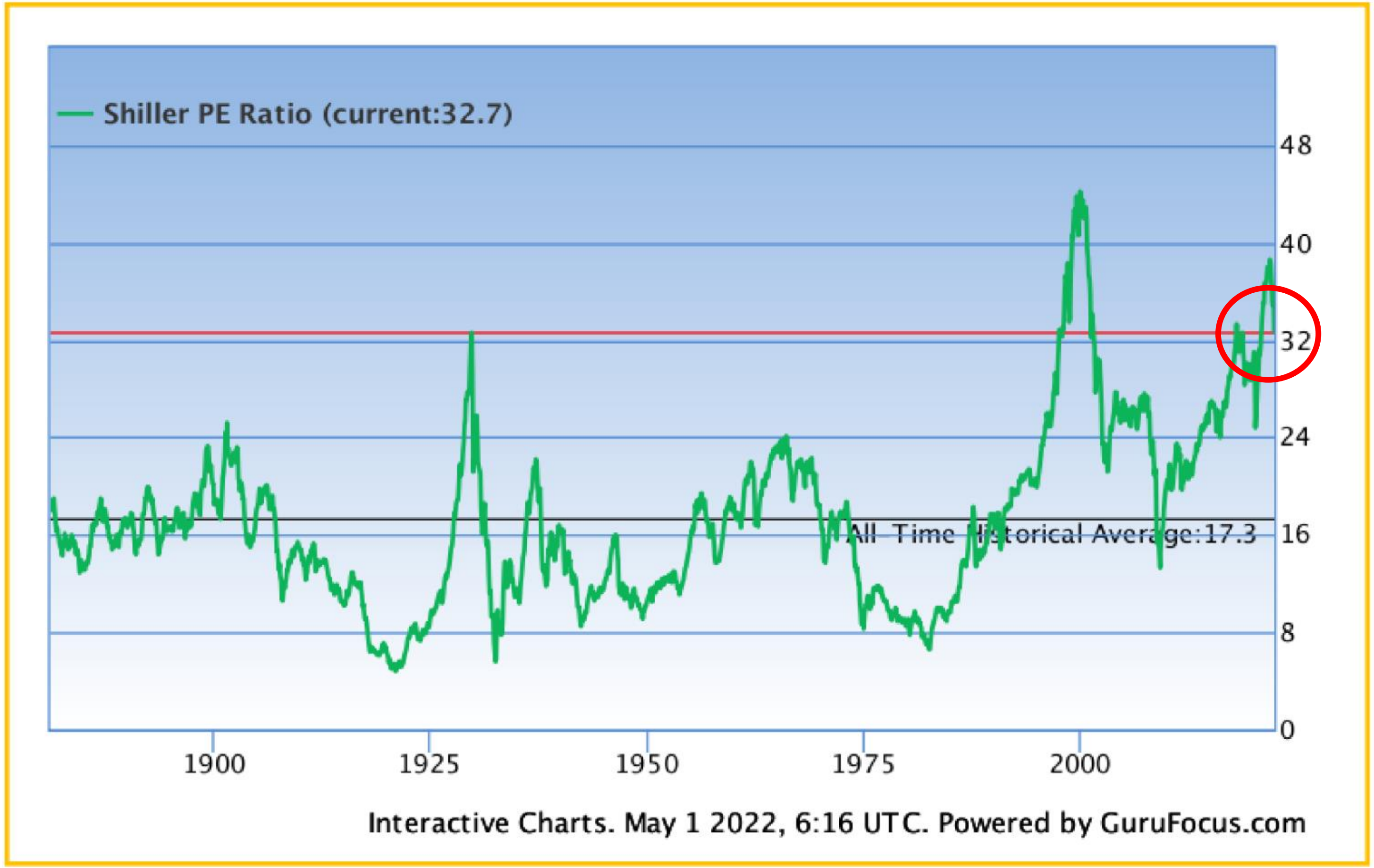
Quantitative Tightening Is A Game Changer

Markets have risen strongly as central bank balance sheets expanded. What happens when the Fed starts unwinding its balance sheet (withdrawing liquidity) by ~$95B per month?

The last time the Fed reduced its balance sheet in 2018 markets fell -20% in three months!

US Equity Markets Are Still Very Expensive

The Shiller PE chart shows the US equity market is still the most expensive in history behind the US Tech boom in 2000 and the Stimulus boom in 2021



Shiller PE: 32.7 (-3.63%)

Shiller PE is 26.5% higher than the recent 20-year average of **25.9**

Implied future annual return: **-2.9%**

Recent 20-year low: **13.3**

Recent 20-year high: **38.6**

S&P 500: **4131.93**

Regular PE: **20.9** (Recent 20-year average: **25**)

Scenario	Shiller PE after 8 Years	Annual Return from Today (%)
Really Lucky	Mean x 150%	2.2%
Lucky	Mean x 125%	-0.1%
Reverse to the Mean	Mean x 100%	-2.9%
Unlucky	Mean x 75%	-6.3%
Really Unlucky	Mean x 50%	-11%

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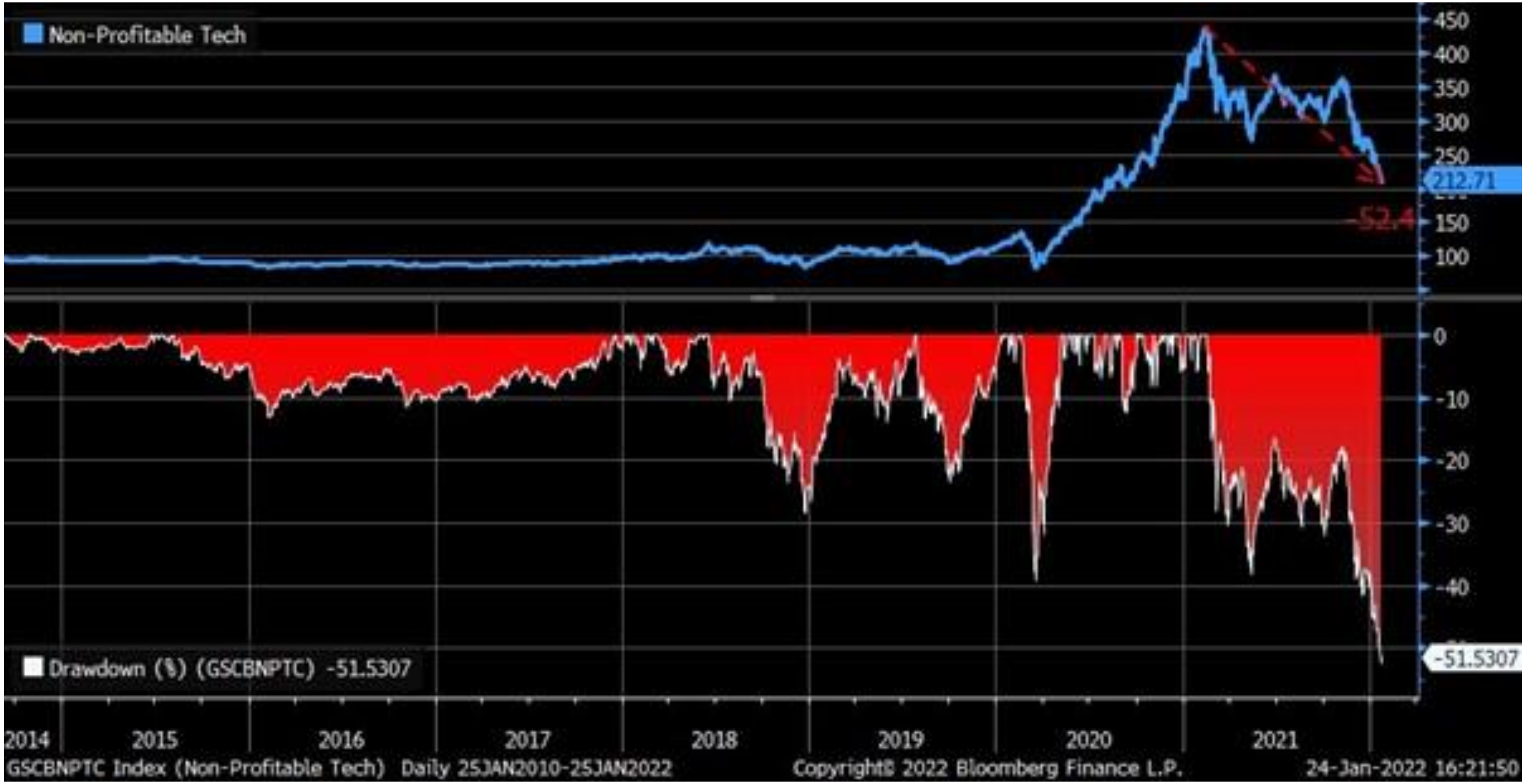
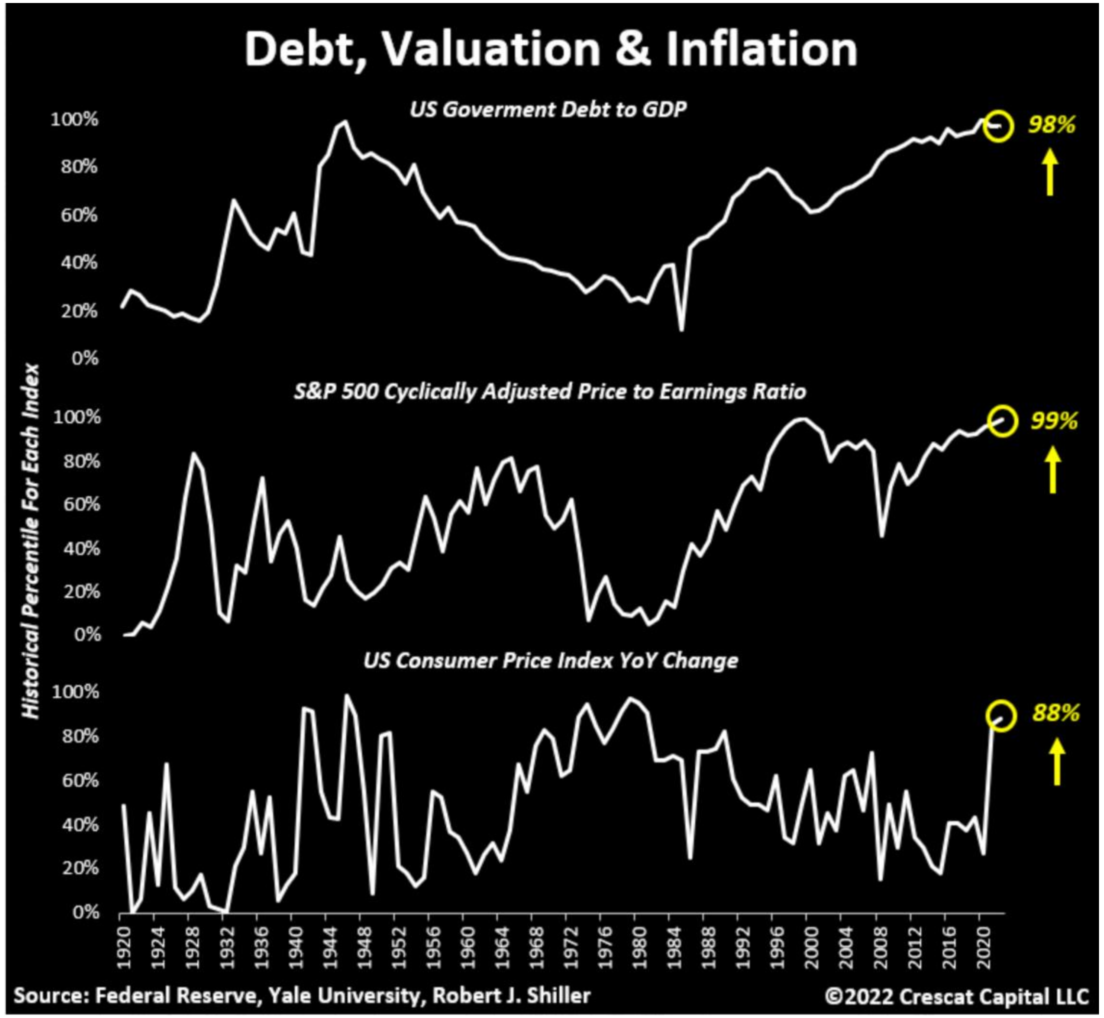
Speculative Assets Have Been Smashed

US non-profitable tech stocks have fallen more than 50% from their 2021 peak, and the ASX all-tech index fallen 32% from its 2021 highs.



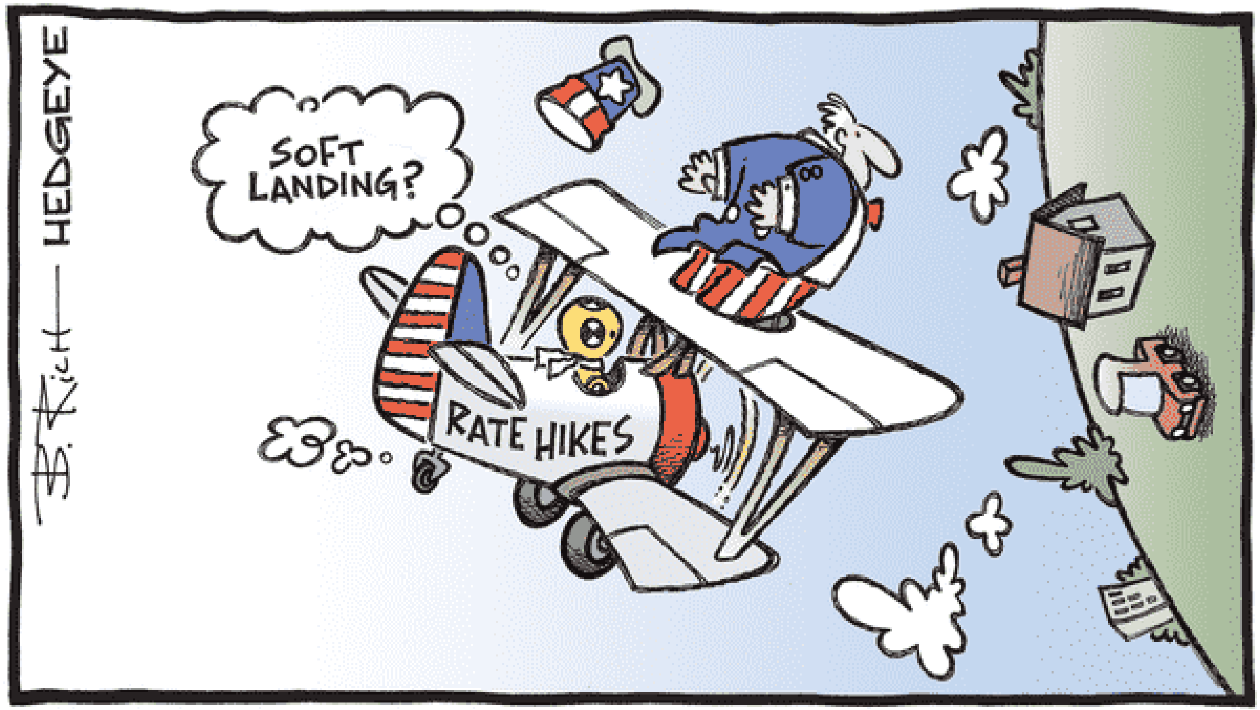
Can The Fed Manage A Soft Landing?

Markets face a multitude of risks, not limited to:



<u>Recession probabilities are rising fast as we look into 2023</u>:

- <u>Yield curve inversion</u> has happened
- <u>Inflation</u> is above 6% and still rising
- <u>Oil prices</u> are above $100 a barrel
- <u>The Fed</u> will have to tighten aggressively & implement QT
- <u>War and China lockdowns</u> also impact consumer sentiment

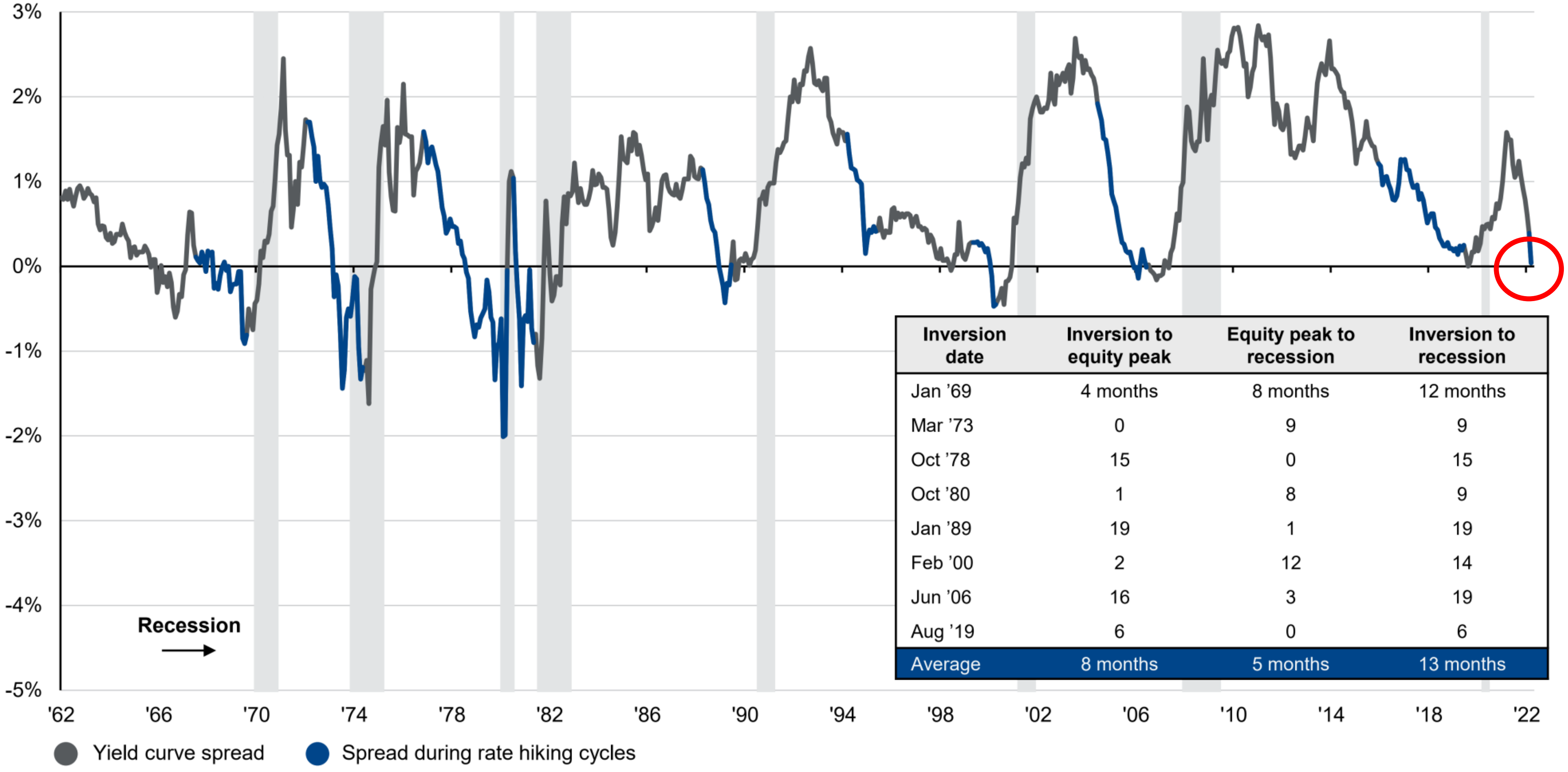


Yield Curve Inversion & Recessions

A yield curve inversion has preceded a recession every time over the last 50 years, why will this time be different?

Yield curve spread

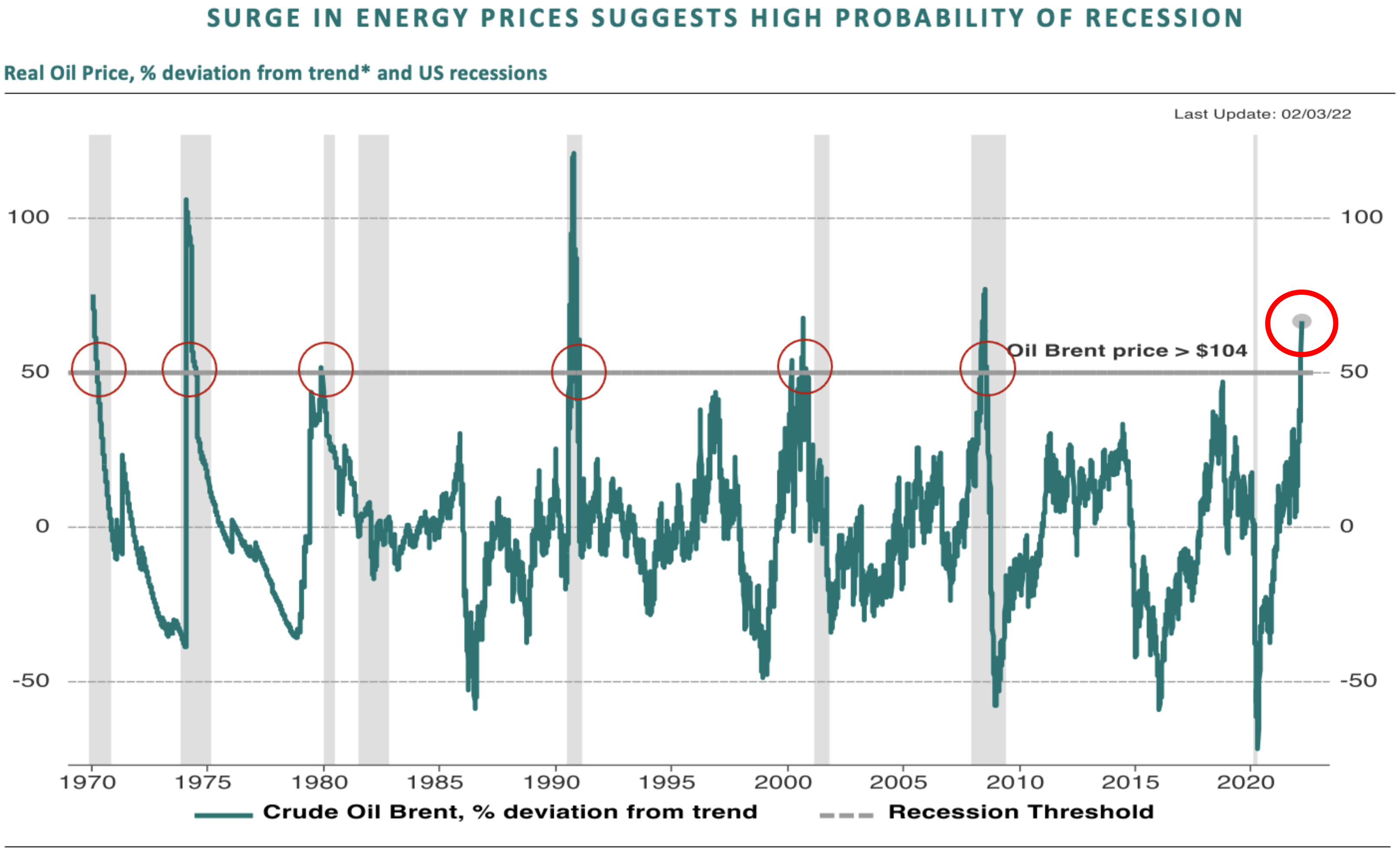
10-year less 2-year U.S. Treasury*



Inversion date	Inversion to equity peak	Equity peak to recession	Inversion to recession
Jan '69	4 months	8 months	12 months
Mar '73	0	9	9
Oct '78	15	0	15
Oct '80	1	8	9
Jan '89	19	1	19
Feb '00	2	12	14
Jun '06	16	3	19
Aug '19	6	0	6
Average	8 months	5 months	13 months

High Oil Prices & Recessions

Oil prices above $100 have preceded a recession every time over the last 50 years, why will this time be different?



Source: Refinitiv Datastream, Pictet Asset Management. *trend is based on a HP filter.

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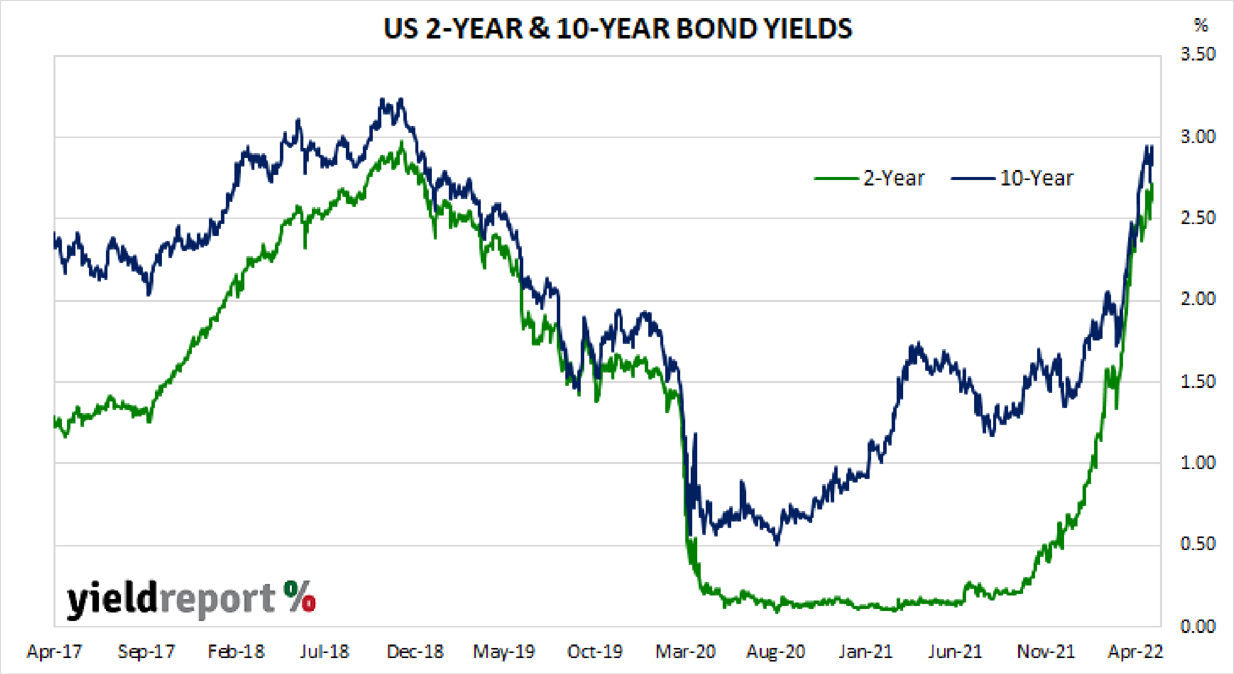
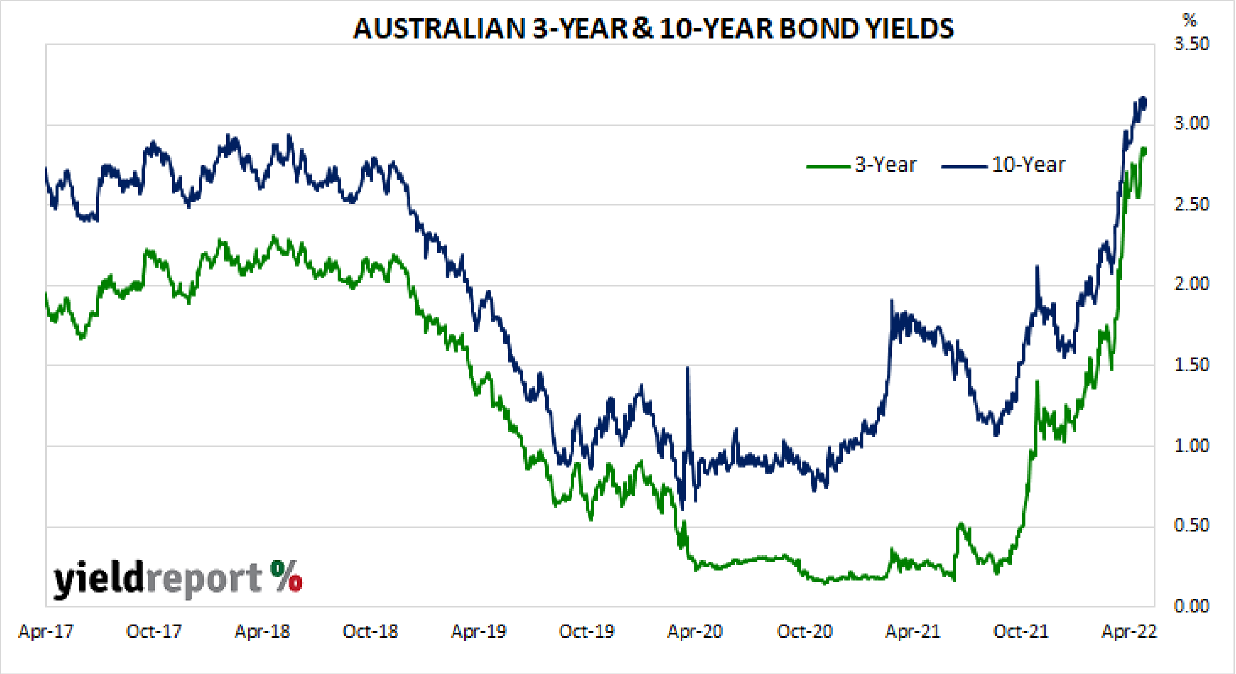
MPW Outlook & Recommended Portfolio Strategy

Asset Class	Tactical Position	Comment
Currency (AUD vs USD)	Neutral	Neutral hedge at current levels, noting potential for full AUD hedge in coming months
Cash & Short Duration	Neutral to Over	Returns are close to 0%, but increase cash opportunistically for buying opportunities
Government Bonds	Neutral to Over	Long-duration yields are above 3% pa and may provide a recession hedge/capital gains
Corporate Credit	Underweight	Spreads can widen in listed markets, but selectively own private credit (Alternatives)
Listed Property & Infrastructure	Underweight	Listed markets are high risk, we will selectively allocate to private market assets
Australian Shares	Under to Neutral	Long short exposure with a value bias, preference for defensive sectors and commodities
International Shares	Under to Neutral	Underweight expensive markets (the US) and overweight value and Emerging Markets
Liquid Alternative Assets	Overweight	Equity market neutral, private debt and equity, commodities, and niche opportunities
Illiquid Alternative Assets	Overweight	Private debt and equity, niche illiquid strategies can provide a long-term return premium

How High Can Rates go?

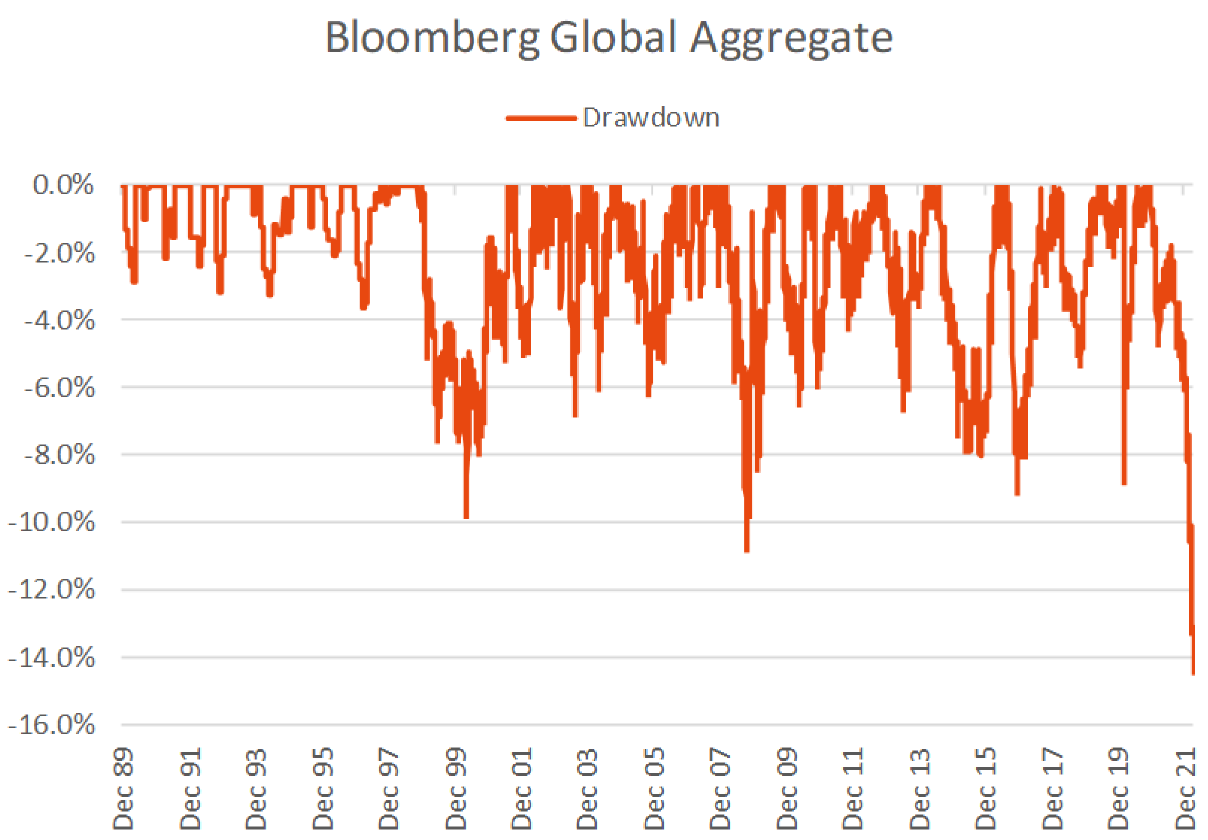
US bond rates are nearing their 2018 levels whereas Australian bond rates have surpassed their 2018 levels

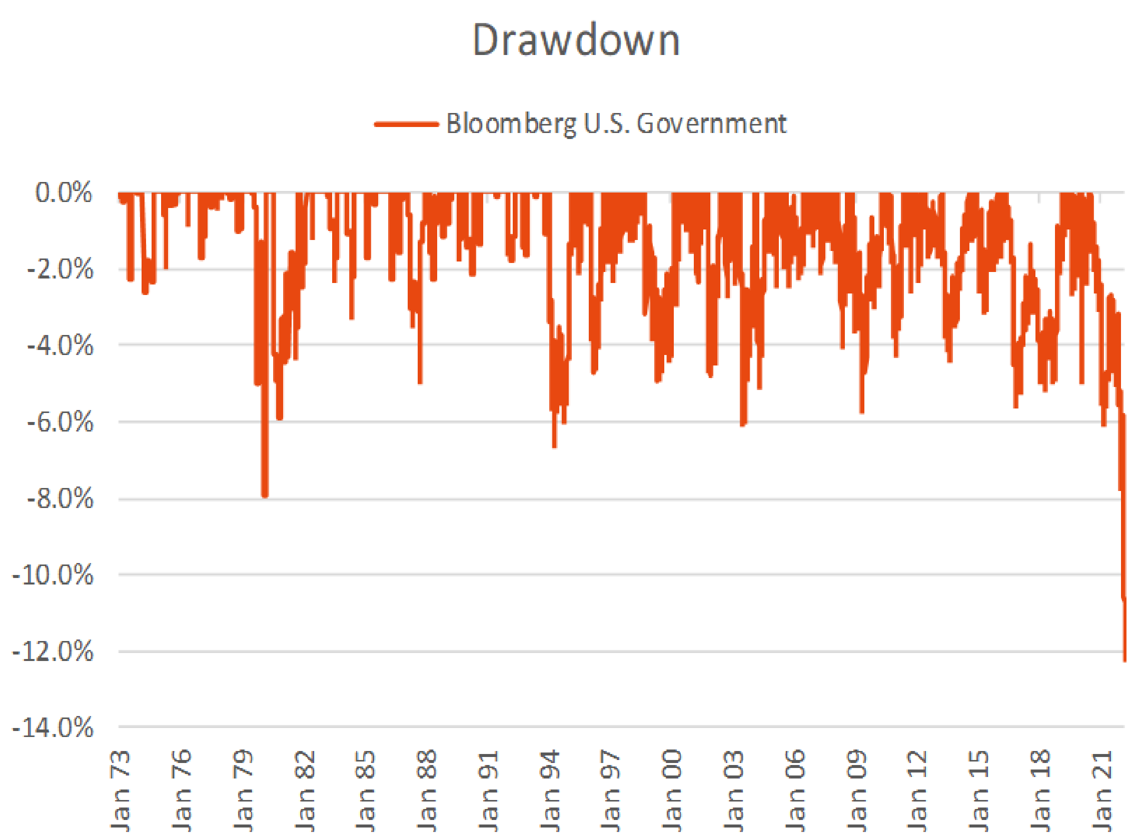




Worst Return For Government Bonds in 50 Years

The drawdown in the Global Bond Aggregate Index of -14% is the worst in 30 years and the worst in 50 years for the US government bond index at -12%.



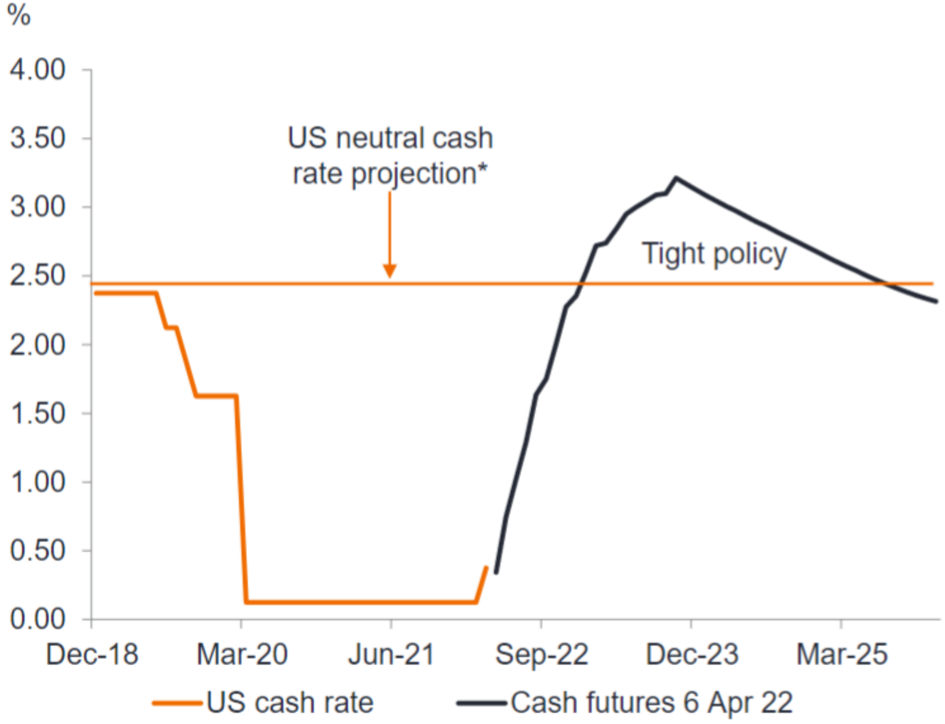


Have Rate Expectations Gone Too Far?

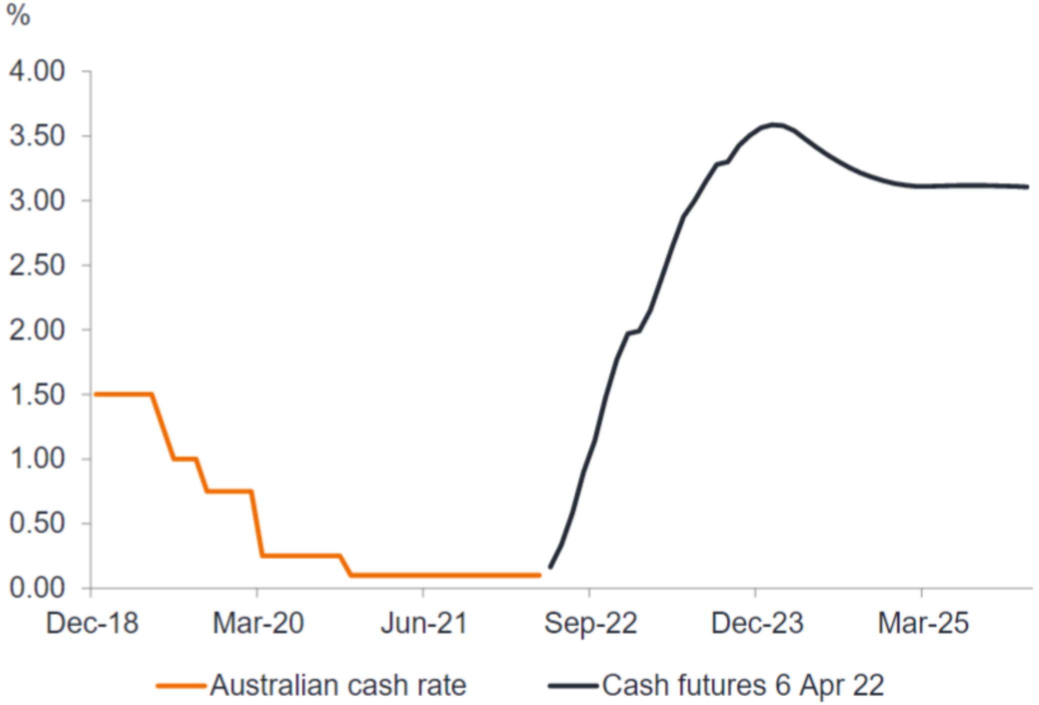
Cash rate expectations have rapidly ‘front-run’ the Fed and RBA, the question is can they actually get there?

RBA is far from performing anything like a Fed pivot

US cash rate expectations



Australian cash rate expectations



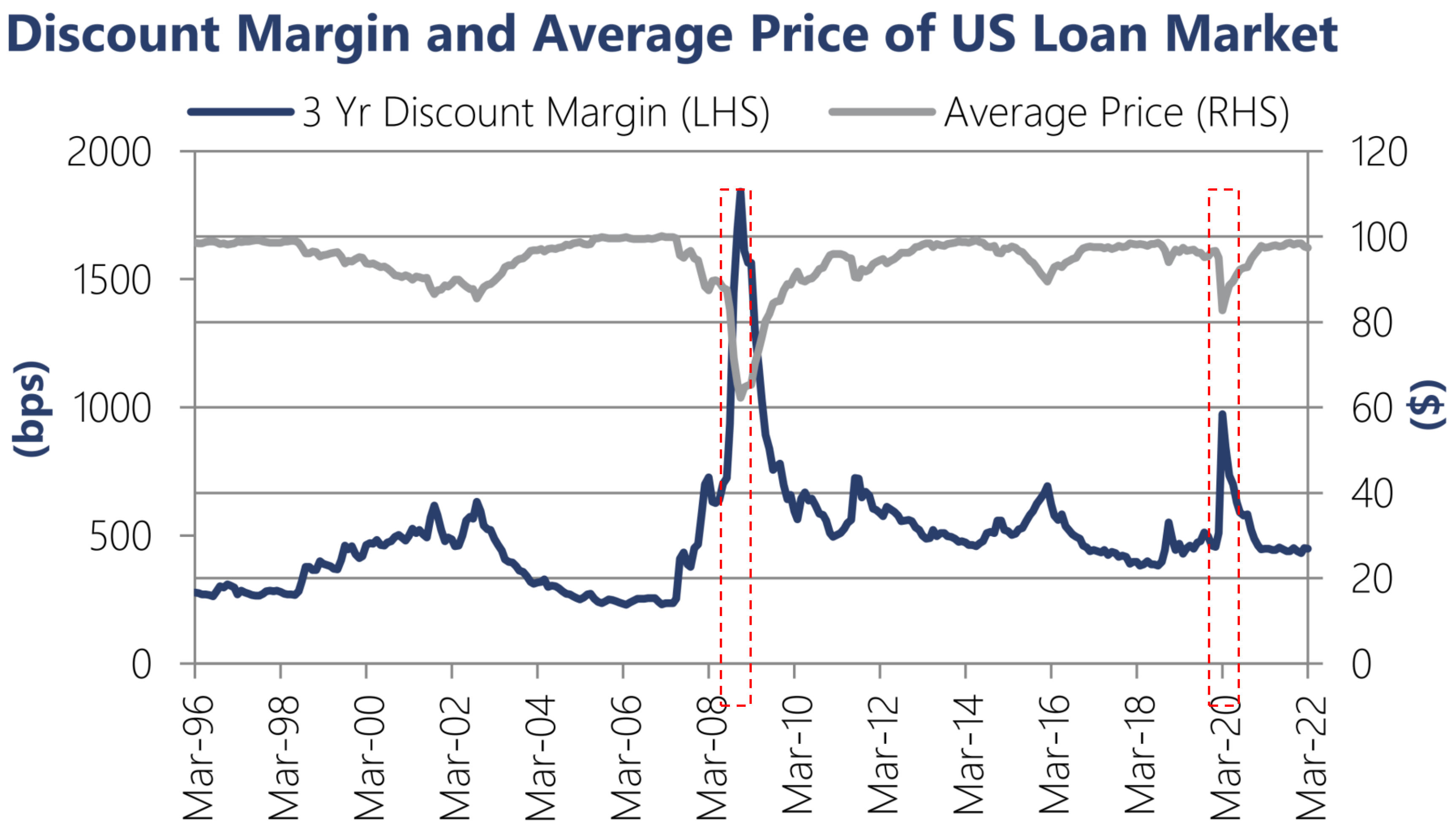
Source: Janus Henderson Investors, Bloomberg, as at 6 April 2022. * US Federal Reserve Mar 22 FOMC projections

Have Government Bonds Now Become Hedges?

This chart shows that in the strongest rally of the last decade, from late 2019 into the 2020 COVID crisis (in which Treasuries proved to be the best safe haven), ZROZ went up 89.1% vs TLT went up 52.9%.

In a major recession and deflation environment these safe-haven options should be considered in client portfolios.

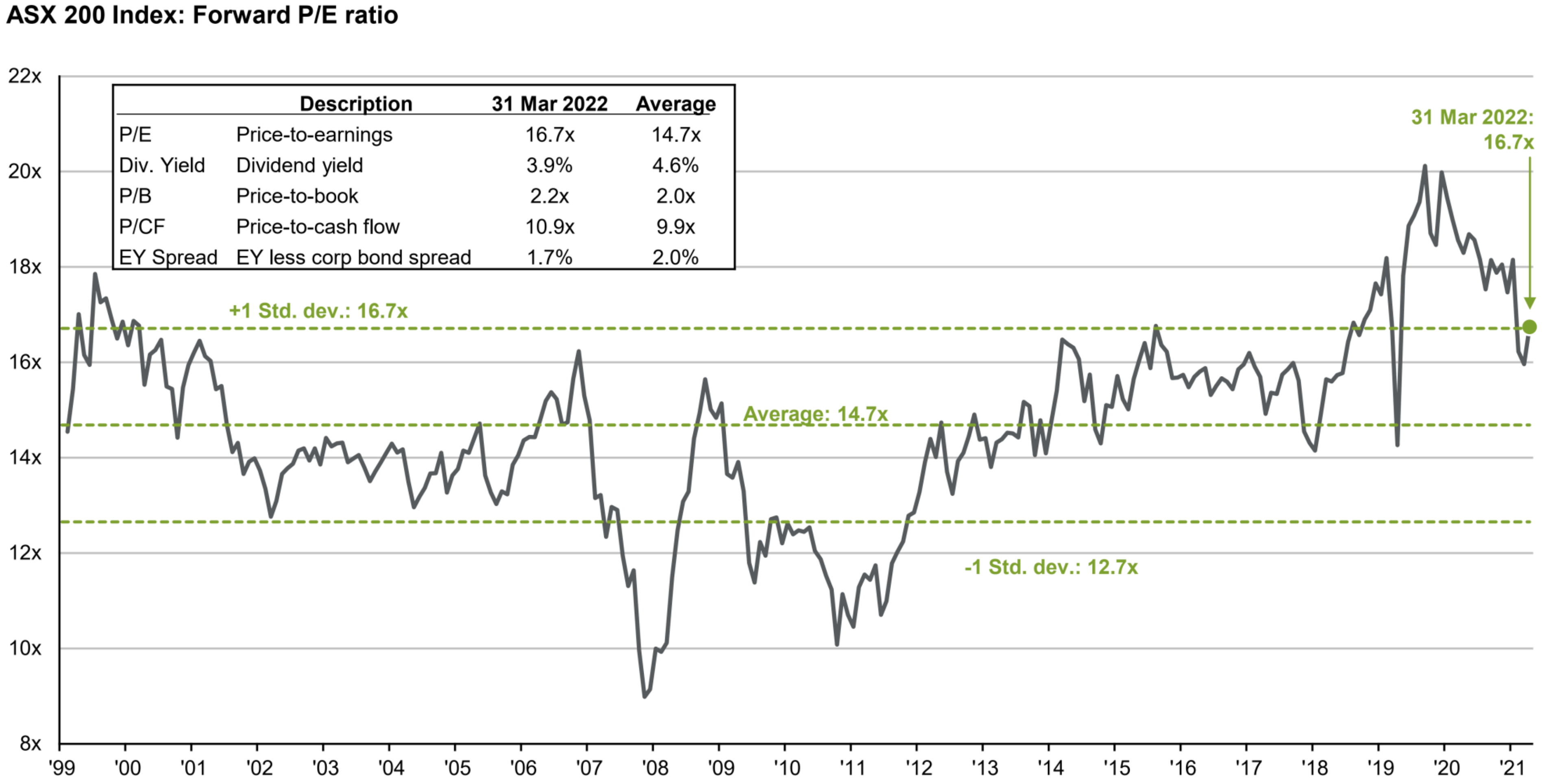
Listed Credit Behaves Like Equity In A Recession



Source: Credit Suisse

Australian Equities Are Mildly Expensive

Australian equity valuations are not cheap, and we favour value and commodity stocks over growth stocks

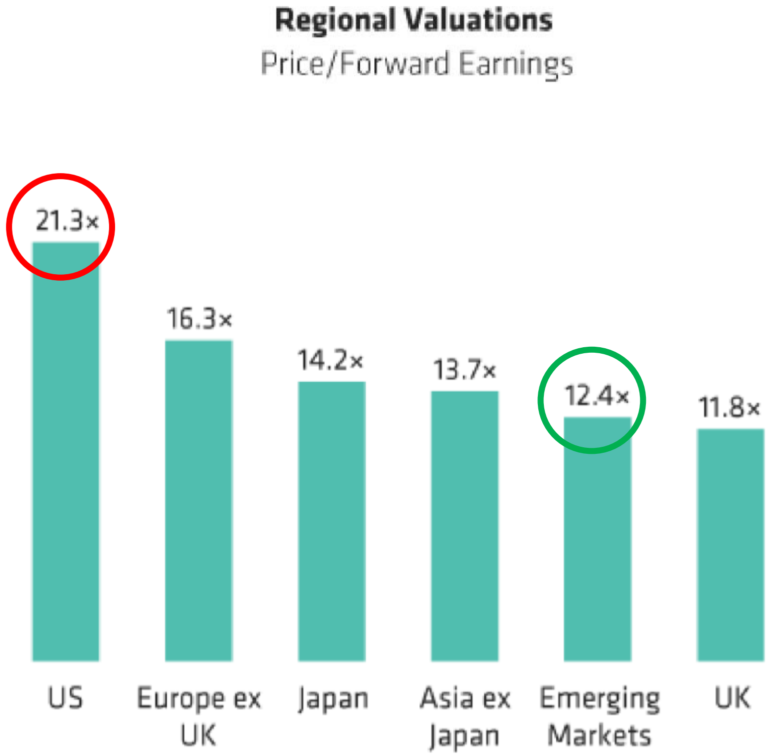


	Description	31 Mar 2022	Average
P/E	Price-to-earnings	16.7x	14.7x
Div. Yield	Dividend yield	3.9%	4.6%
P/B	Price-to-book	2.2x	2.0x
P/CF	Price-to-cash flow	10.9x	9.9x
EY Spread	EY less corp bond spread	1.7%	2.0%

Source: FactSet, Standard & Poor's, J.P. Morgan Asset Management.

Global Equities Require A Selective Approach

US equities are historically very expensive, global equities are fair value

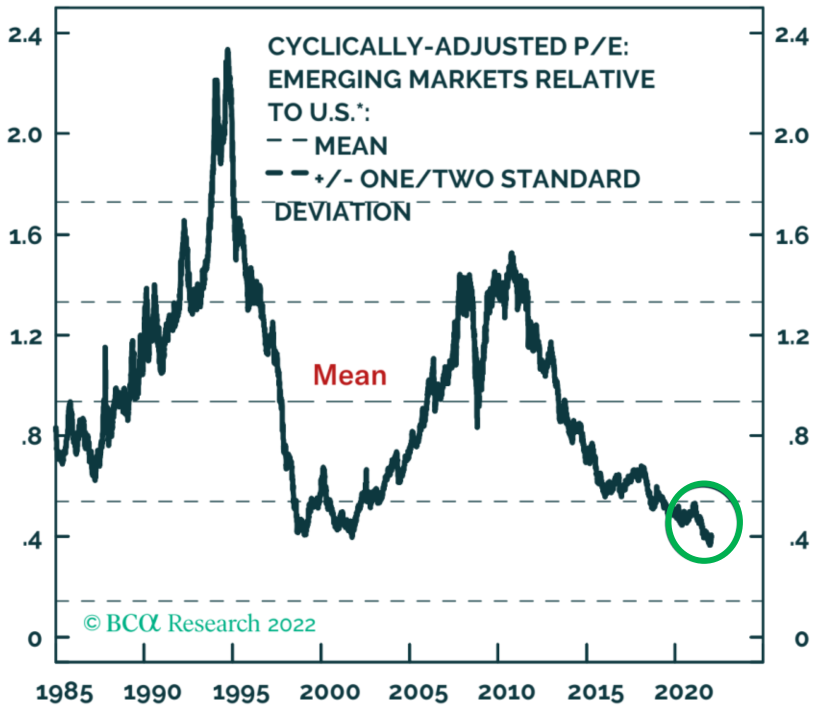


Based on forecast earnings for the next 12 months. US represented by S&P 500, Europe ex UK by MSCI Europe ex UK, Japan by MSCI Japan, Asia ex Japan by MSCI Asia ex Japan, emerging markets by MSCI Emerging Markets and UK by MSCI UK

As of December 31, 2021

Source: FactSet, FTSE Russell, MSCI, S&P and AB

Emerging Markets are very cheap



*CALCULATED USING EM AND U.S. STOCK PRICES AND THE 6-MONTH MOVING AVERAGE OF EPS IN U.S. DOLLAR TERMS, AND THEN DEFLATING BY U.S. CONSUMER PRICE INFLATION;

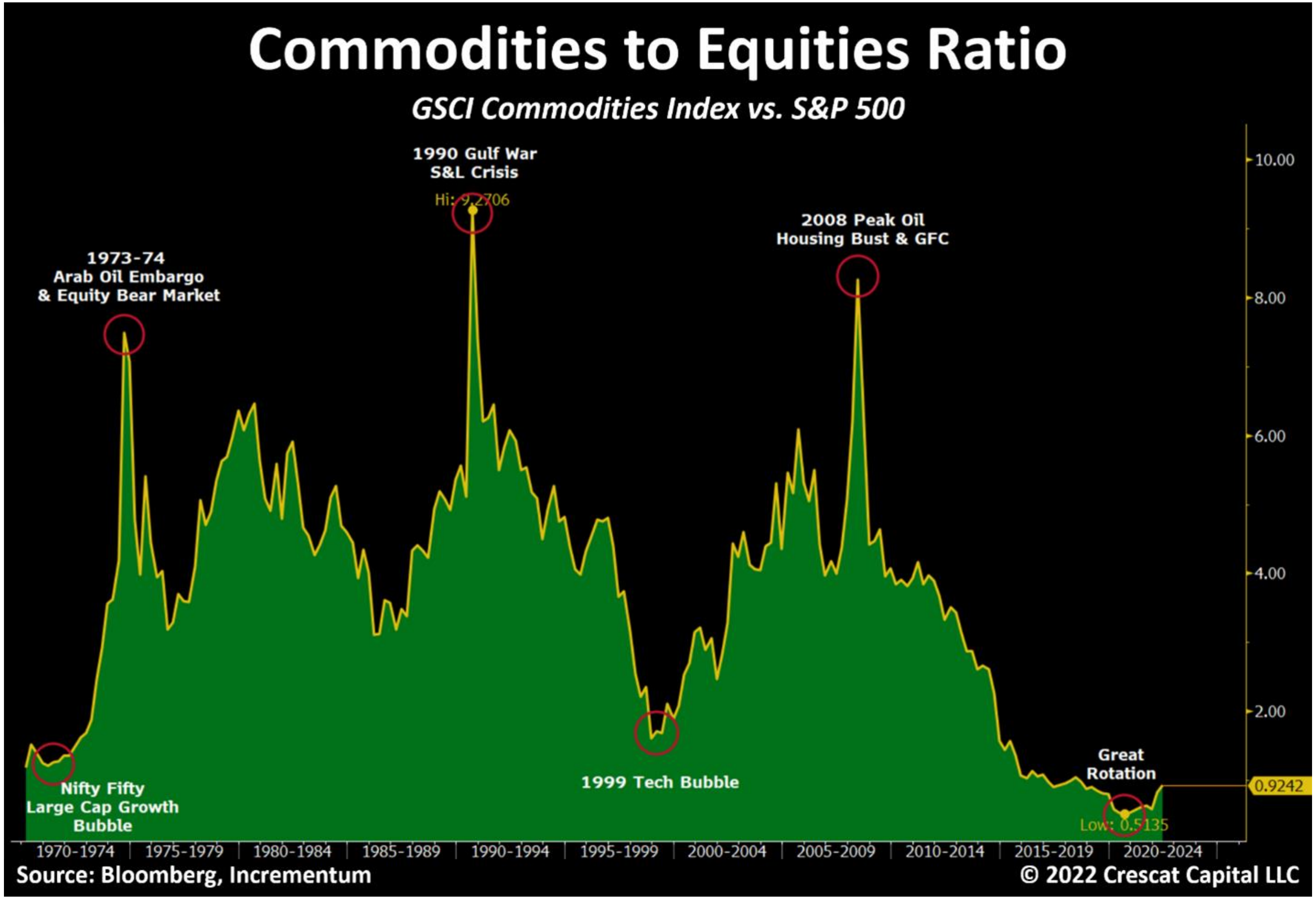
The 'Commodities To Equities' Ratio Is Compelling

The 'commodities-to-equities' ratio has never been cheaper.

Potential Strategy:

1. Long commodities
2. Short expensive equities

Commodities can also provide a hedge against the risk of persistently higher inflation.



The Role of Alternative Assets In Portfolios

Framework-driven portfolio construction: What role do different categories play in the portfolio?

	Fixed income-like	Hybrids	Equity-like	
RETURN ENHANCERS Global diversification and tactical/ opportunistic returns	Distressed credit	Special situations	Private Equity, Venture Capital	LOWER Income/ HIGHER Volatility
CORE COMPLEMENTS Added diversification and/or enhanced returns	Corporate mezzanine loans	Hedge funds	Noncore real assets	
CORE FOUNDATION Stable Income with lower volatility, diversification ad inflation sensitivity	Core Private credit	Core real estate, infrastructure and transport	Low volatility core equity	HIGHER Income/ LOWER Volatility

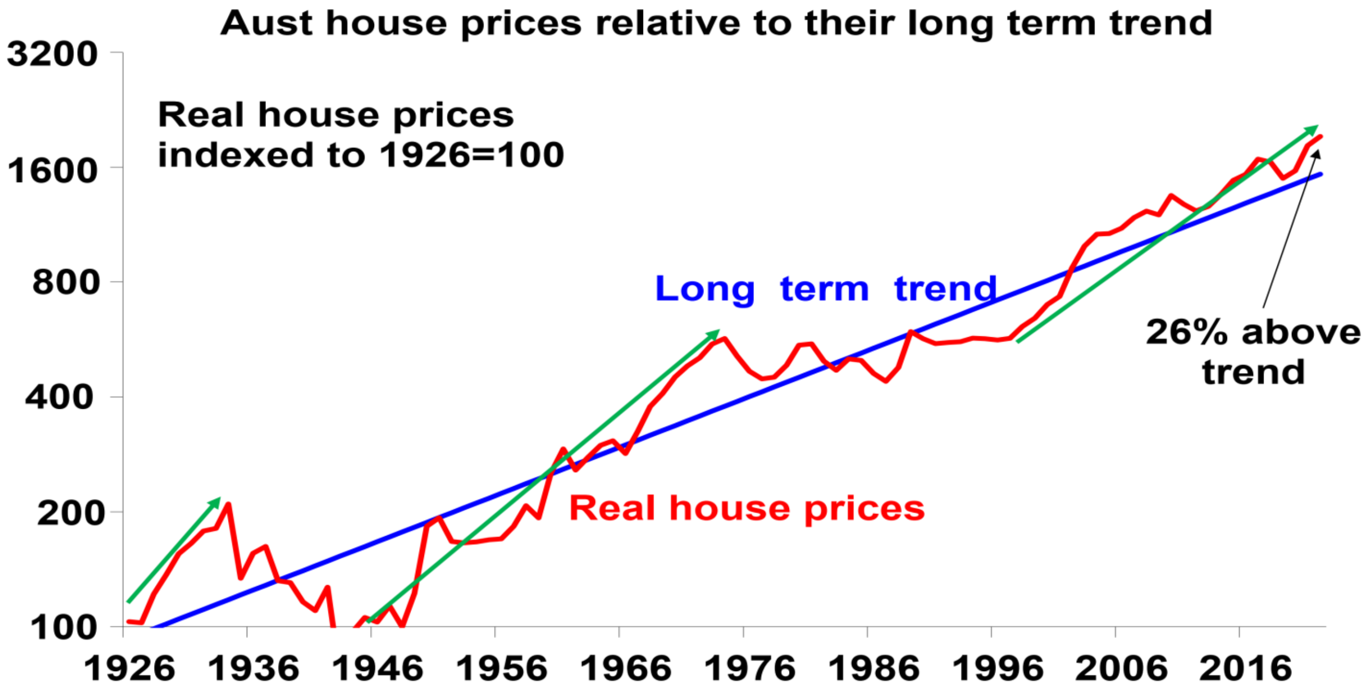
■ = Overweight for the next 12 to 18 months

Source: JP Morgan Asset Management Alternative Solutions Group & MPW

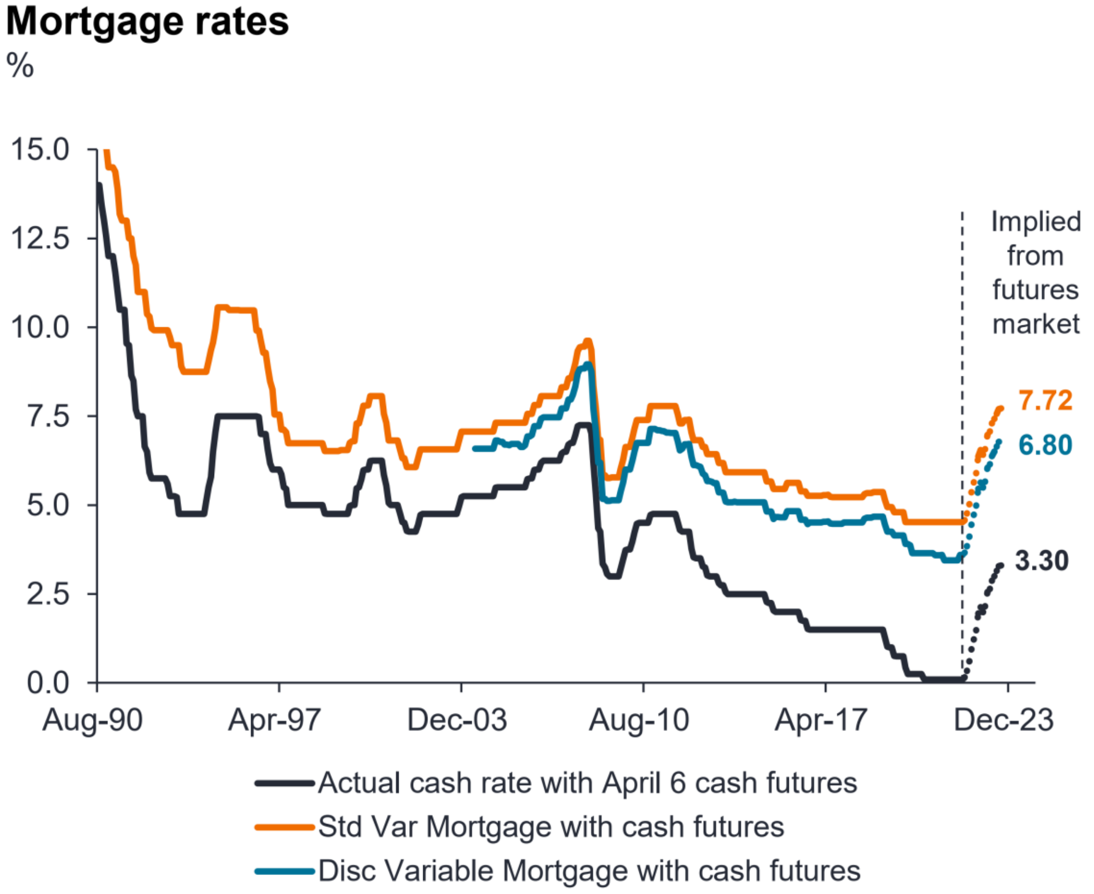
Australian Property & Mortgage Rates

Australian house prices are currently 26% above their long-term trend and subject to correction should mortgage rates rise to 'implied' levels

Mortgage rates of 6-8% would put significant default pressure on borrowers, and hence it is hard to see rates going as high as implied.

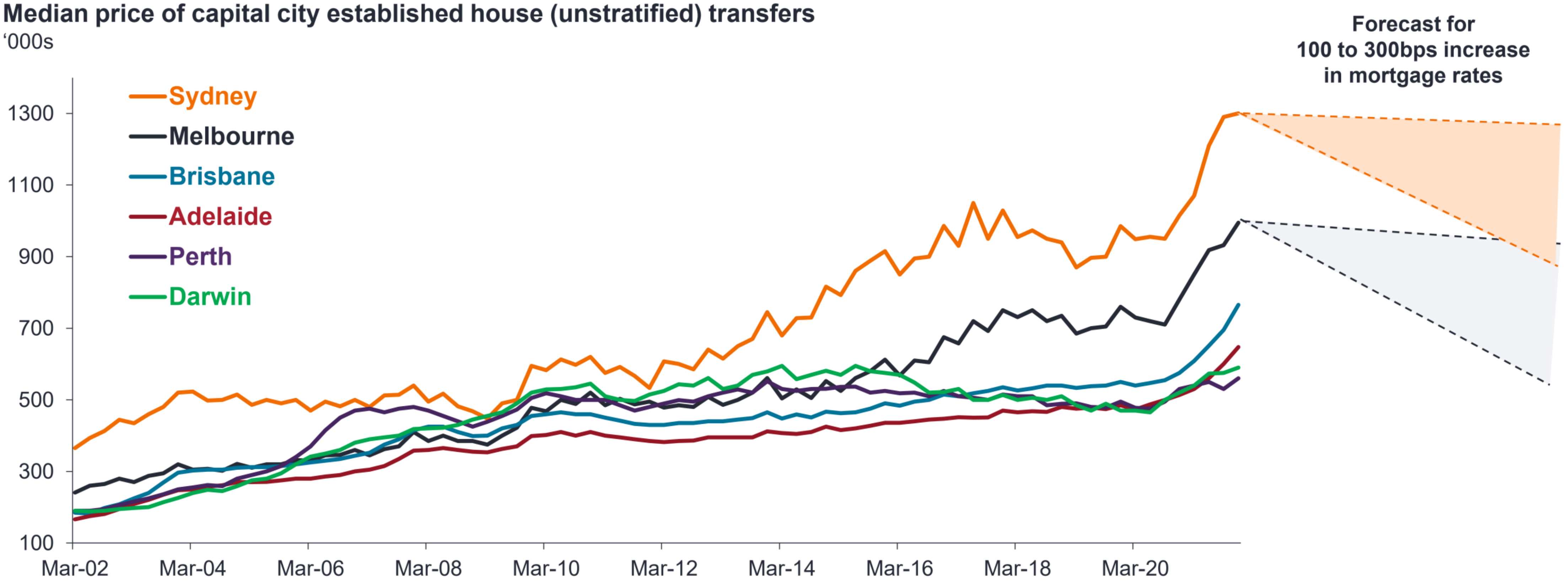


Source: ABS, AMP



Australian Property – Where To For Prices?

Australian house prices remain very sensitive to rising mortgage rates, with forecast price falls of between 5% to 30% by 2023 subject to how aggressive the RBA is with interest rates



Source: Janus Henderson Investors, ABS, to December 2021

Vanguard Long-Term Return Expectations

The table below shows the Vanguard Capital Markets Model **<u>return and volatility forecasts over the next 10 years</u>** across four Global Diversified Portfolios.

Conclusion: Generating returns using just listed stocks and bonds will be much more challenging in the future and investors will need to take more risk for less return.

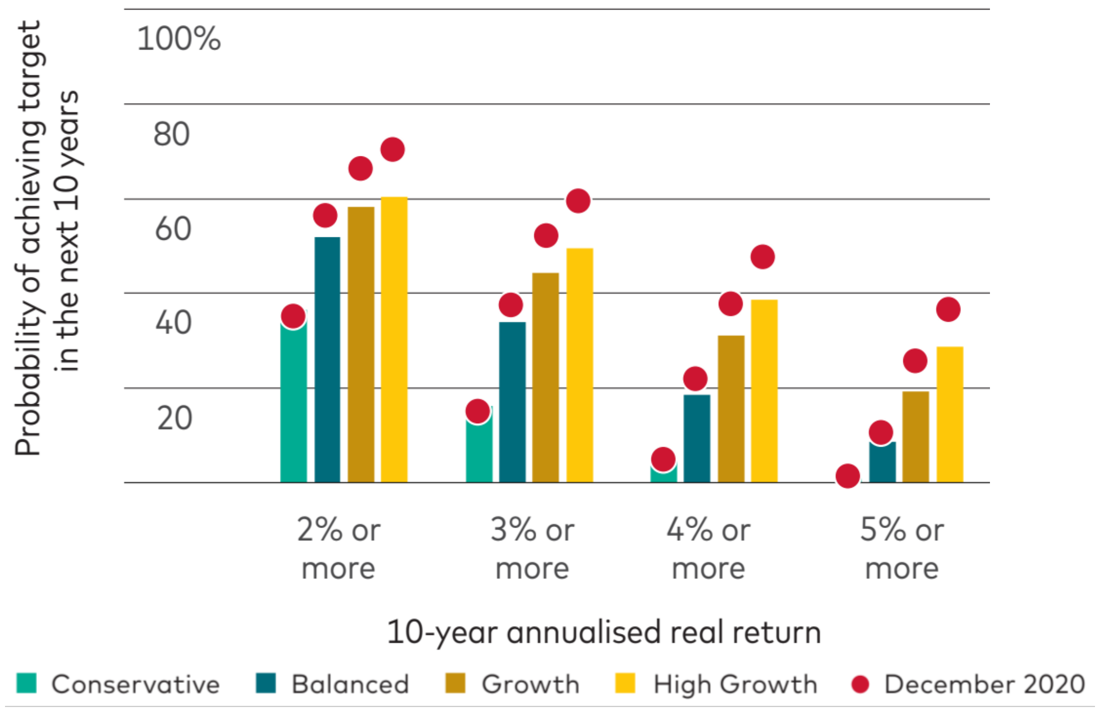
	Return Percentile					Volatility
	5th	25th	Median	75th	95th	Median
Conservative	1.2%	2.4%	3.3%	4.2%	5.5%	5.4%
Balanced	0.7%	2.6%	3.9%	5.2%	7.3%	8.7%
Growth	-0.1%	2.6%	4.4%	6.3%	9.0%	12.2%
High Growth	-1.1%	2.4%	4.8%	7.2%	10.7%	15.8%

Source: Vanguard, March 2022 using 31 December 2021 VCMM Simulation.

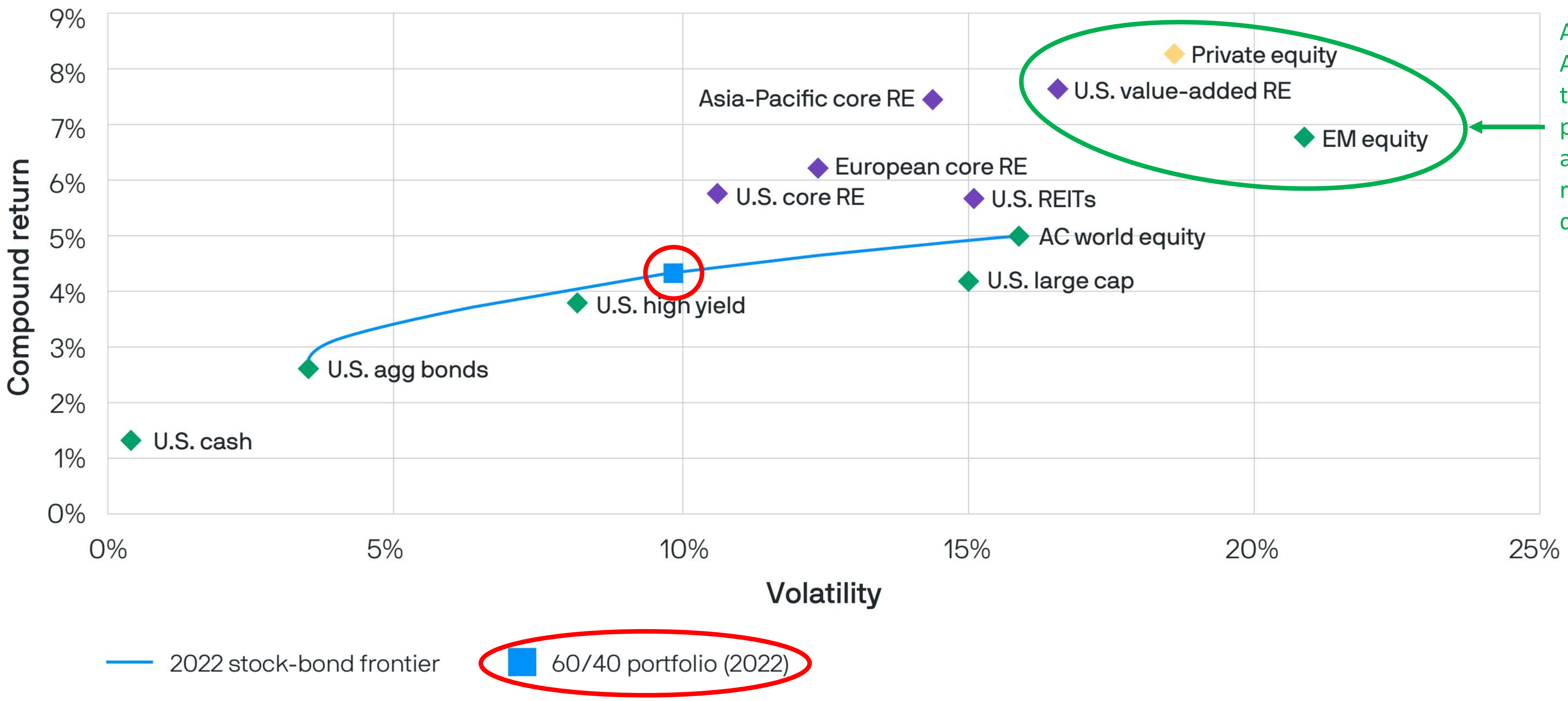
The chart below shows the **<u>probability of achieving a real return target over the next 10 years</u>** for a range of Global Diversified Portfolios.

Conclusion: The probability of a CPI+ 3% return is less than 50% regardless of how much risk you want to take.

Probability of achieving real return target



JP Morgan Long-Term Return Expectations



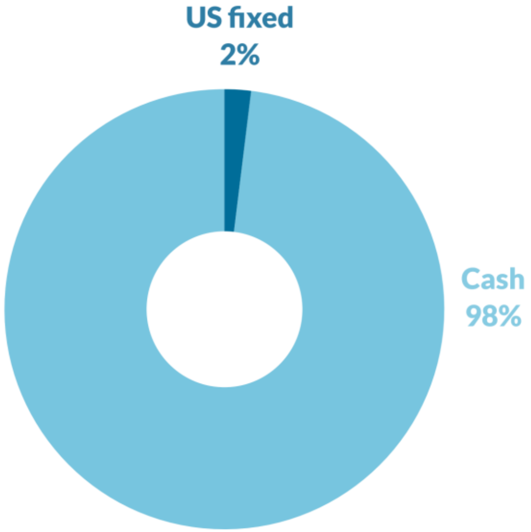
Allocating to Alternative Assets has the potential to increase expected portfolio returns whilst also potentially reducing risk via increased diversification benefits.

Source: J.P. Morgan Asset Management; data as of September 2021. All returns (in USD) based on projections for 10–15 years. Volatility measures include de-smoothing for private assets to ensure comparability with listed assets.

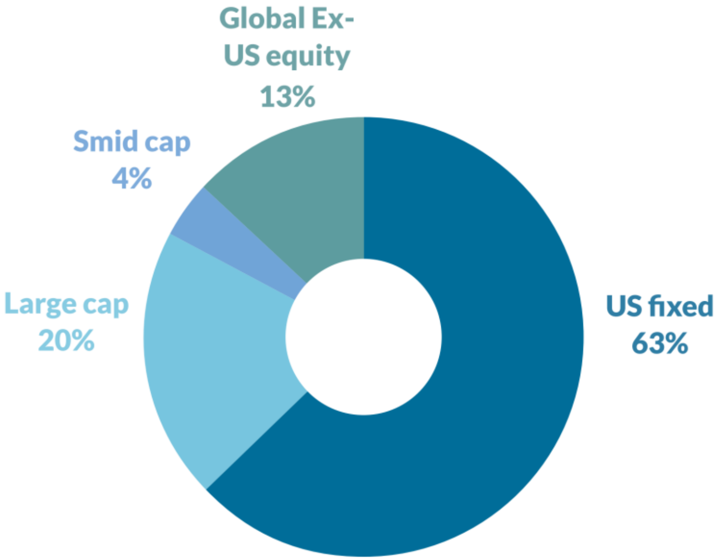
Taking More Risk For The Same Return

7% expected returns over 30+ years

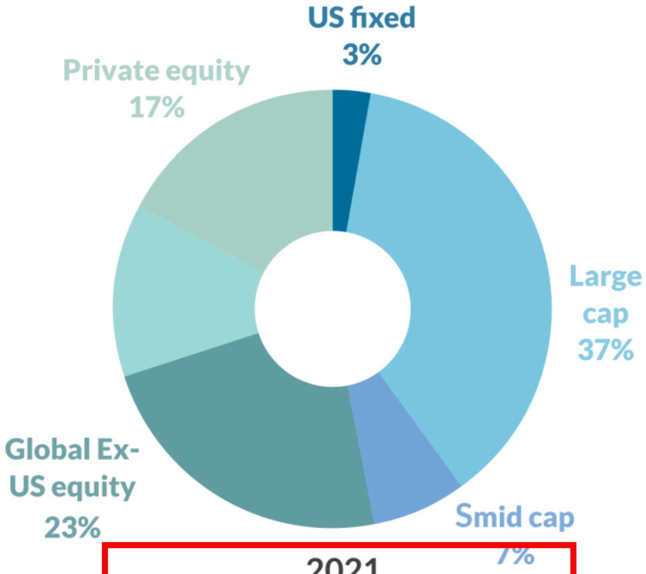
Increasing complexity →



1991
RETURN: 7.0% RISK: 1.1%



2006
RETURN: 7.0% RISK: 6.7%



2021
RETURN: 7.0% RISK: 17.3%

Increasing risk →

In 1991, our expectations for cash and broad US fixed income were 6.95% and 8.95%, respectively. Return-seeking assets were not required to earn a 7% projected return.

15 years later, an investor would have needed over a third of the portfolio in public equities to achieve a 7% projected return, with 6x the portfolio volatility of 1991.

Today, an investor is required to include 97% in return-seeking assets to earn a 7% projected return at almost 16x the volatility compared to 1991.

Source: Callan, 2021. There is no assurance that similar investments will be made. Past performance is not indicative of future results.

MPW Concluding Summary

2022 will be volatile as markets navigate a global central bank tightening cycle.

This is a regime change that requires careful consideration of both risk and return.

Central banks had our backs for a last decade, but things can change.

- **MPW has downside protection strategies built into portfolios.**

Central banks may need to bring on a recession to curb demand inflation.

- **Markets last saw inflation in the early 1980's. Are we prepared?**

High PE stocks and speculative assets have fallen sharply in recent months.

- **We are at a critical market juncture that requires a cautious approach.**

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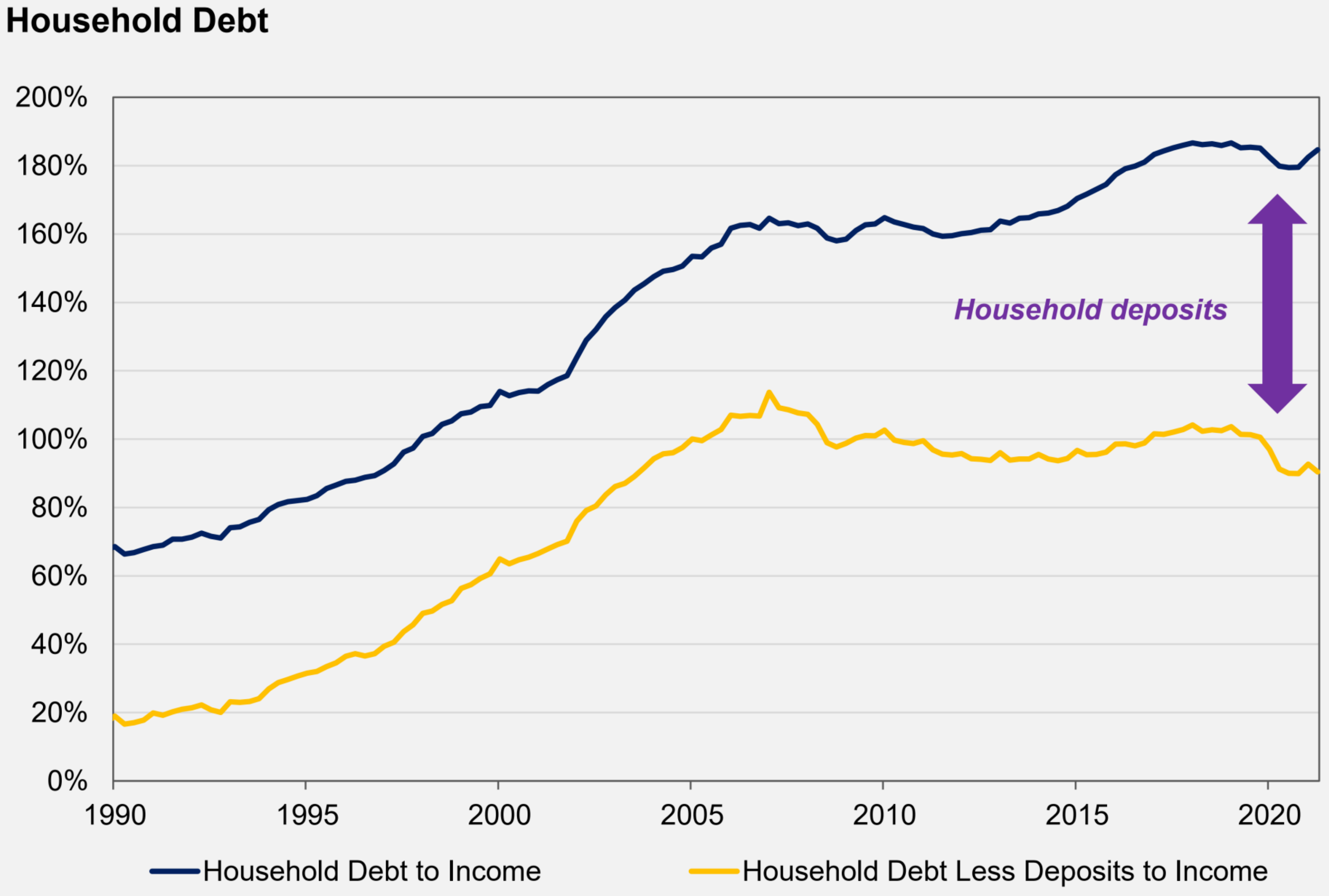
Household Net Leverage Is At A 15-Year Low



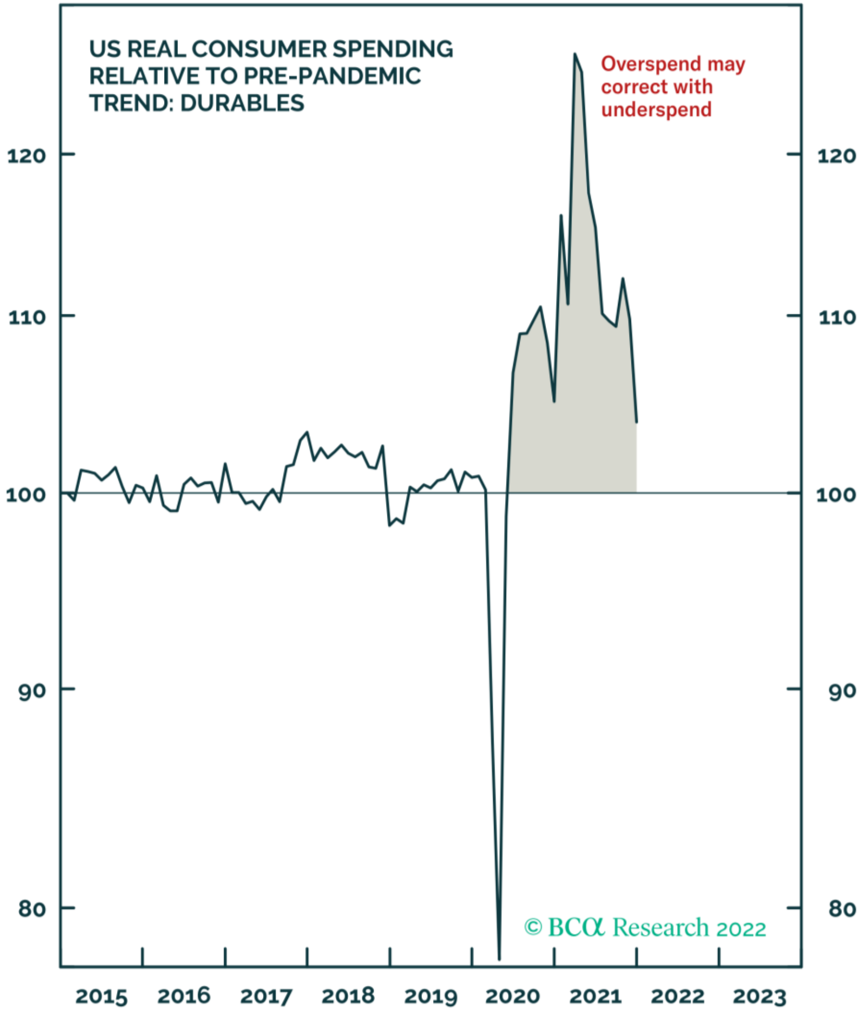
Demand For Goods vs Demand For Services

The consumption of services is constrained by time, opportunity, and biology.

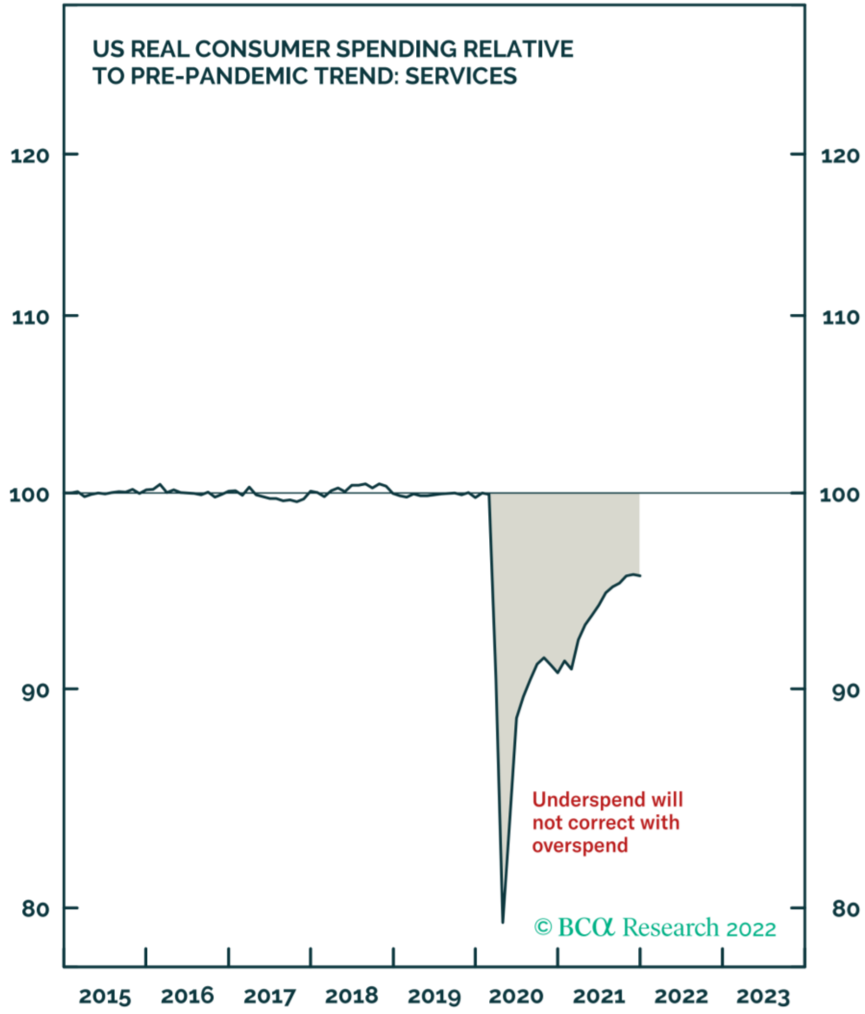
This means the underspend will not become a symmetric overspend.

In fact, the underspend on certain services will persist. This is because we have made some permanent changes to our lifestyles.

An Overspend On Goods Can Be Corrected By A Subsequent Underspend...

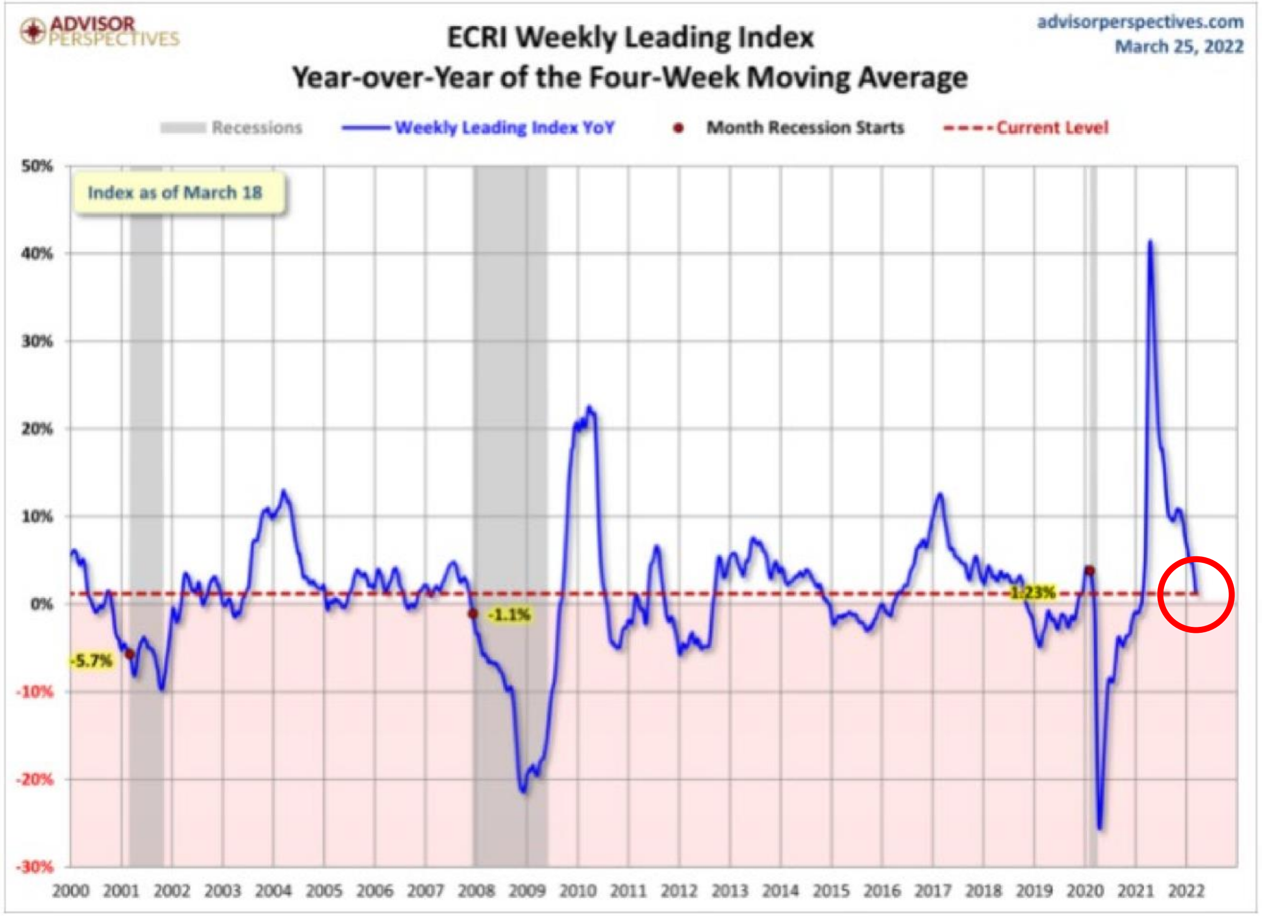


...But An Underspend On Services Cannot Be Corrected By A Subsequent Overspend



US Leading Indicators Are Weakening, Why?

ECRI Weekly Leading Index Says U.S. on the Verge of Recession Now!



Source: https://www.advisorperspectives.com/dshort/updates/2022/03/25/ecri-weekly-leading-index-update

www.HSDent.com

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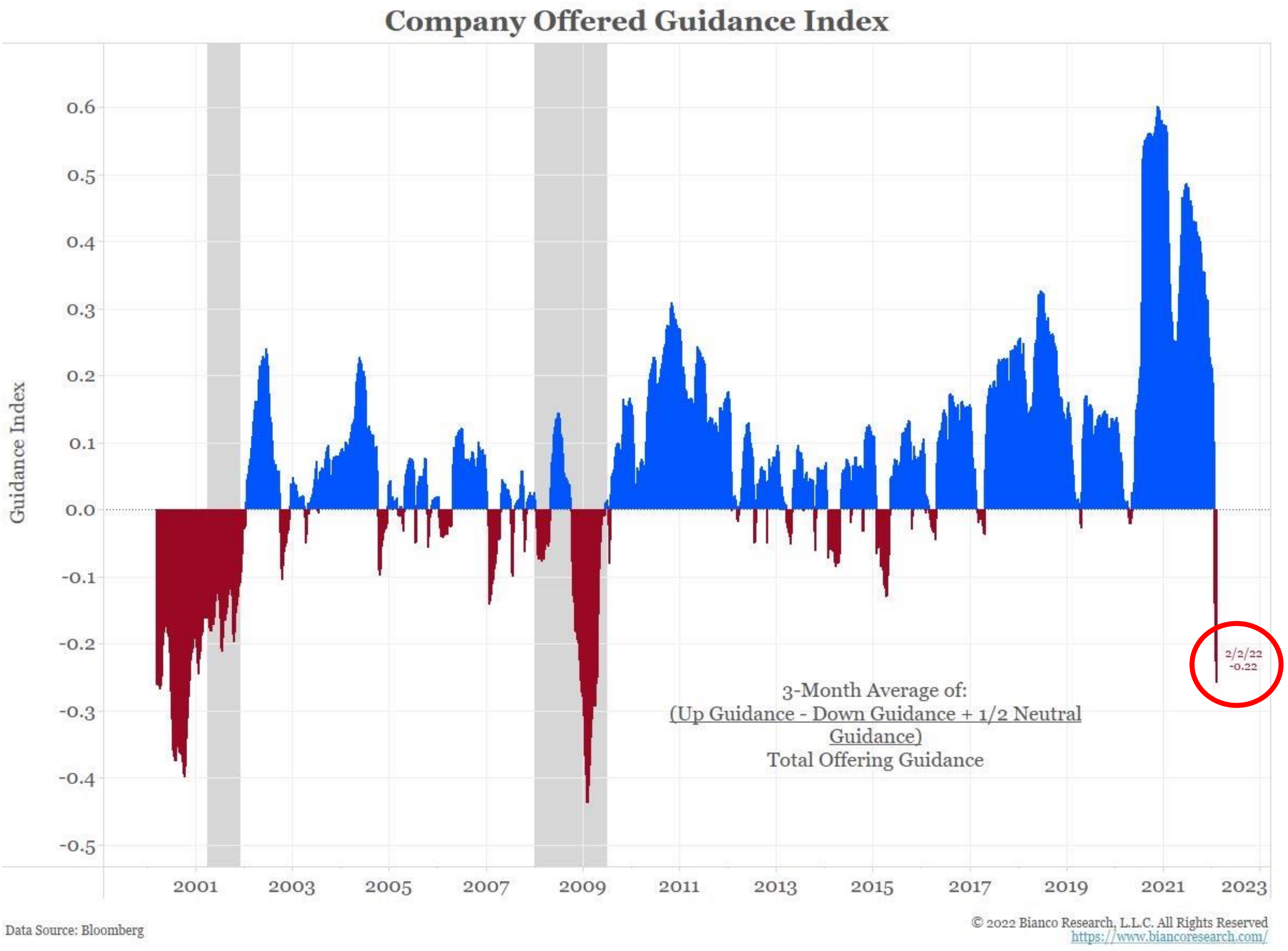
Inflation Is A Tax On Business

US corporate earnings guidance is at previous recessionary levels.

Corporates that cannot pass on rising costs to consumers will see margins squeezed, and current valuations are not pricing this in, yet.



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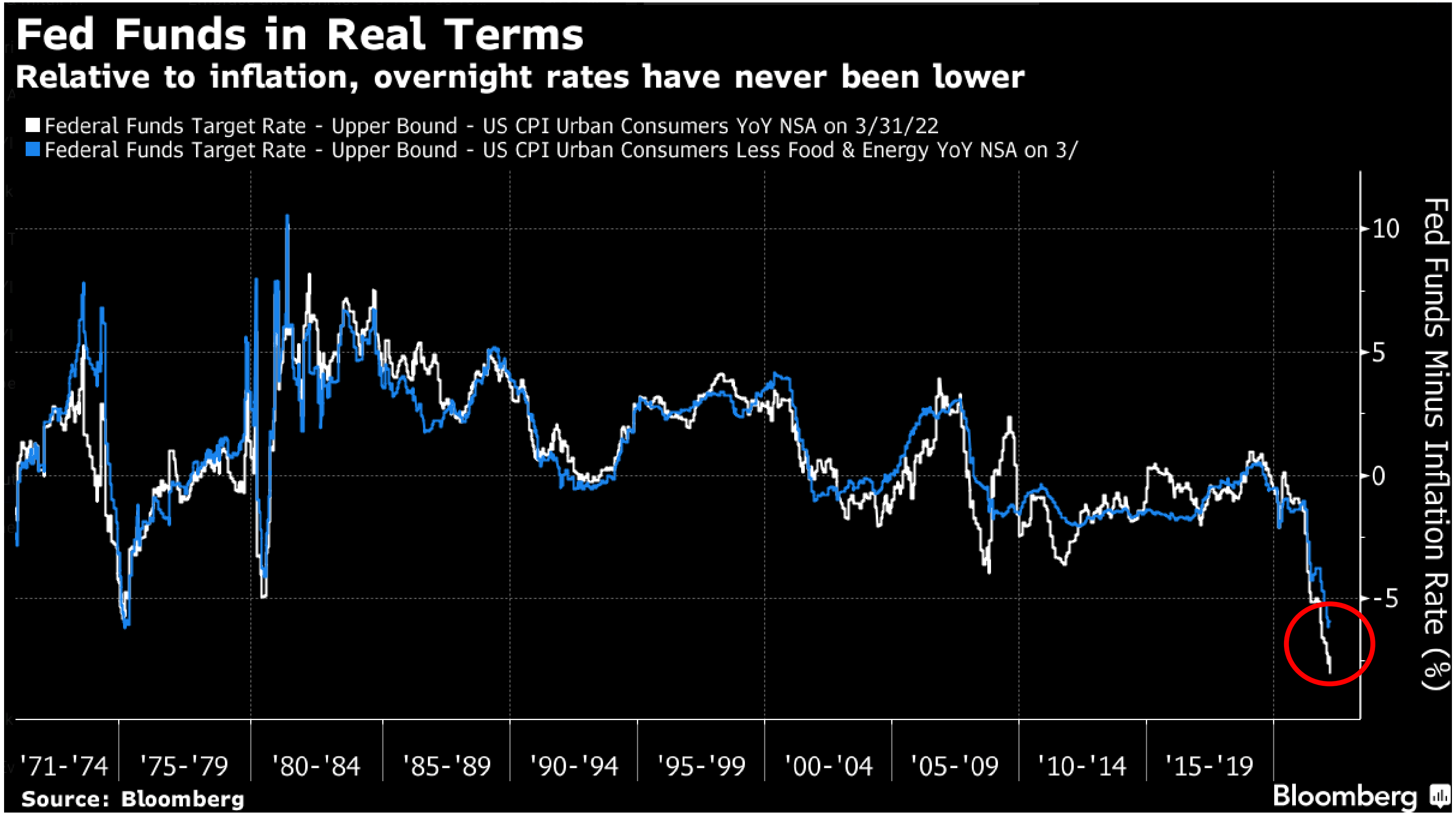
The Fed Will Have To Aggressively Raise Rates

The Fed will be forced to get interest rates at least to neutral (~3%) and reduce the supply of money (quantitative tightening)



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Speculative Assets Have Been Smashed

The De-SPAC Index, which tracks 25 companies that have gone public through a merger with a SPAC, has fallen -71% from its February 2021 peak

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Past Recessions & Equity Market Losses

If a US recession unfolds the average Earnings Per Share (EPS) decline is -13% and the average S&P 500 decline is -24%. Valuations are still high even after the recent -14% S&P500 decline and -24% Nasdaq decline, how much more is to come?

Exhibit 8: S&P 500 EPS typically declines by 13% during recessions

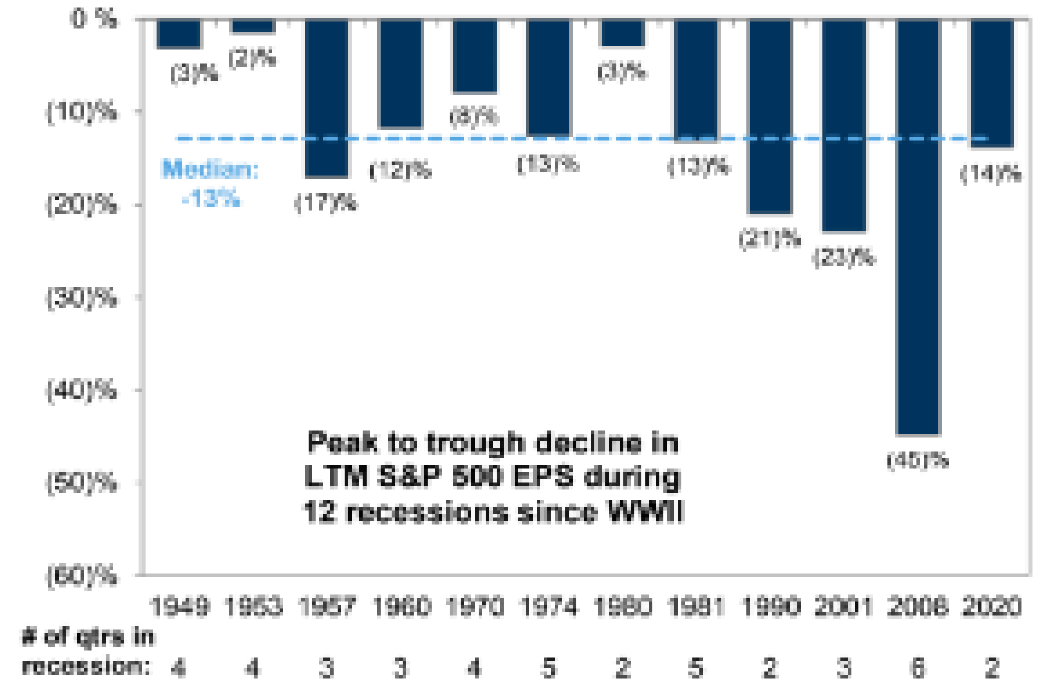
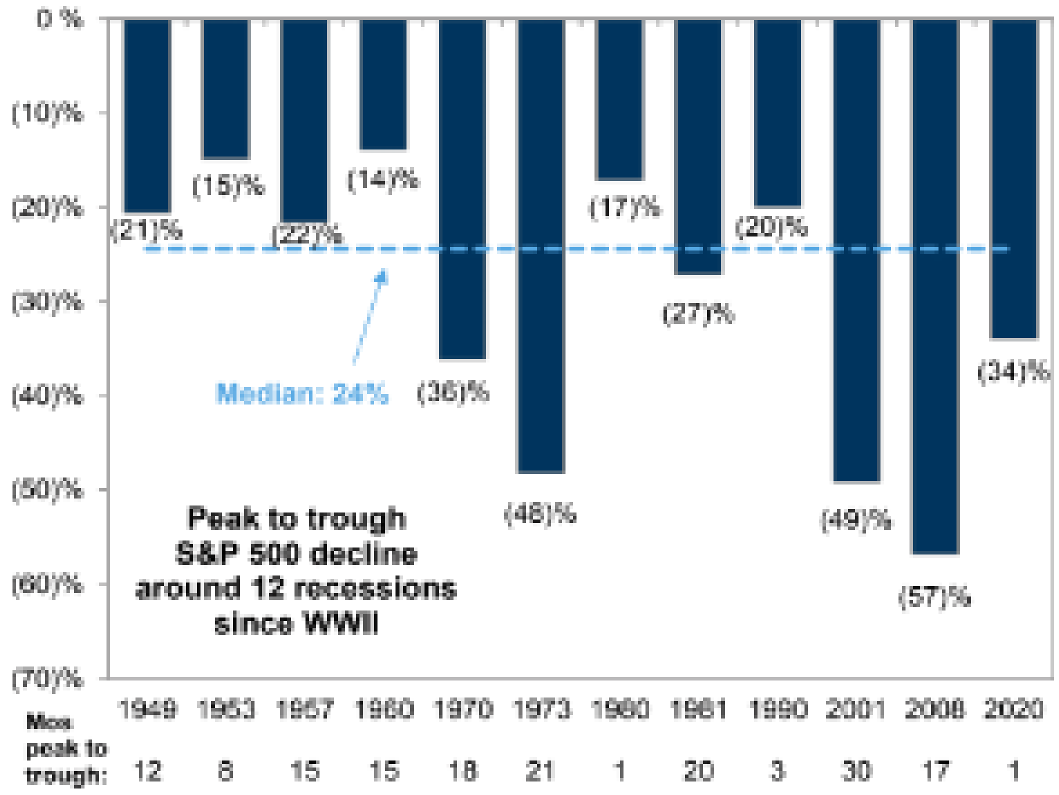


Exhibit 9: S&P 500 price declines around recessions



Source: Goldman Sachs

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