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# MPW Half Year Market Update - February 2023

## 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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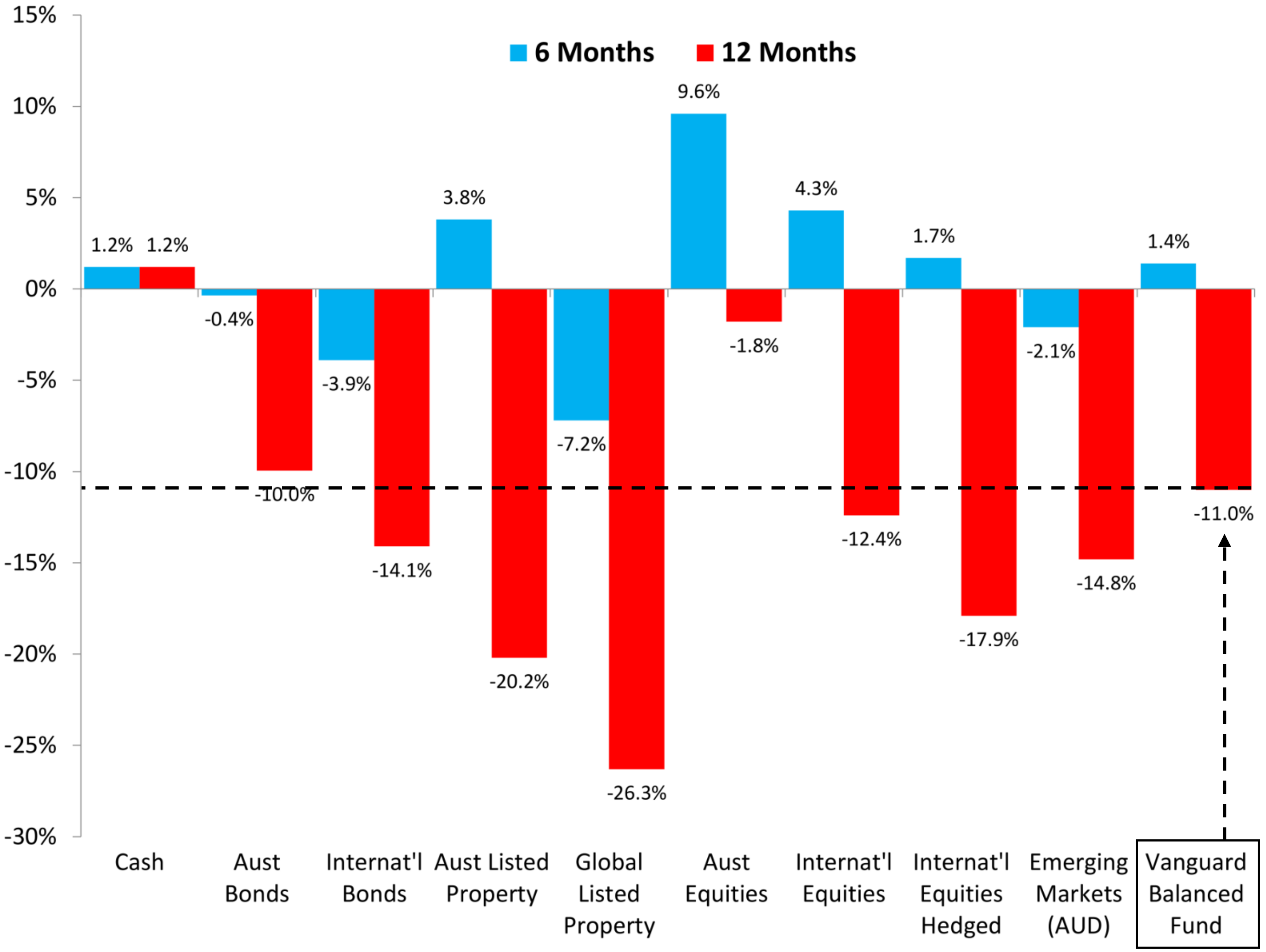
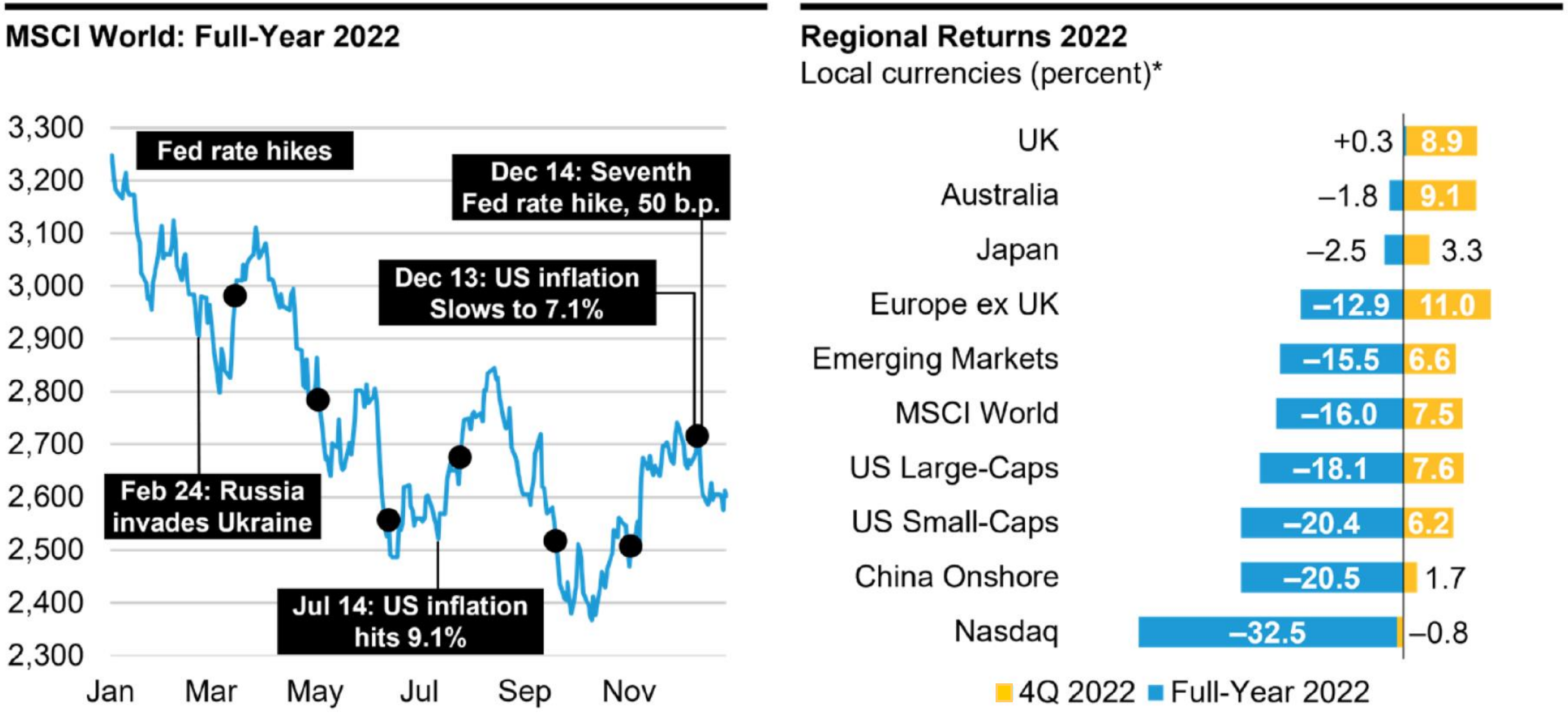
# Asset Class Returns To 31st December 2022



# Global Equity Returns To 31st December 2022

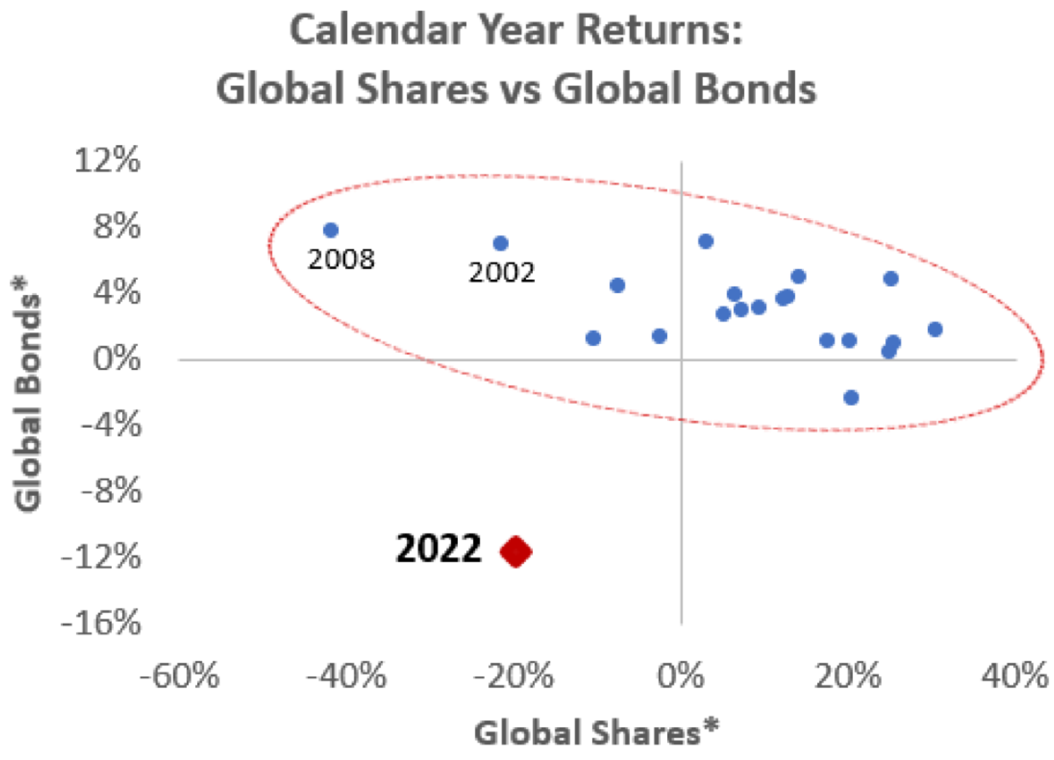
## Global Stocks Fell Sharply Amid Uncertainty Over New Investing Regime



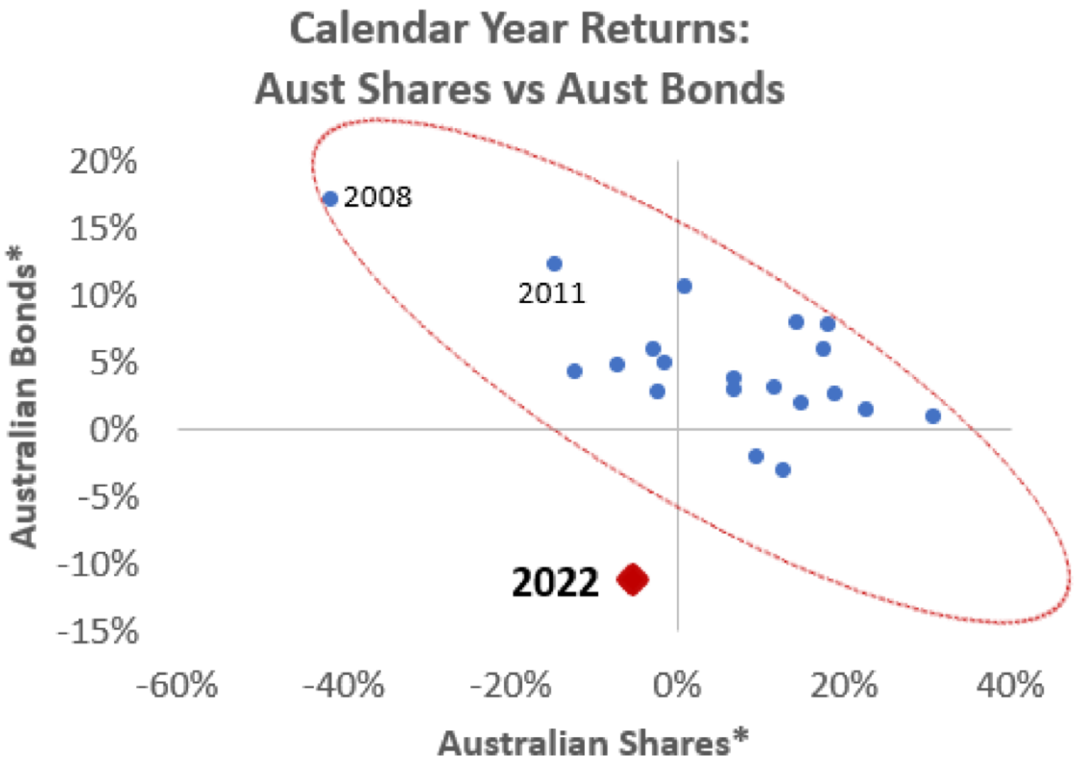

**Past performance and current analysis do not guarantee future results.**

*UK represented by FTSE All-Share Index, Australia by S&P/ASX 300, Japan by TOPIX, Europe ex UK by MSCI Europe ex UK Index, emerging markets by MSCI Emerging Markets Index, US large-caps by S&P 500, US small-caps represented by Russell 2000 Index, and China Onshore by MSCI China A Index. As of December 31, 2022. Source: Bloomberg, FactSet, FTSE Russell, MSCI, Nasdaq, S&P, Tokyo Stock Exchange and AB

# Bonds Provided No Diversification For Shares In 2022




* Global Shares = MSCI World ex Australia Index (US$)
* Global Bonds = S&P Global Government Bond Index in US$
Source: Bloomberg




* Australian Shares = S&P / ASX 200 Index
* Australian Bonds = S&P / ASX Aust Fixed Interest Index
Source: Bloomberg

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# Central Banks: Soft Landing or Recession?

**Central bank credibility is being questioned:**

- In late 2021 central banks were wrong on their inflation outlook, calling it transitory.
- In early 2022 the RBA said that interest rates in Australia would not rise until <u>2024</u>!
- Can central banks manage a soft landing* or will policy mistakes send us into a deeper recession?
  - Raise interest rates too high and risk recession, or
  - Don’t raise enough and risk embedded inflation


**<u>NO-ONE</u> KNOWS how this plays out, but the outcome will determine the direction of markets in 2023.**

**<u>In our view, recession is a higher probability outcome</u>.**

*Note, a ‘soft landing’ refers to a low growth or mild recession scenario

# MPW Outlook & Scenario Analysis For 2023 CY

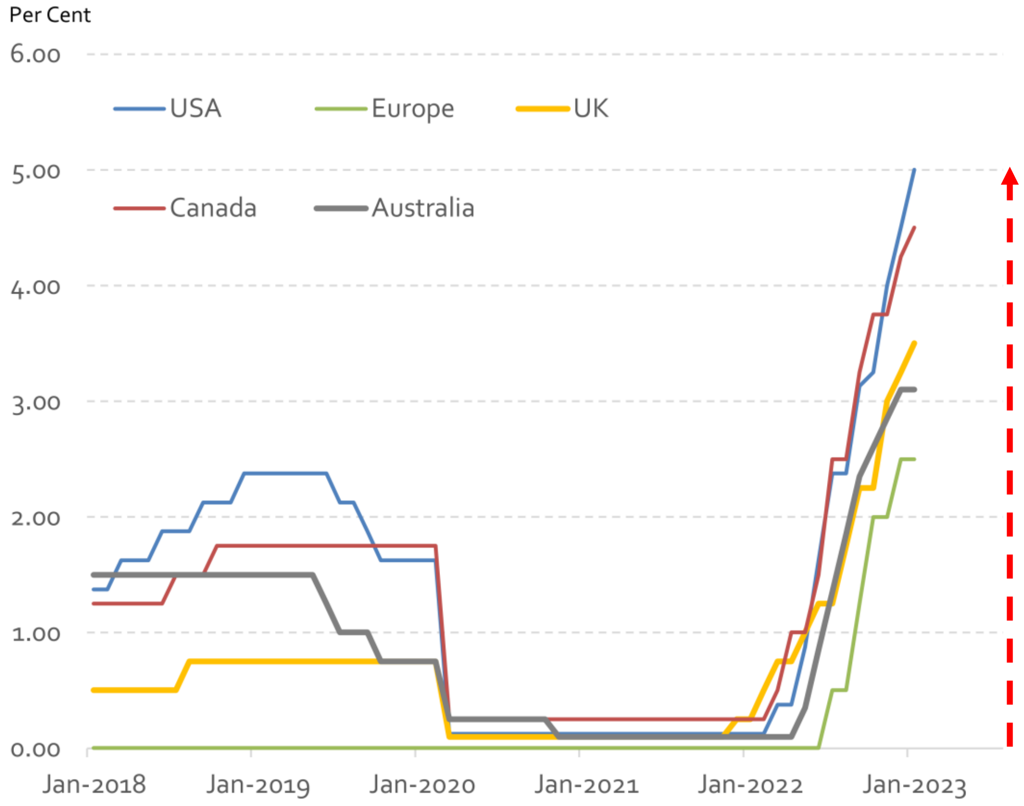
| 1. Hard Landing: Global Recession<br>MPW Probability = 70% | 2. Soft Landing: Mid-Cycle Slowdown<br>MPW Probability = 25% | 3. Strong Growth: New Bull Market<br>MPW Probability = 5% |
|---|---|---|
| • Inflation remains stubbornly high<br>• Central banks tighten too much<br>• Unemployment rises 1-2%<br>• Savings rates evaporate<br>• Economic data deteriorates<br>• Corporate earnings fall<br>• Geopolitical risks intensify (wars)<br>• US debt ceiling results in a default | • Inflation moderates towards targets<br>• Central banks pause rate hikes<br>• Unemployment rises marginally<br>• Savings rates are preserved<br>• Economic data stabilises<br>• Higher revenues offset higher costs<br>• No further sanctions are imposed<br>• Supply issues don't spike oil prices | • Inflation moderates quickly<br>• Central banks consider rate cuts<br>• Employment growth remains strong<br>• Savings rates remain elevated<br>• Economic data pivots to growth<br>• Companies pass on higher costs<br>• Russia and China pivot their stance<br>• Supply chain & labour issues abate |
| **Markets are not priced for this, expect another decline from here (~10-30%)** | **Markets are priced for this, value can be selectively found at current levels** | **Markets are not priced for this, risky assets will perform very strongly** |

# Higher Global Interest Rates & Inflation Risks

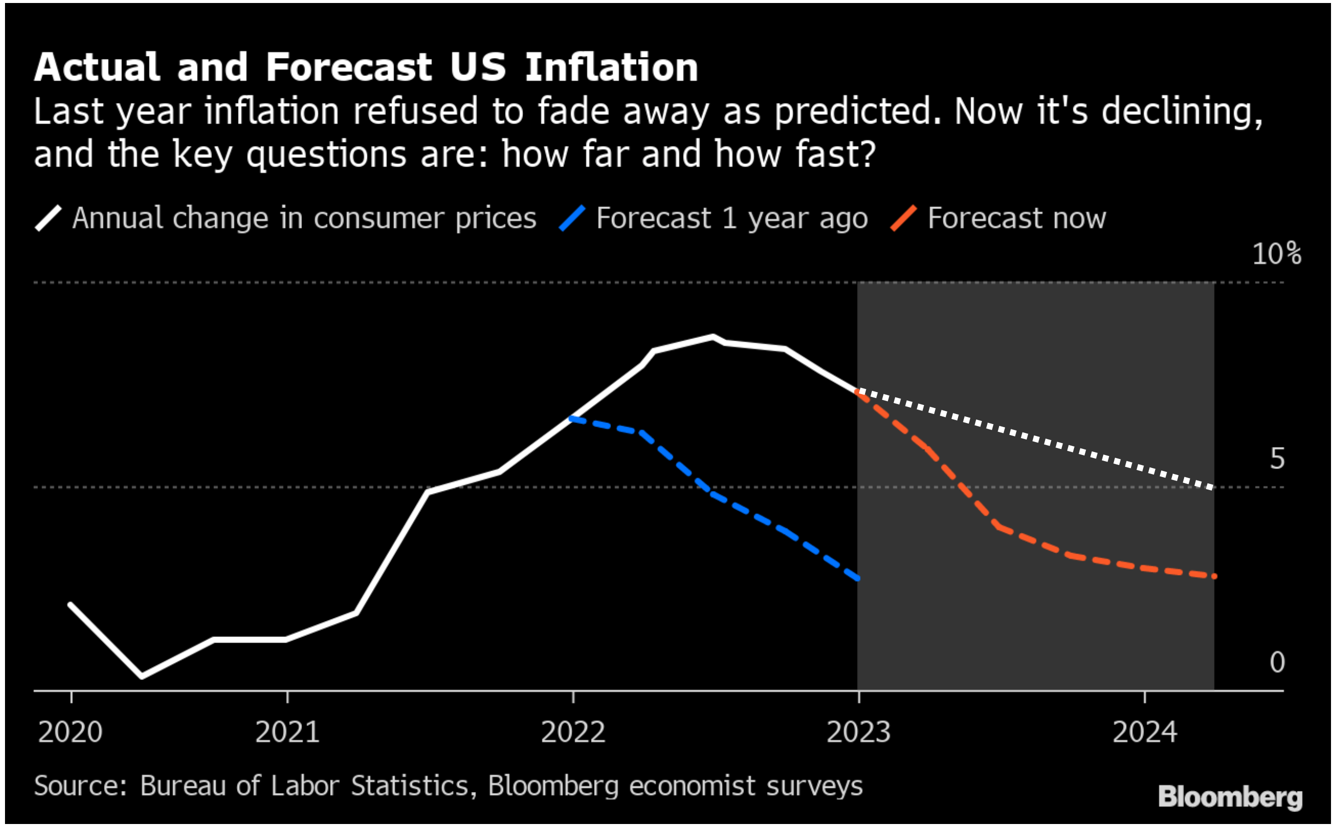
Global interest rates rose at a historically fast pace in 2022, it will be more subdued in 2023

US inflation peaked mid-2022, but it is a long way from the Fed's target 2% range.  Will 'sticky' inflation persist in 2023?

**Global Policy Rates**



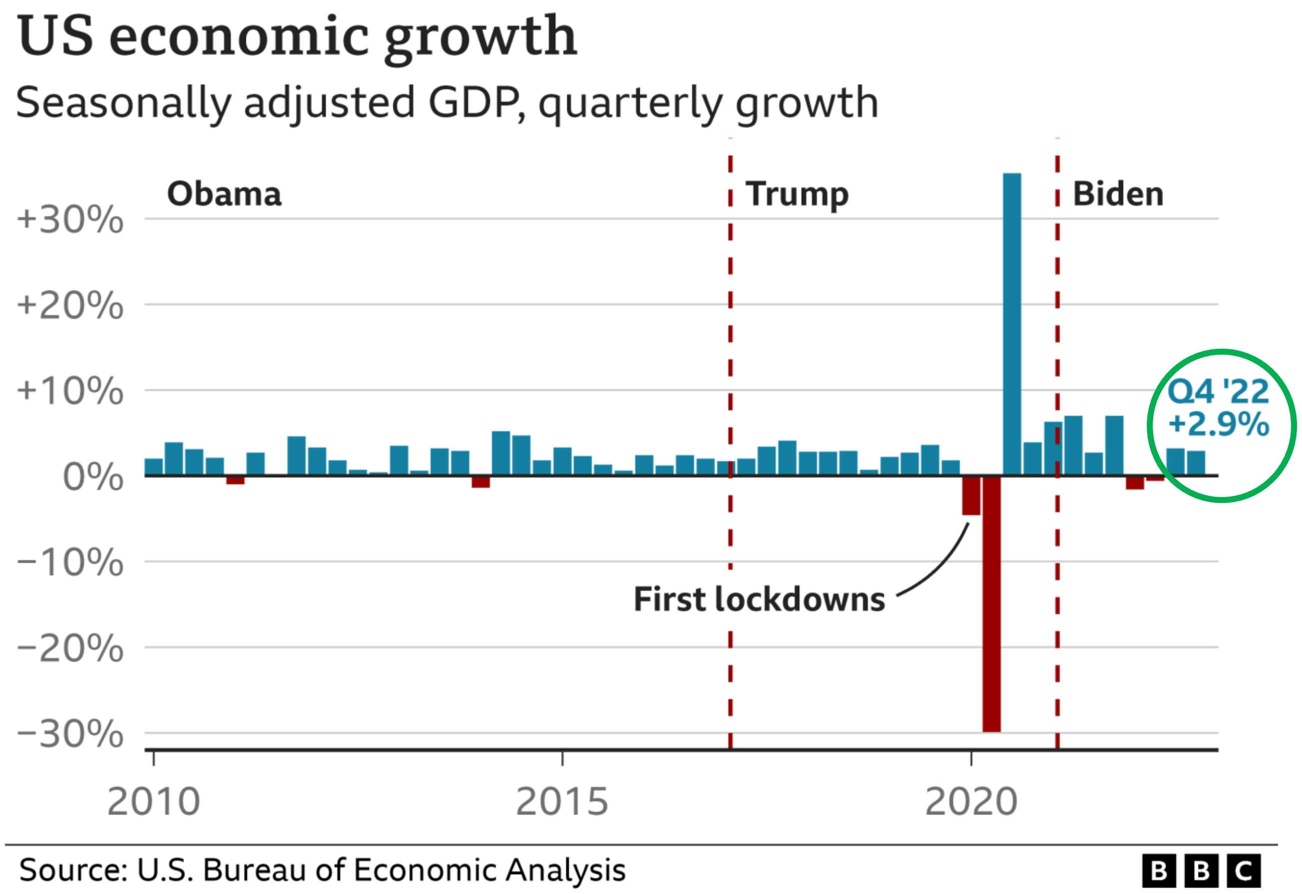

*Source: NBP, Trading Economics, EQ Economics*

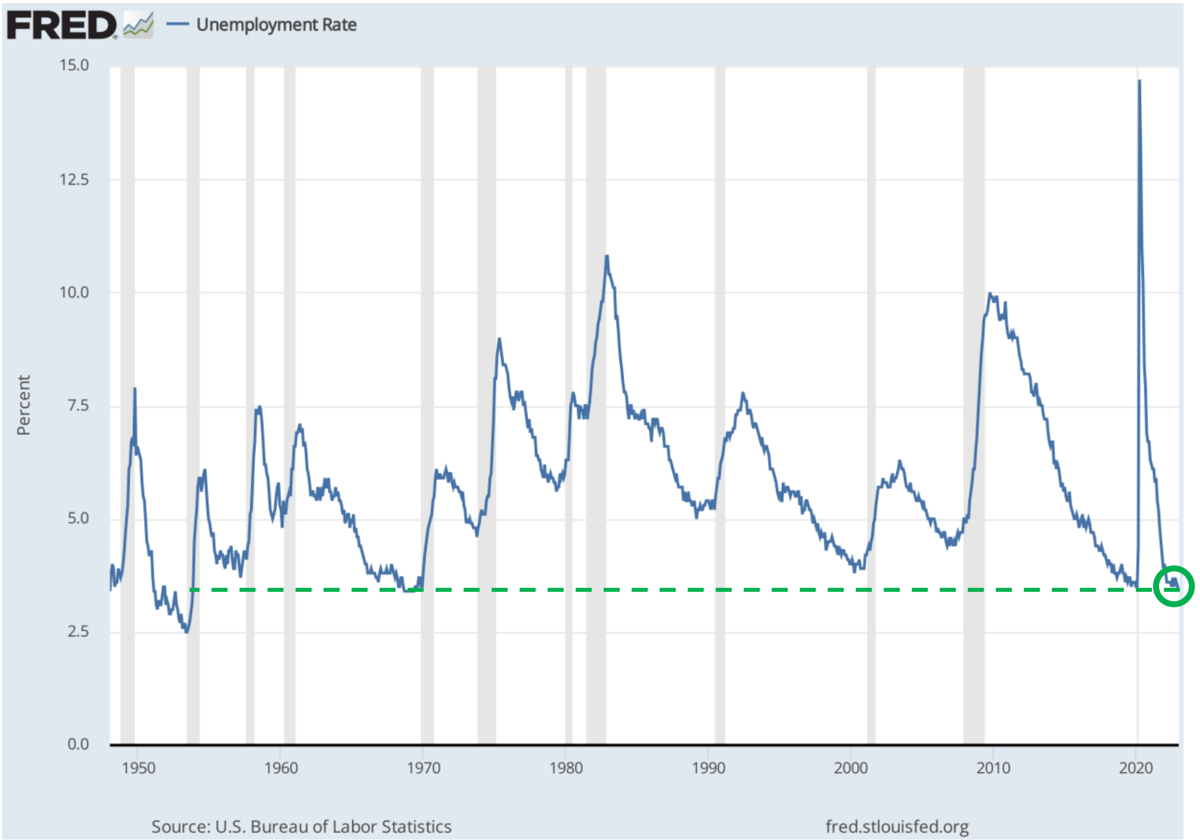


# Strong US Growth & Low Unemployment

US GDP growth has been resilient in the second half of 2022 but is expected to slow into 2023

US unemployment is at a 50-year low, a very tight labour market. Job vacancies are at 1.9x per unemployed person



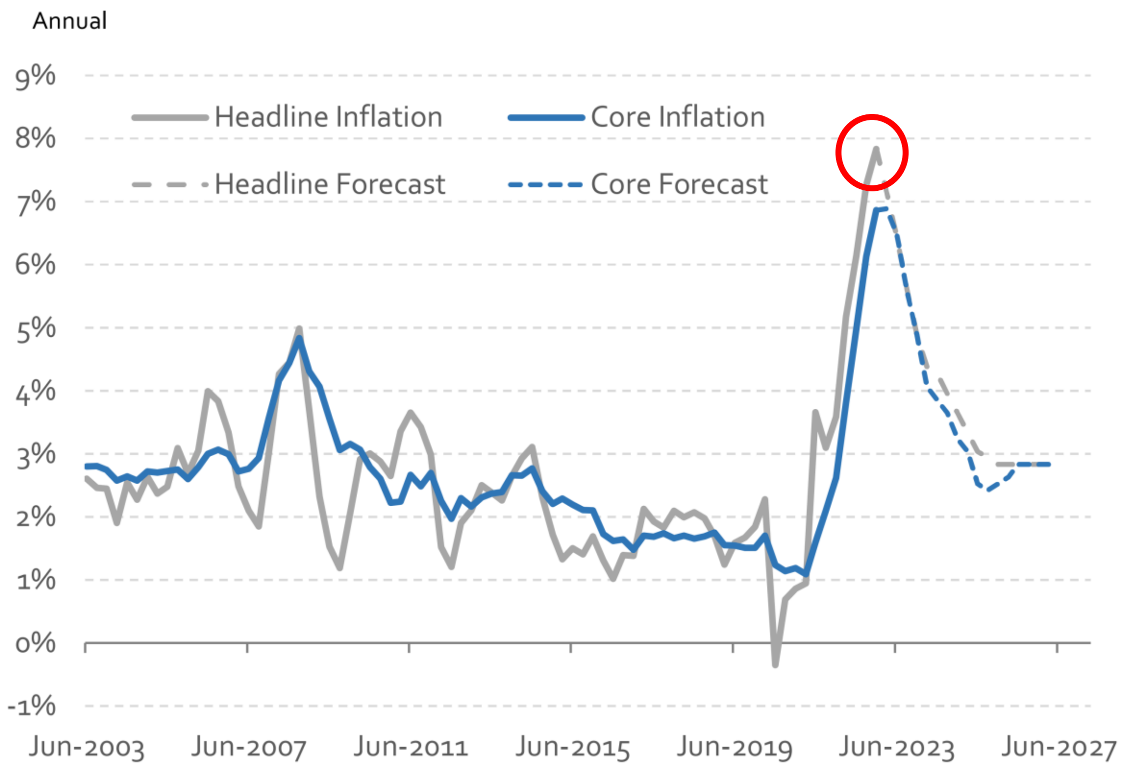



# Australian Interest Rates & Inflation – No Peak Yet

Australia has yet to see peak inflation, noting forecasts predict large falls by 2024

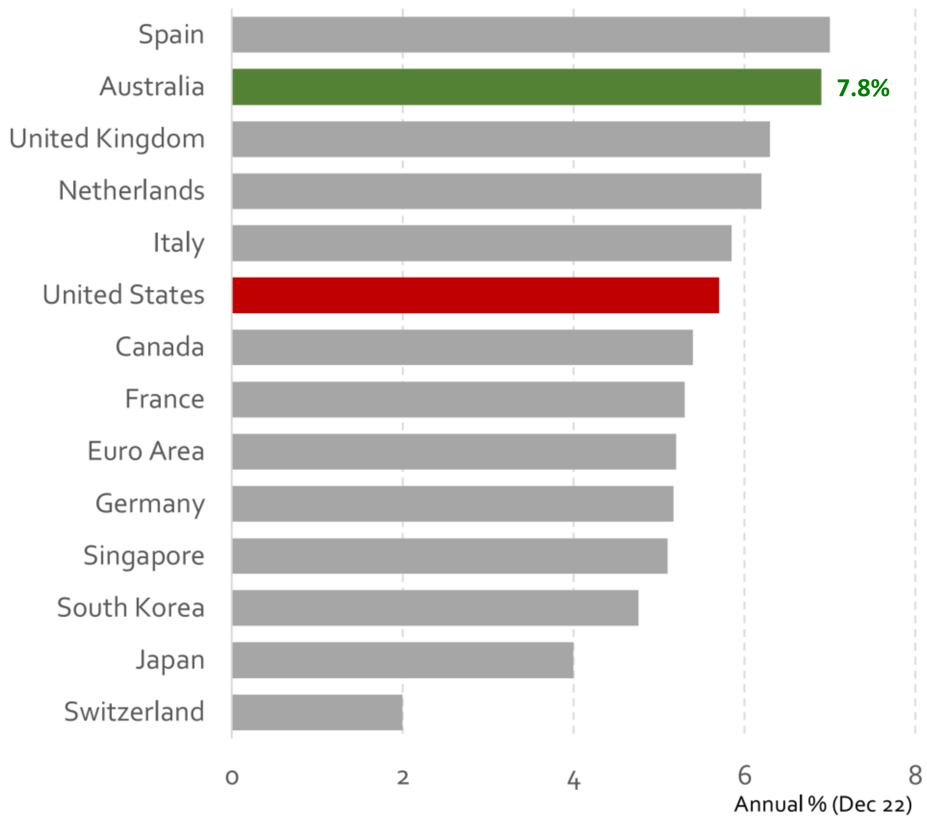
With Australia's inflation still one of the highest in the world, the RBA still has more work to do

**Australian Inflation**




*Source: ABS, RBA, Trading Economics, EQ Economics*

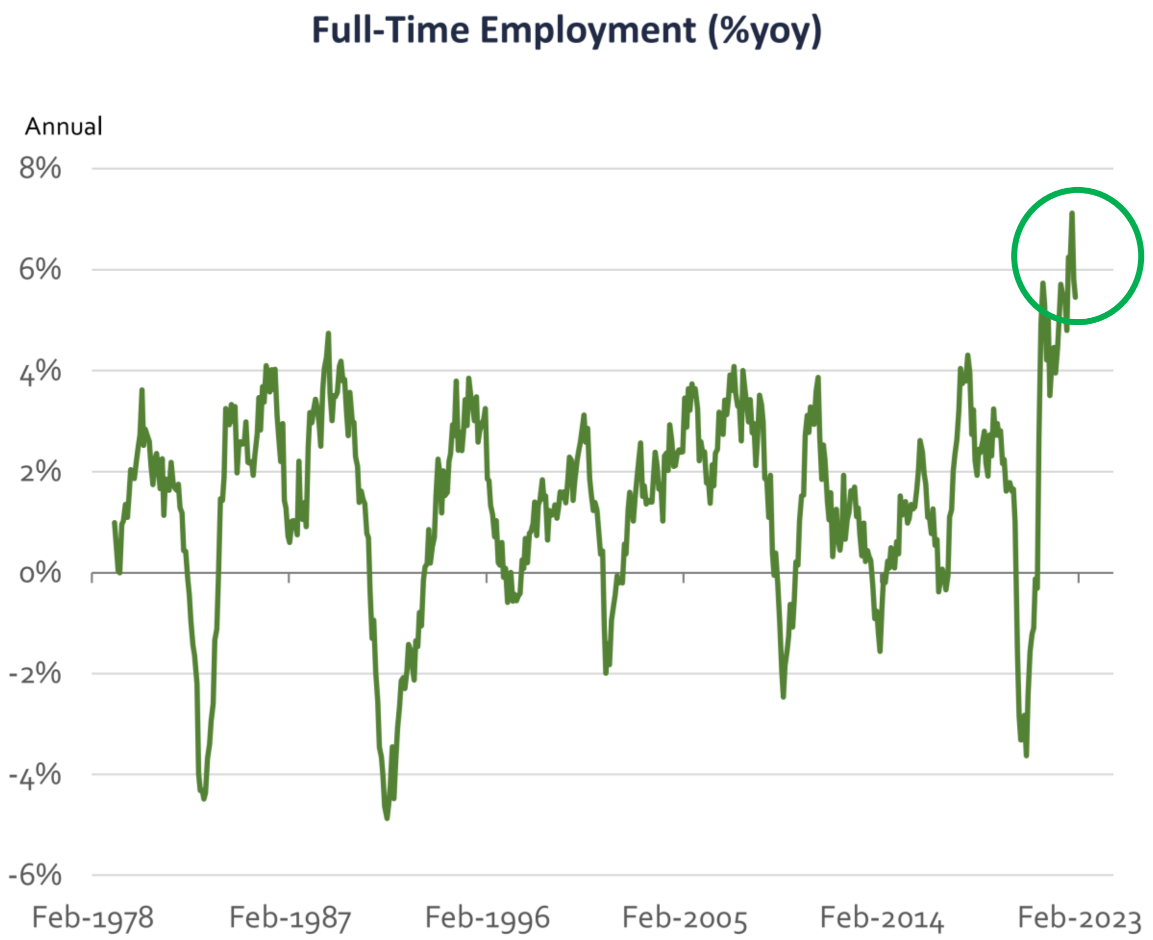
**Core Inflation (G-20 Nations)**

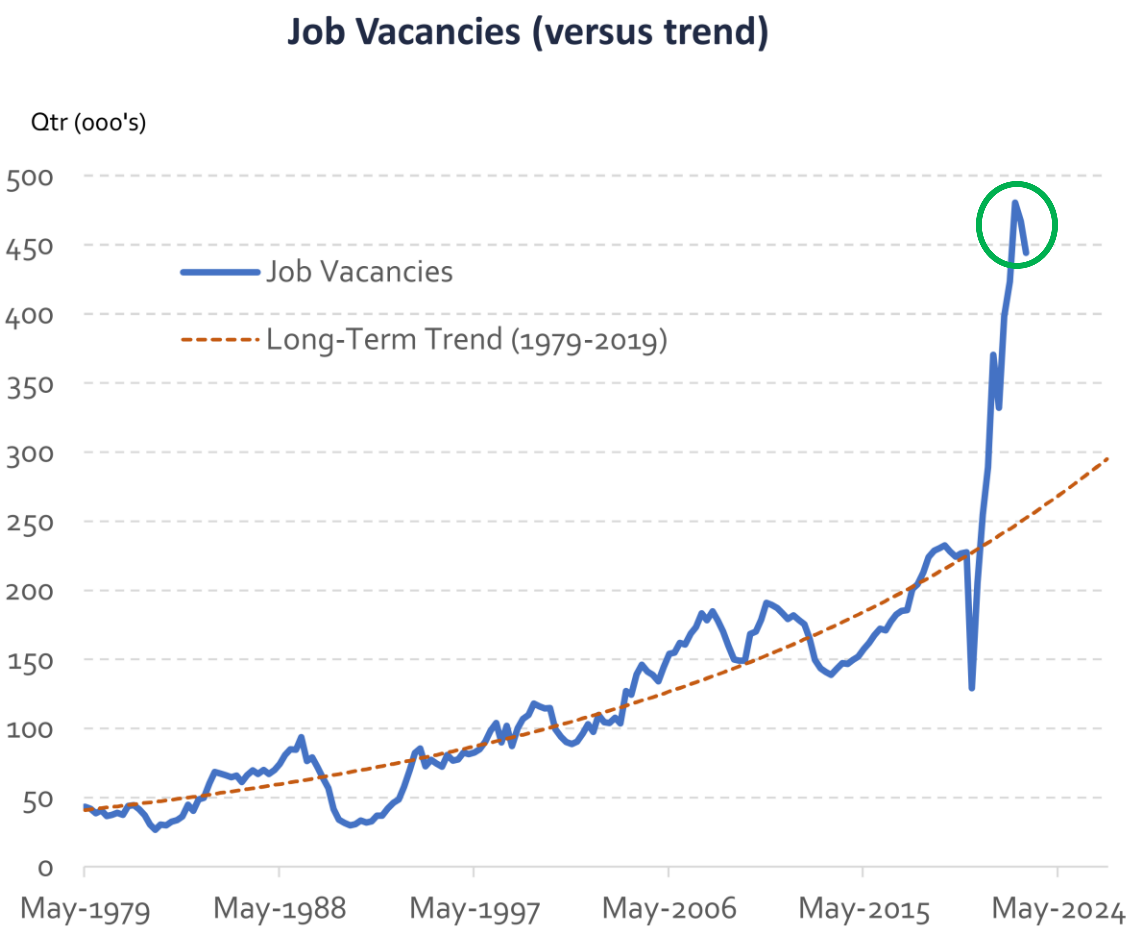


# Australian GDP & Employment Remain Strong

Australia saw historically high full-time employment growth in 2022, putting further pressure on the RBA

Australian job vacancies need to fall 43% to return to long-term trend. Labour demand fuels inflation

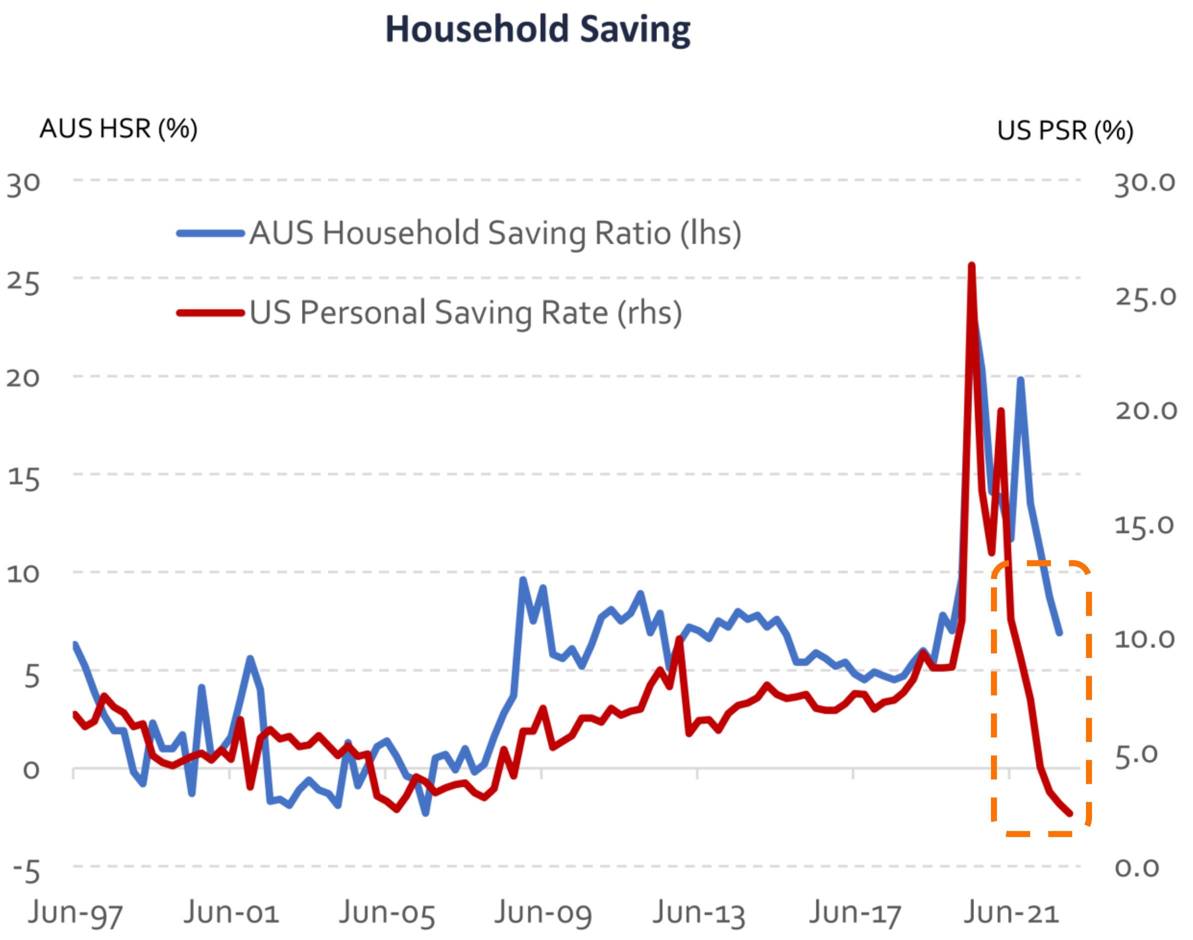



*Source: ABS, EQ Economics*

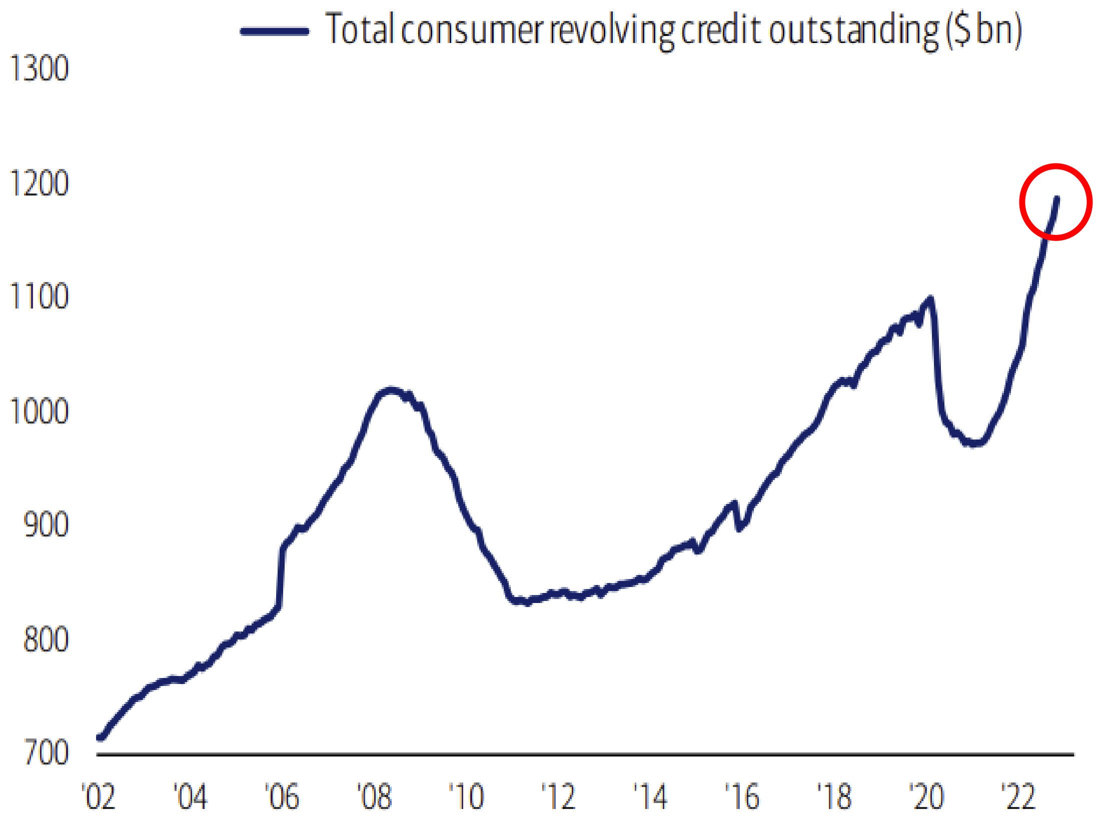
# Savings Rates Are Falling, Consumer Credit Is Rising

US savings rates have collapsed and Australia's savings rates are heading in the same direction




Source: FRED, ABS, Melbourne Institute, EQ Economics

US household consumption is now being driven by consumer credit, will Australia follow by late 2023?

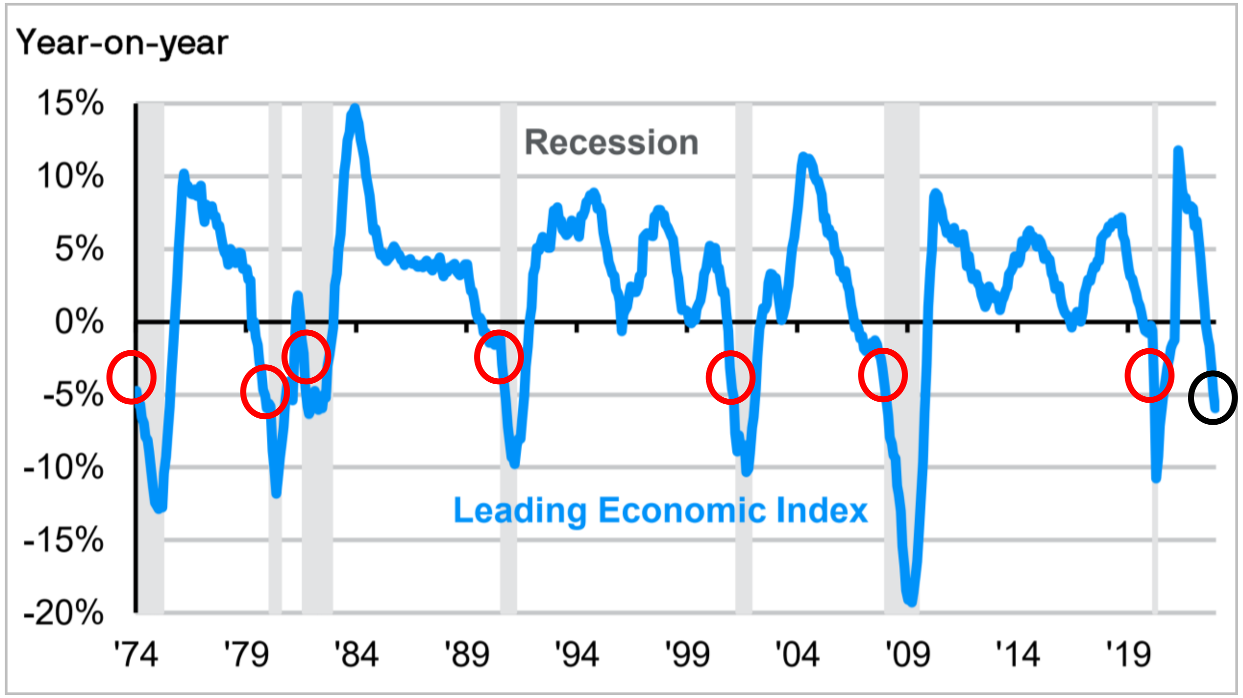



**Source:** BofA Global Investment Strategy, Bloomberg

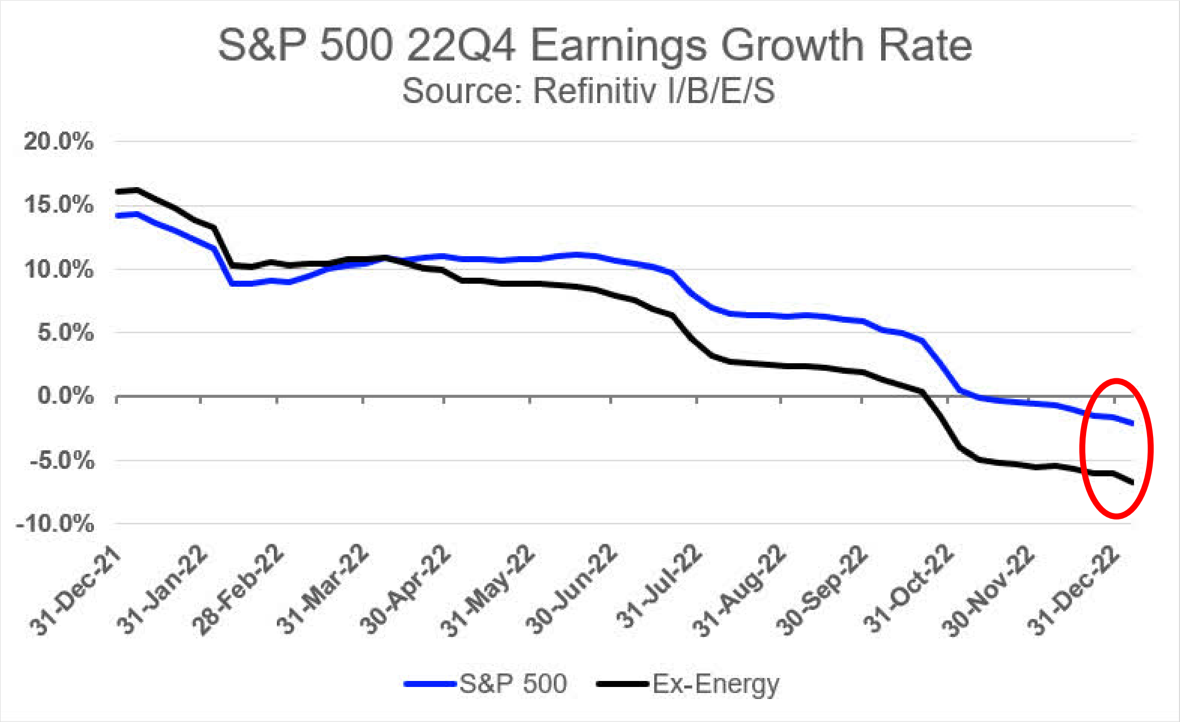
# US LEI's Are Falling and Earnings Are Negative

US Leading Economic Indicators (LEI's) suggest that recession is around the corner

US corporate earnings are negative as consumer spending slows and economic growth slows



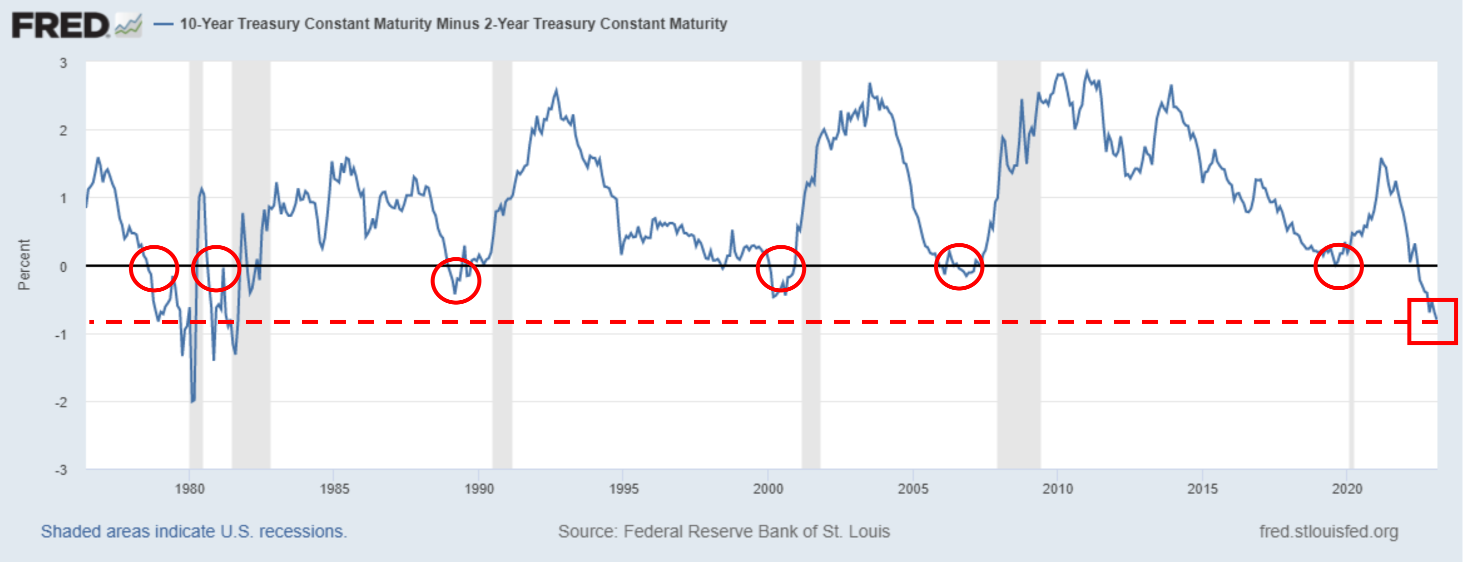

J.P.Morgan ASSET MANAGEMENT



# US Yield Curve Is Heavily Inverted – Recession Ahead?

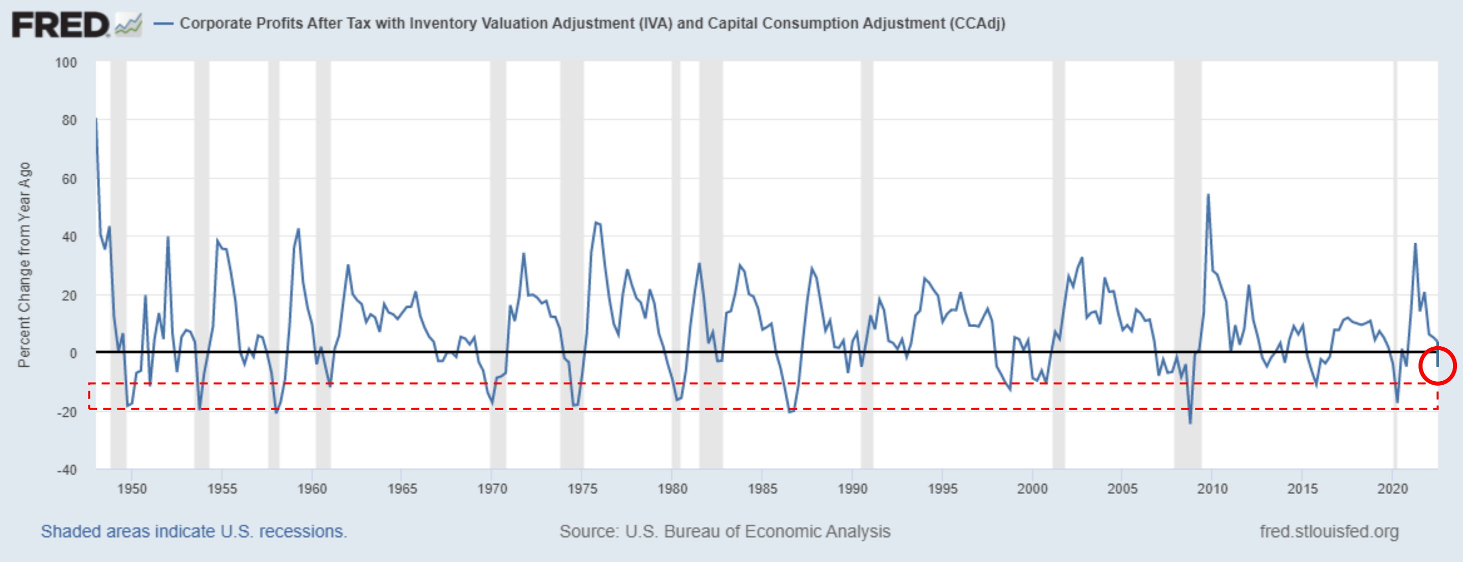
The US 10 and 2-year yield curve (difference between 10 year and 2 year bond yields) is now inverted the most in the last 40 years.

This suggests a very high probability that there is a recession ahead.




US corporate profits are currently -5% for the Q4 2022 reporting period.

Earnings generally fall 10-20% during recessions: What does this mean for current equity market valuations?

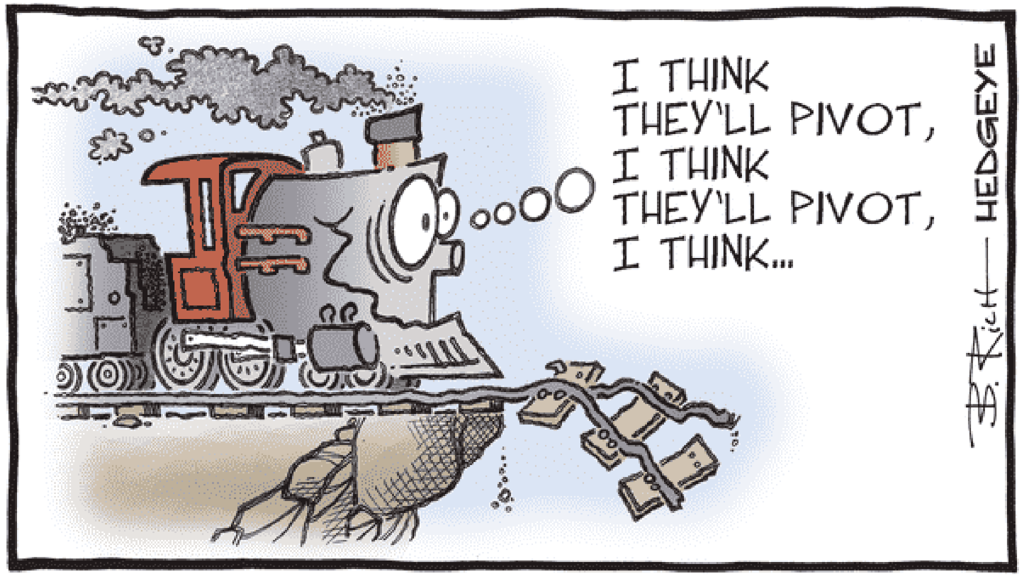


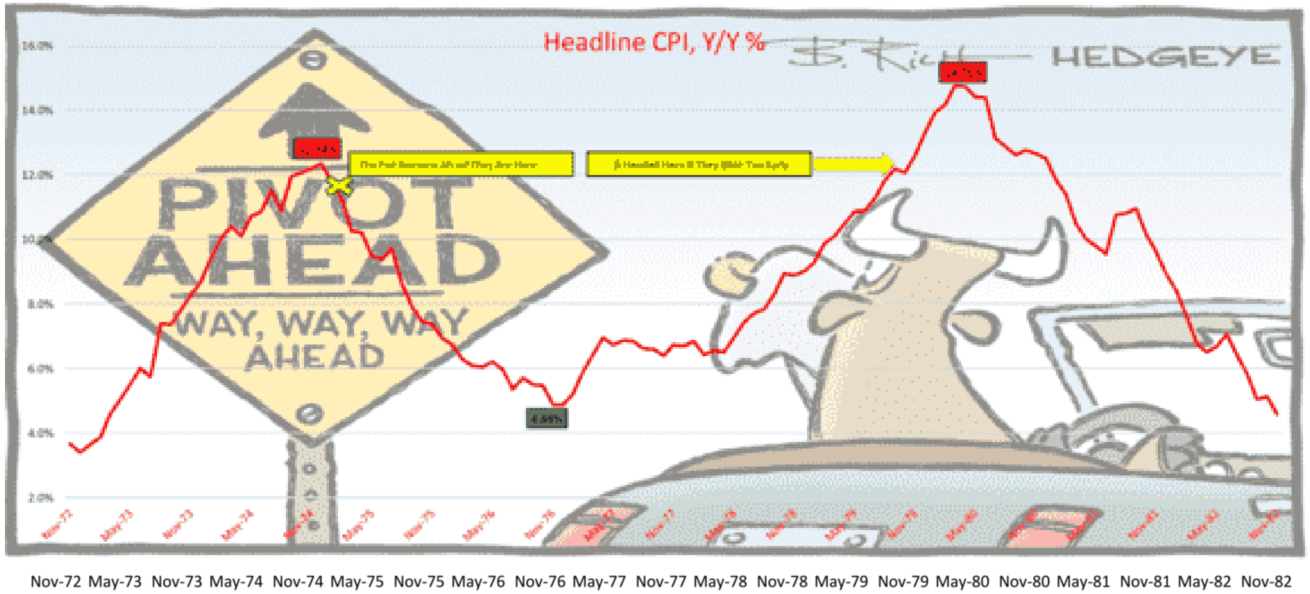
# So What Does All Of This Mean For Markets?

Will the doves control the narrative and will central banks pivot with interest rate cuts in late 2023?

**OR**

Will the hawks take control and deliver the message of higher rates for longer, with no interest rate cuts in 2023?




**This Scenario = Soft Landing**
**Action: Selectively buy assets**

**This Scenario = Recession**
**Action: Stay defensively positioned**

# MPW Recommended Portfolio Strategy

| Asset Class | Tactical Position | Comment |
|---|---|---|
| Currency (AUD vs USD) | Neutral | Neutral hedge at current levels, AUD to fall into global recession and recover out of it |
| Cash & Liquidity | Neutral to Over | Rates are ~3% and rising, hold cash for better buying opportunities throughout 2023 |
| Government Bond Duration | Underweight | Long-duration yields have fallen to unattractive levels and are already priced for rate cuts |
| Corporate Credit & Debt | Underweight | Listed credit spreads can widen further, but own selective private credit strategies |
| Listed Property & Infrastructure | Underweight | Listed markets are high risk, but own selective unlisted assets |
| Australian Shares | Underweight | Not cheap, retain long short exposure with a quality value bias, underweight small caps |
| International Shares | Underweight | Not cheap, particularly the US, Emerging Markets cheaper but still represent high risk |
| 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 |

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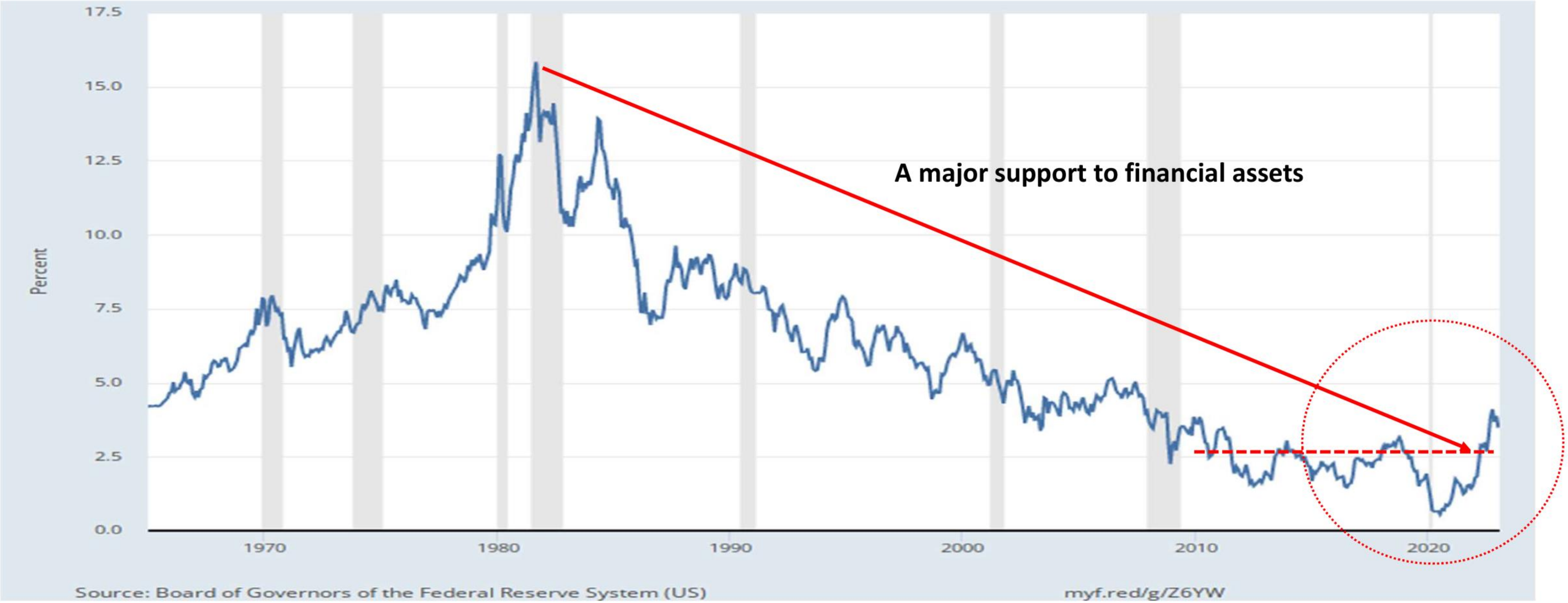
# The Investment Landscape Has Changed

Falling interest rates have supported asset prices for 40-years, what should the cost of capital be now?

US 10 Year Government Bond Yield

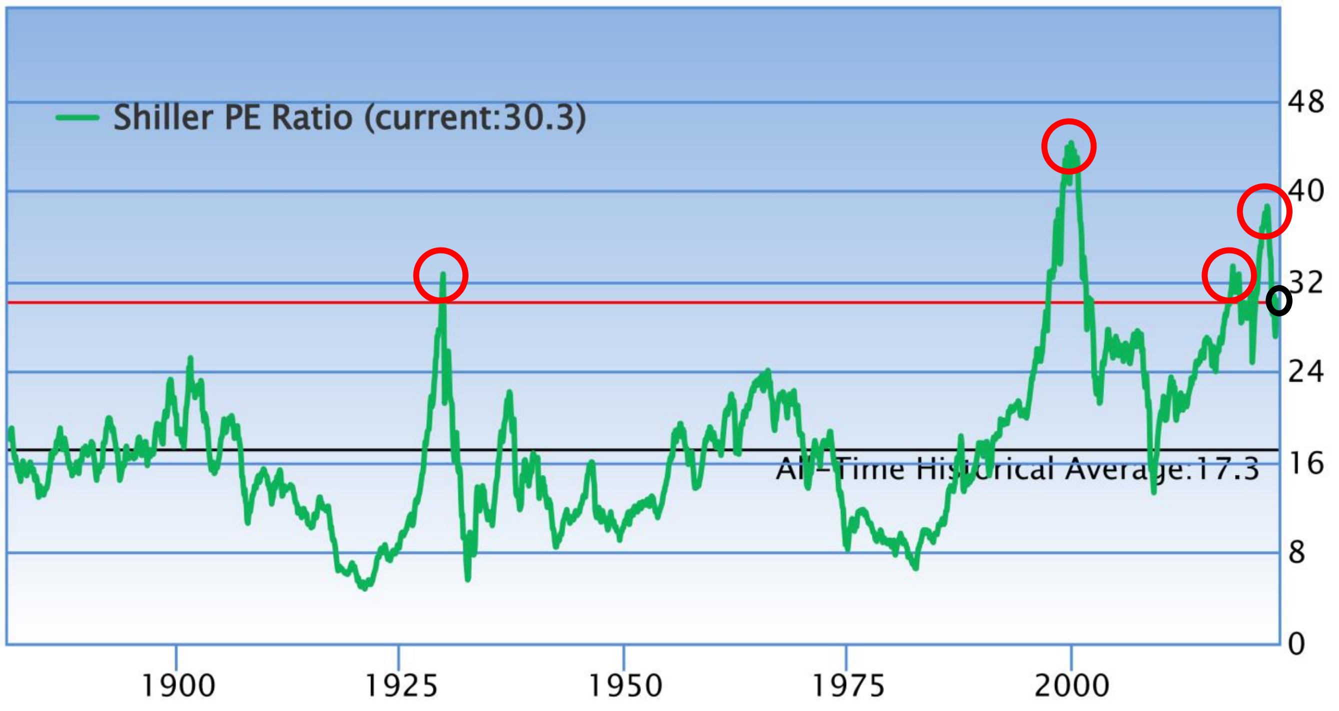


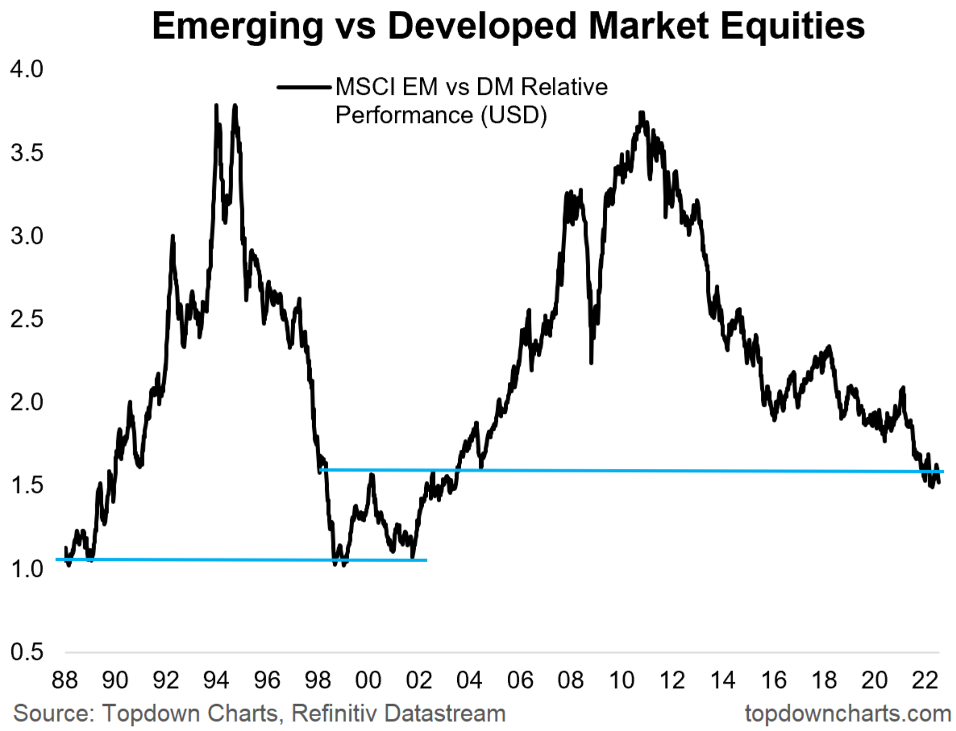

Source: US 10 Year average Yield – constant maturity – FRED – St Louis Federal Reserve – to Jan 2023

# Most Markets Are Not Cheap Given the Recent Rally

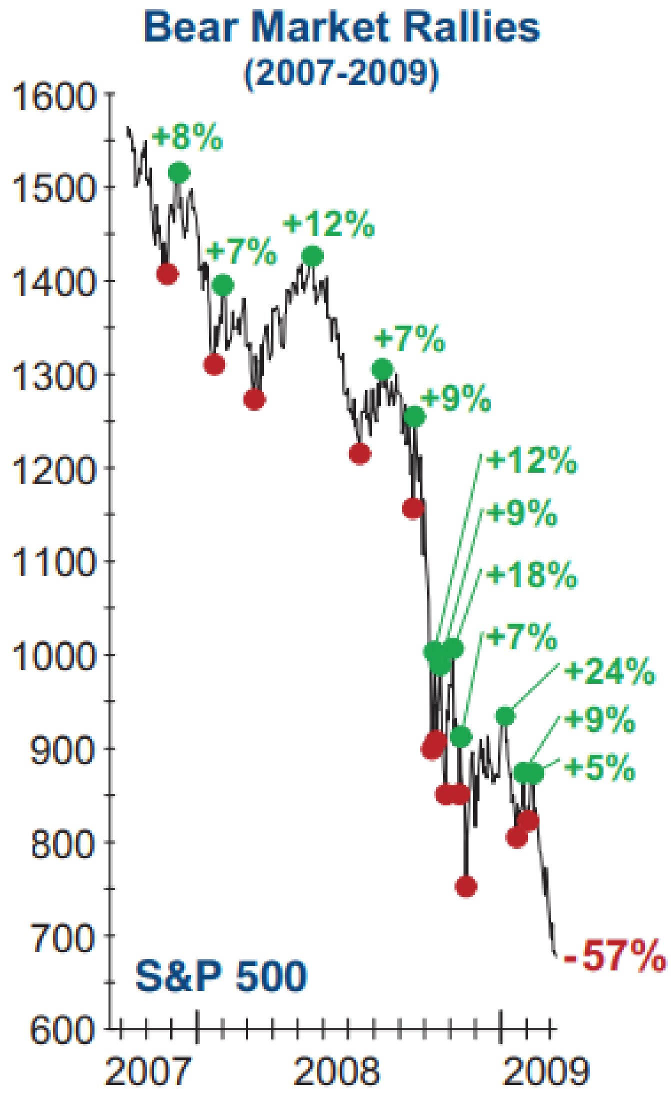
The US Shiller PE ratio at 30.3 is still very expensive on a historical basis, having been above this level only 4 times in history

Whilst the US is still expensive, other markets such as Emerging Markets are cheap on a relative basis



# Bear Market Rallies Are Common – Tread Carefully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# Now Is Not The Time To Be Complacent

In a 0% interest rate environment, growth at any price was ok because there was no cost of capital.

In a rising interest rate environment speculative assets like non-profitable tech and crypto have been smashed.

Goldman Sachs non-profitable tech index


Source: Bloomberg

Borrowing rates are now +5% and some valuations have adjusted, others haven't yet.

Does complacency go back to the way it was?

# The Role of Alternative Assets In Portfolios

<u>Framework-driven portfolio construction: What role do different categories play in the portfolio?</u>

| | Fixed income-like | Hybrids | Equity-like | |
|---|---|---|---|---|
| **RETURN ENHANCERS**<br>Global diversification and tactical/ opportunistic returns | Distressed credit | Special situations | Private Equity, Venture Capital | LOWER Income/ HIGHER Volatility |
| **CORE COMPLEMENTS**<br>Added diversification and/or enhanced returns | Corporate mezzanine loans | Hedge funds | Noncore real assets | |
| **CORE FOUNDATION**<br>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

# MPW Concluding Summary

**Uncertainty remains: Can central banks manage a ‘soft landing’ or do they cause a deeper recession?**

***<u>Soft Landing Scenario</u>:* *Markets have priced-in this outcome and believe central banks will cut rates in 2023.***

- Current market valuations don’t leave much room for further upside.
- **This outcome is <u>not our base-case</u>.**


***<u>Recession Scenario</u>:* *Fighting inflation is the Fed’s priority and markets have not priced-in the consequences of this.***

- A deeper recessionary environment means risk assets fall much further.
- **This outcome is <u>our base-case</u>.**


**Portfolio Implications:**

- Be defensively positioned
- Be overweight alternative assets
- Be patient, opportunities will arise


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