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MARKET & STRATEGY UPDATE
FEBRUARY 2024

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tailored your way

MPW Market & Strategy Update – February 2024

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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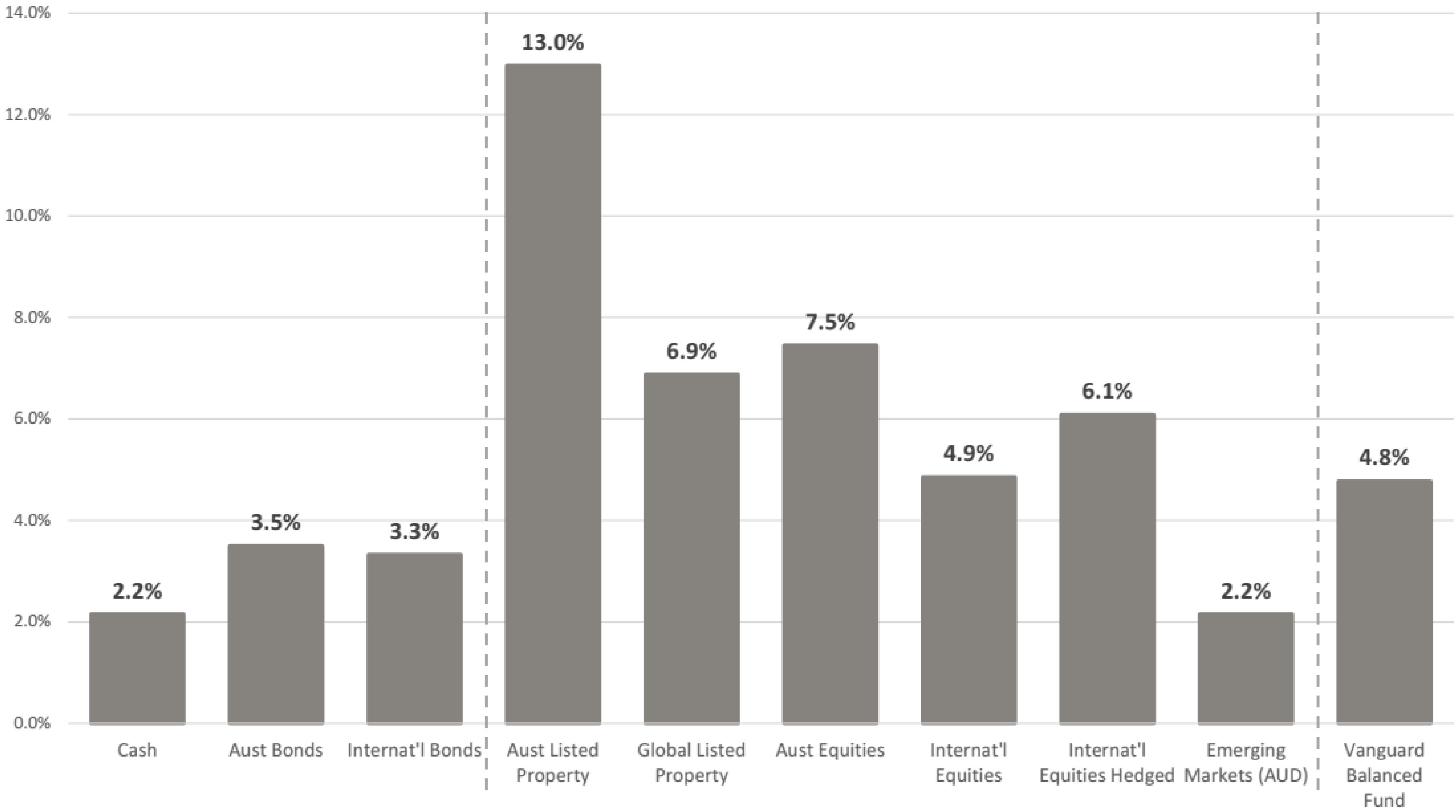
Asset Class Returns 6 Months to 31st December 2023



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Why The Market Proved Resilient In 2023

Despite many uncertainties and headwinds throughout 2023, the global economy and markets proved very resilient. Why?

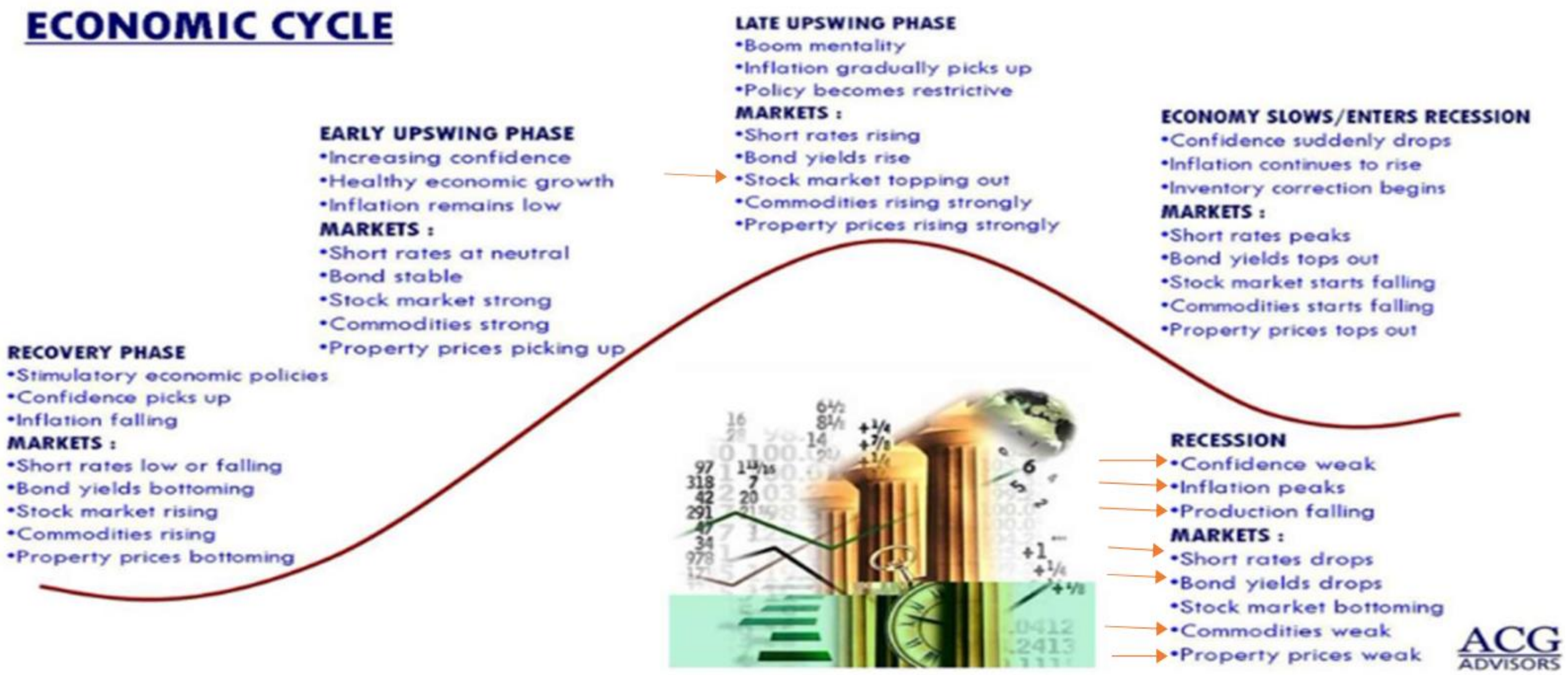
- **Unemployment** remained very low;
- **Inflation** fell from 40-year peak levels;
- **Corporate earnings** were less bad;
- **Consumers** spent their excess savings; and
- **Investor sentiment** improved into year-end as US interest rate cuts were priced-in.

The chart opposite shows the Australian share market down 6% into November before rallying 12% into year-end as sentiment improved.

What will 2024 bring for markets?

source: tradingeconomics.com

A ‘Hard Landing’ or ‘Soft Landing’ Outcome

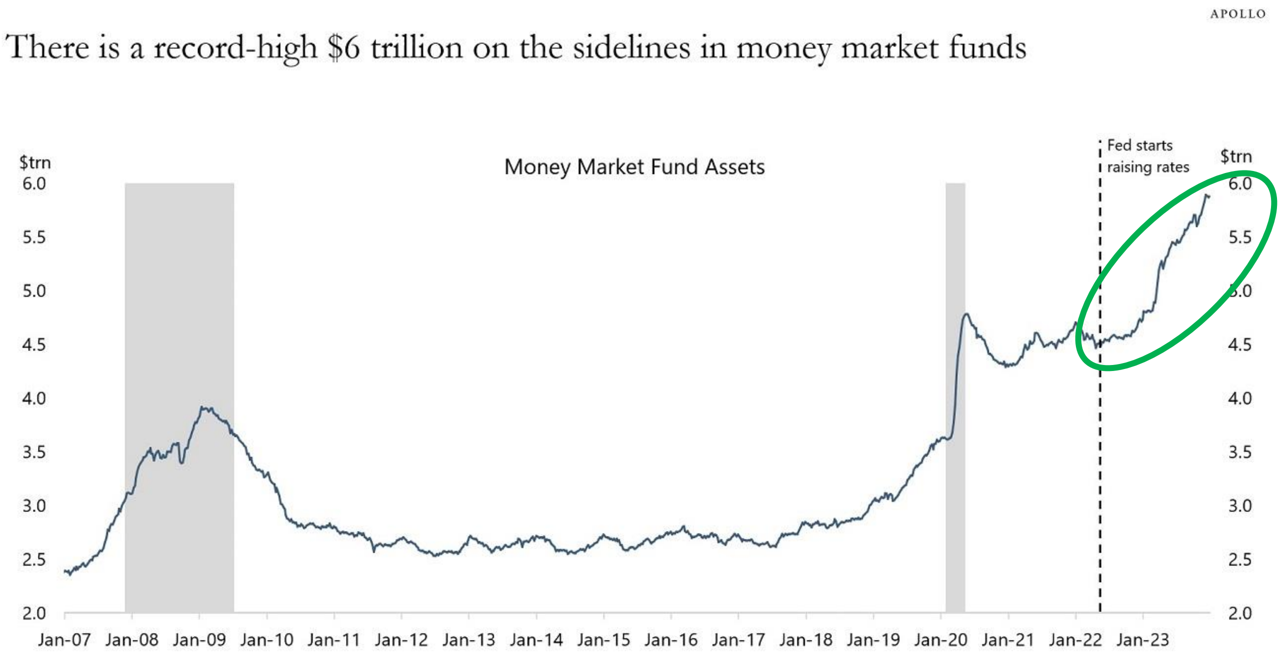


MPW Outlook: 2024 Recession Risks Increase

1. Hard Landing: Global Recession MPW Probability = High	2. Soft Landing: Mid-Cycle Slowdown MPW Probability = Medium	3. Strong Growth: New Bull Market MPW Probability = Low
• Inflation remains stubbornly high	• Inflation moderates towards targets	• Inflation moderates more quickly
• Central banks tighten too much	• Central banks pivot and cut rates	• Central banks cut rates more quickly
• Unemployment rises 1-2%	• Unemployment rises marginally	• Employment growth remains strong
• Savings rates evaporate	• Savings rates are neutral	• Savings rates remain elevated
• Economic data deteriorates	• Economic data stabilises	• Economic data pivots to growth
• Corporate earnings fall further	• Higher revenues offset higher costs	• Companies improve productivity
• Geopolitical risks intensify (wars)	• No further sanctions or conflict	• Geopolitical risks and conflict abates
• Oil price spike magnifies the above	• Supply issues don't spike oil prices	• Oil prices stabilise at lower levels
Markets are <u>not</u> priced for this, expect further decline from here (~-20% plus)	**Markets <u>are</u> priced for this, value can be selectively found at current levels**	**Markets are <u>not</u> priced for this, risky assets will perform very strongly**

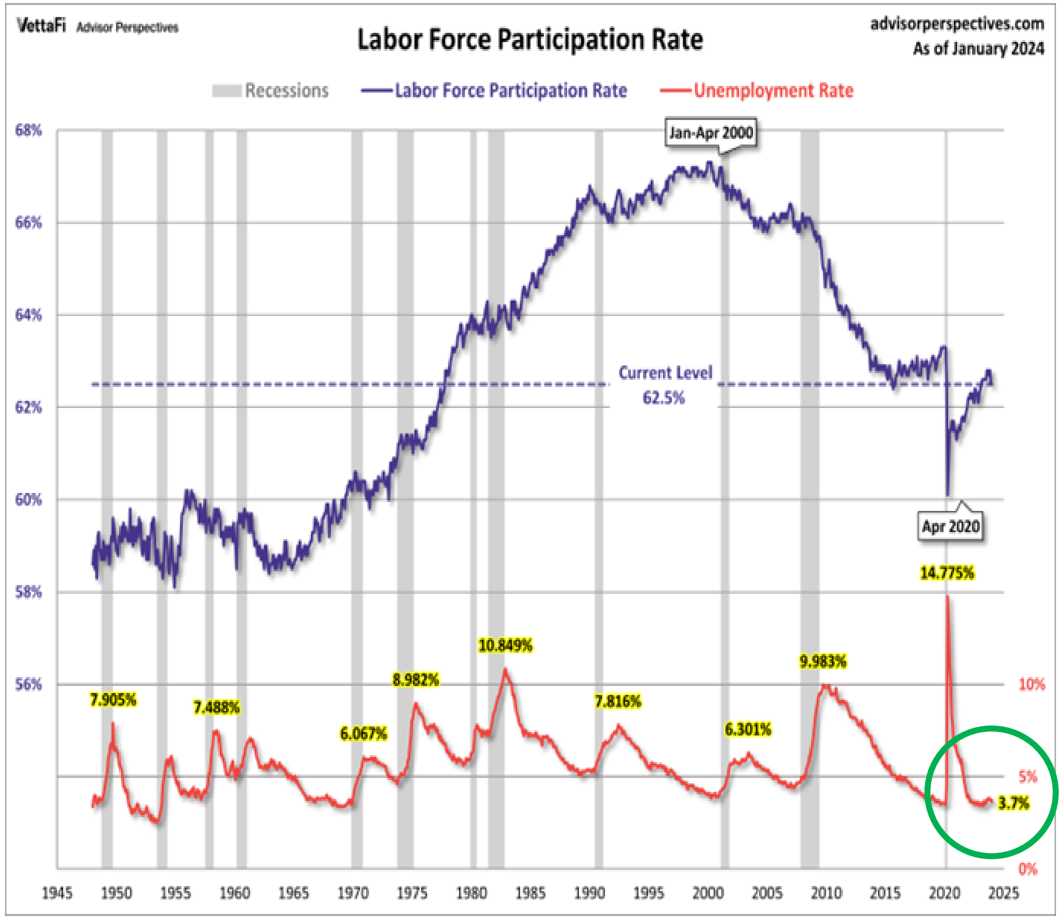
Why We Could Be Headed For A 'Soft Landing'

Since the Fed started raising rates in March 2022, **cash in money market funds** has increased to $6 trillion. If the Fed does start cutting rates get ready for cash to flow back into other asset classes and the economy. Will it be inflationary?



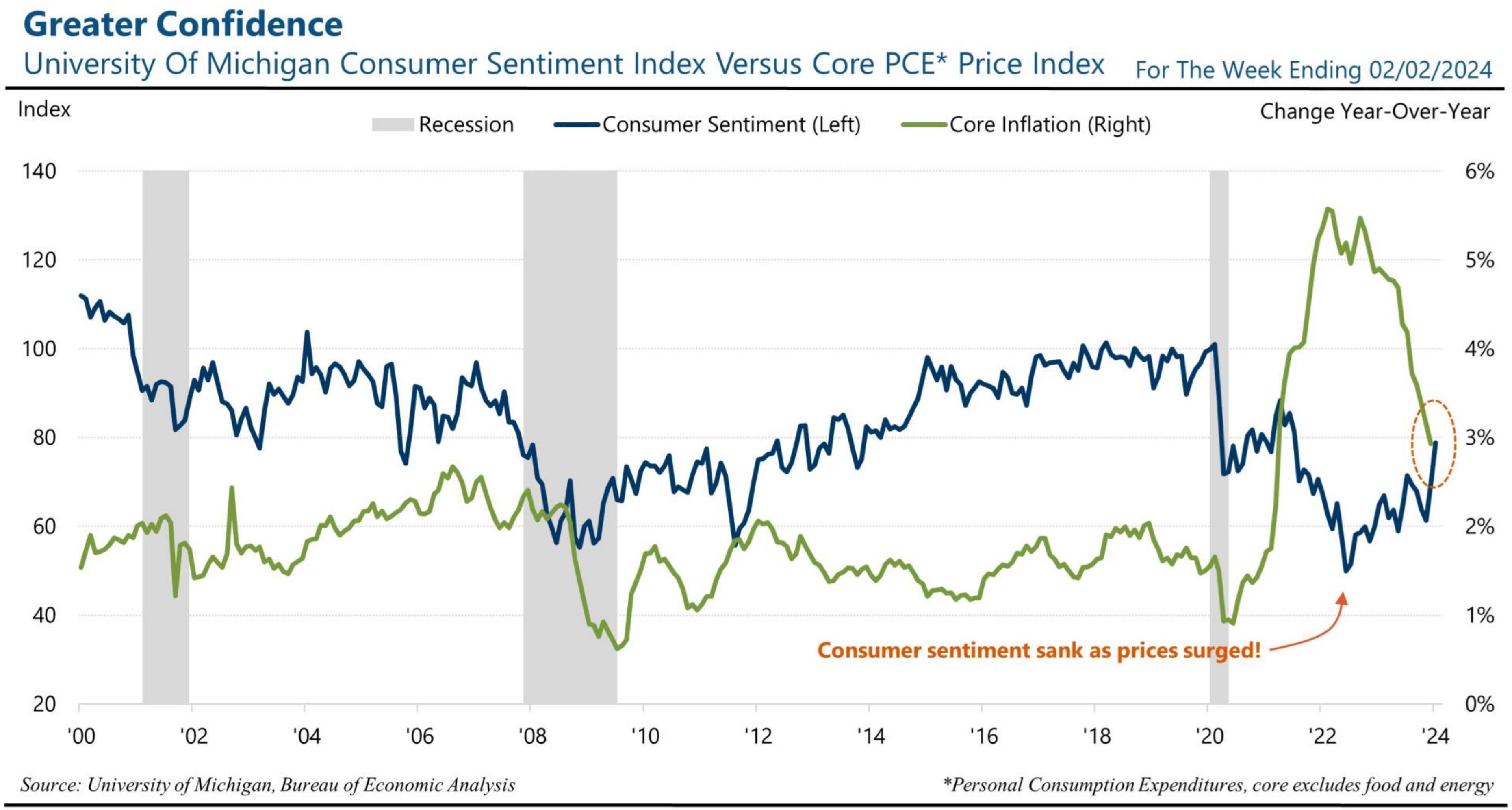
Source: Bloomberg, Apollo Chief Economist (January 2024)

The **US unemployment rate** remains near 50-year lows.



US Consumer Confidence Rising As Inflation Falls

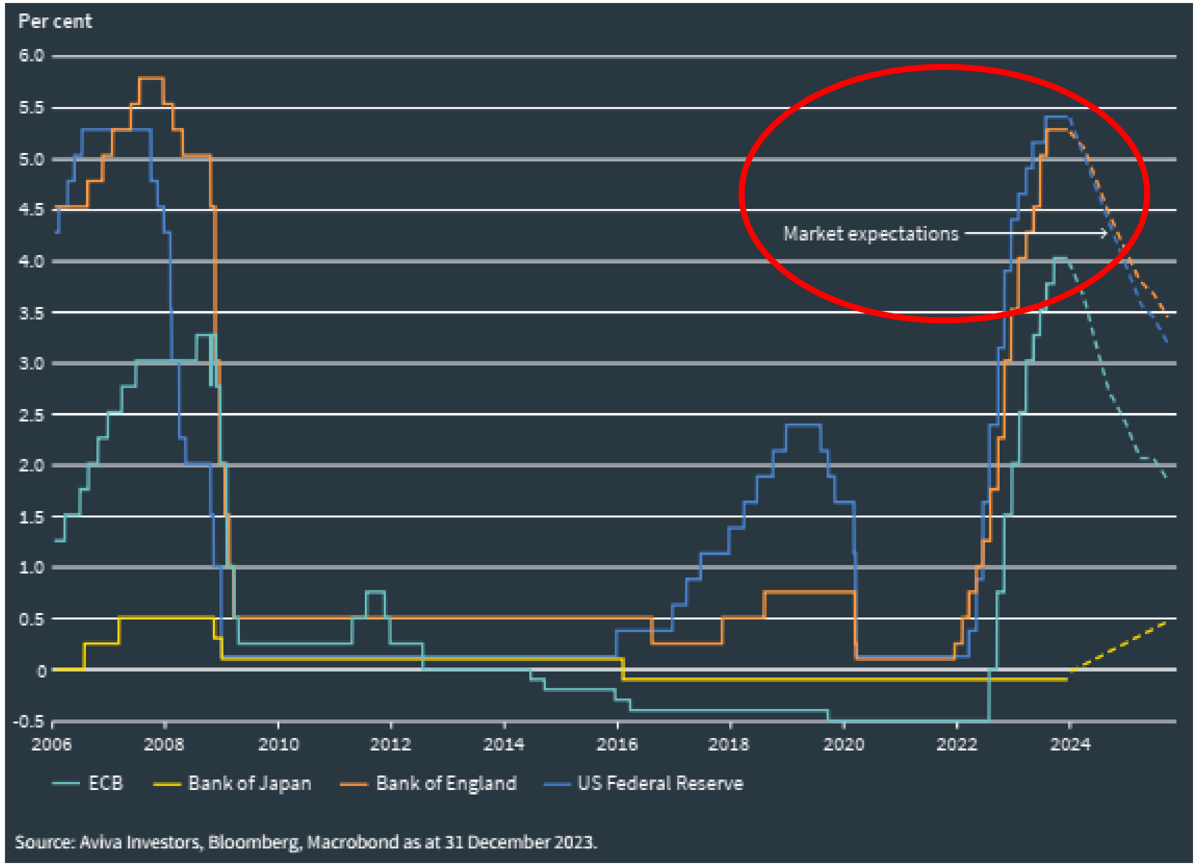
Inflation in the US (green line) is falling and **consumer confidence** (blue line) is rising as a result.

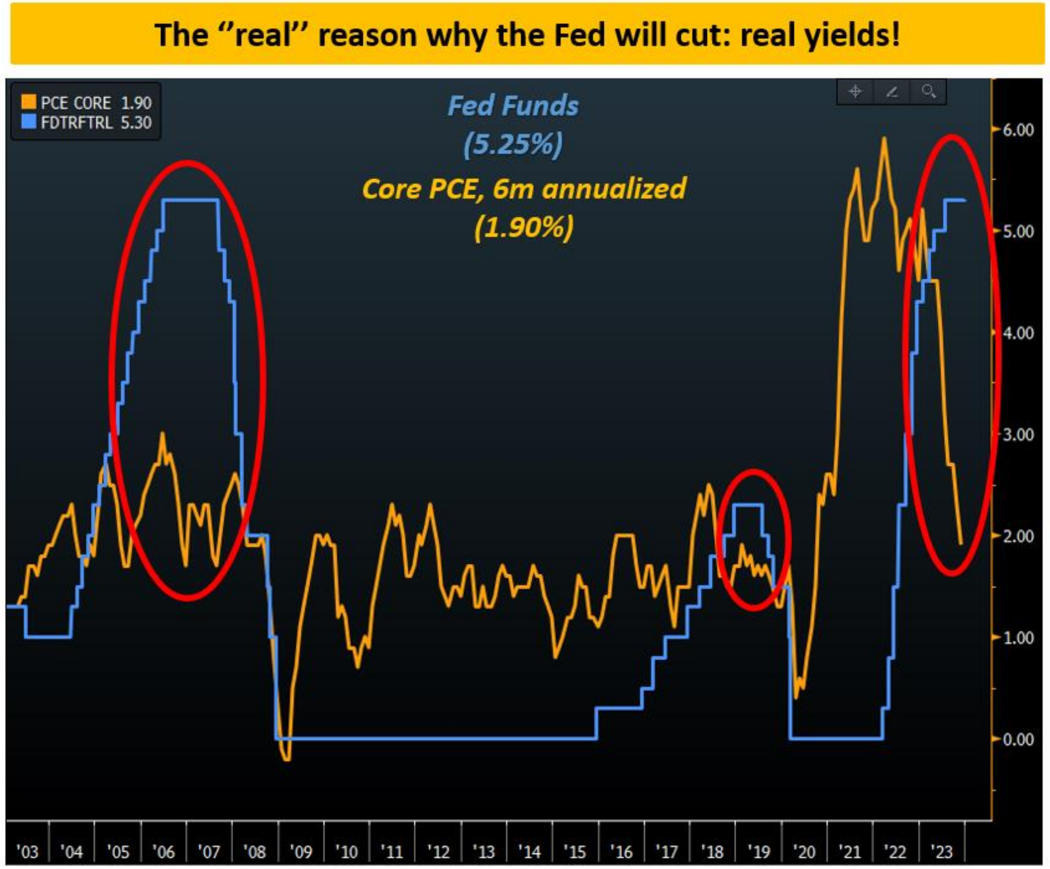


When Will the Fed Cut Interest Rates?

Interest rates may have peaked in this cycle, the question now is when will central banks start cutting rates? Markets are very optimistic about near-term cuts.

Given that **inflation** has fallen a lot since peaking in 2022, **'real yields'** (adjusted for inflation) are now very restrictive. This provides cause for the Fed to start cutting rates soon.

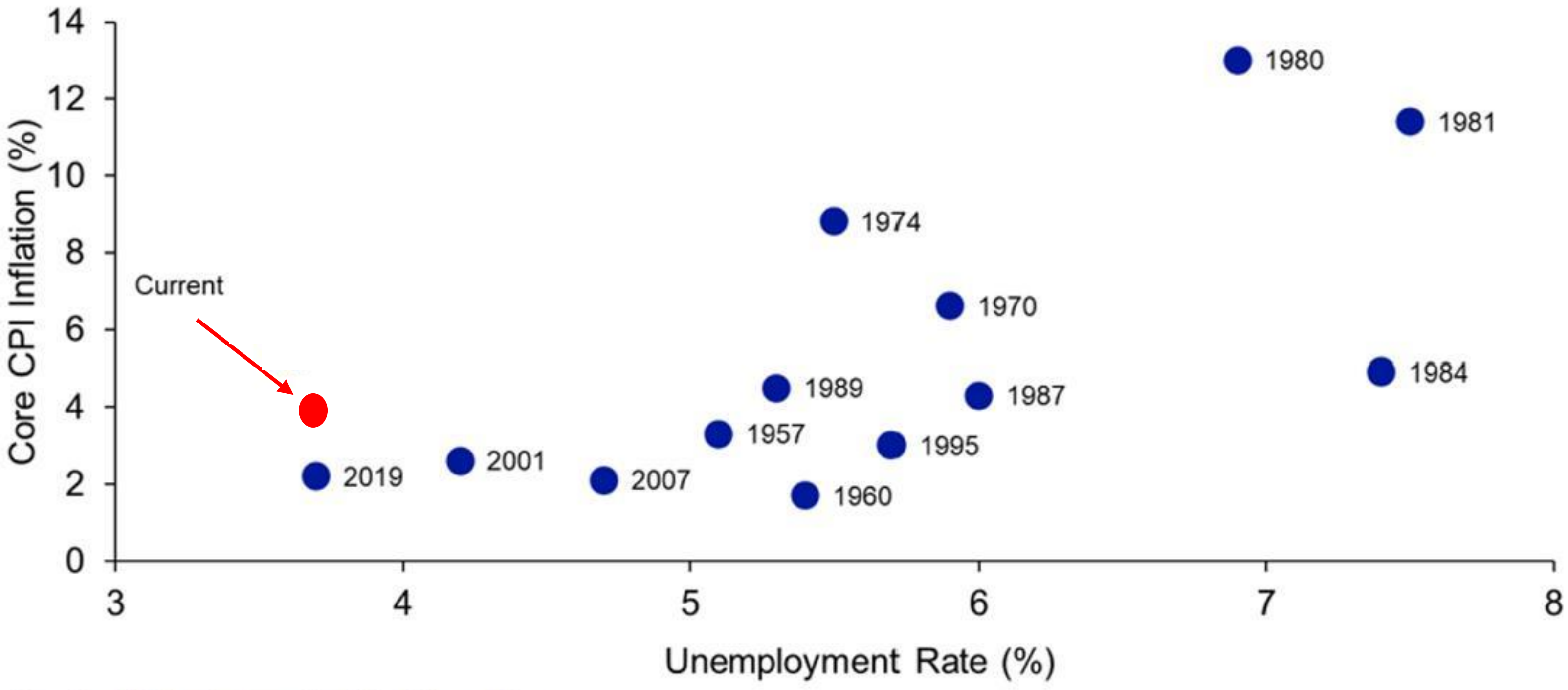




Why Cut Rates When The Economy Is Strong?

Yes, **inflation** is falling and will continue to fall. But why cut interest rates when the economy has **full employment** and inflation is still above the long-term target range of 2%? The Fed may remain cautious on interest rate cuts in H1 2024.

Core US inflation vs. unemployment at first cut in each Fed easing cycle since 1957



Note: For 1957 we have used headline CPI as no Core.
Source: BLS, Bloomberg Finance LP, Deutsche Bank

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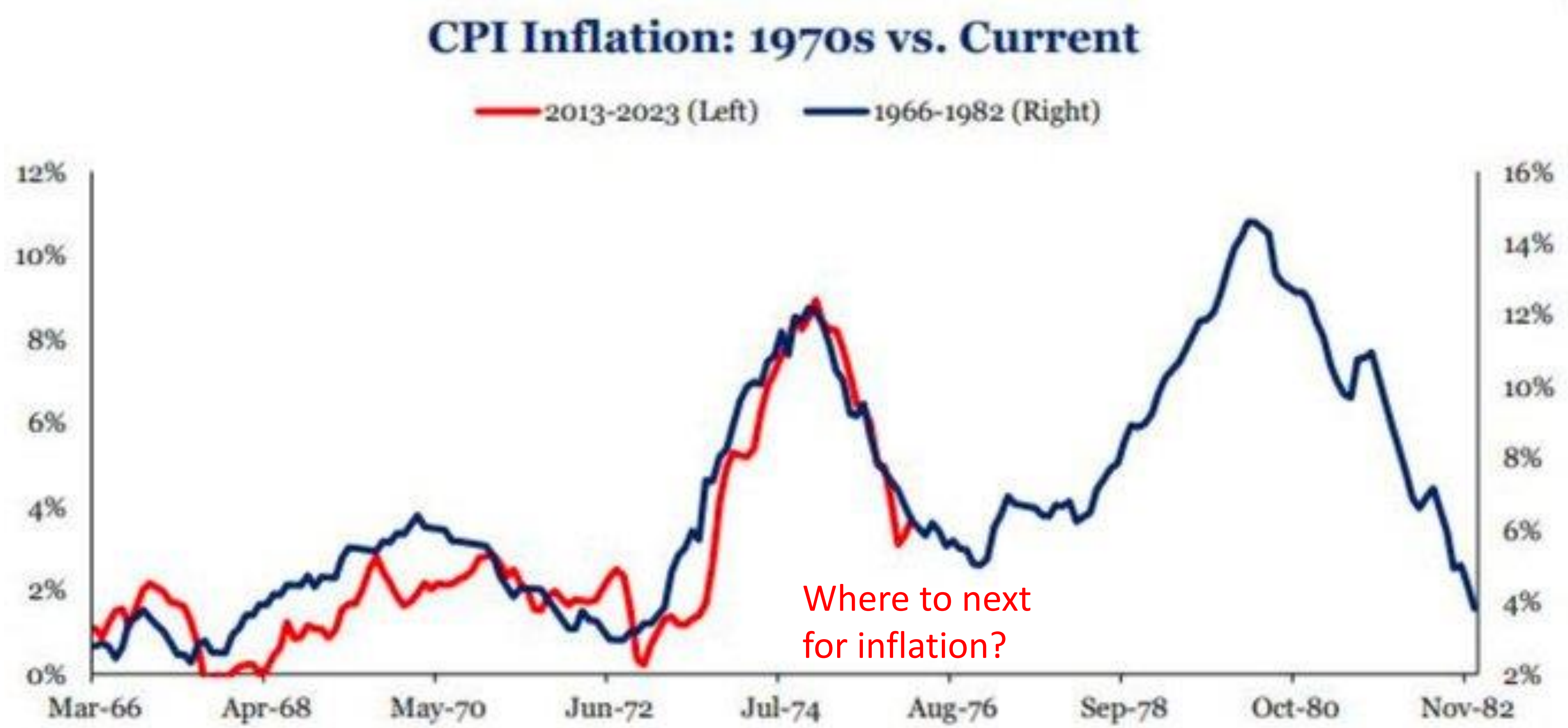
Will Central Banks Repeat The Mistakes of the 1970's

The blue line represents **inflation** from 1966-1982. The red line represents the current inflation cycle overlayed, and yes inflation is falling now, but will central banks risk a second wave of inflation by taking their foot off the tightening cycle now?



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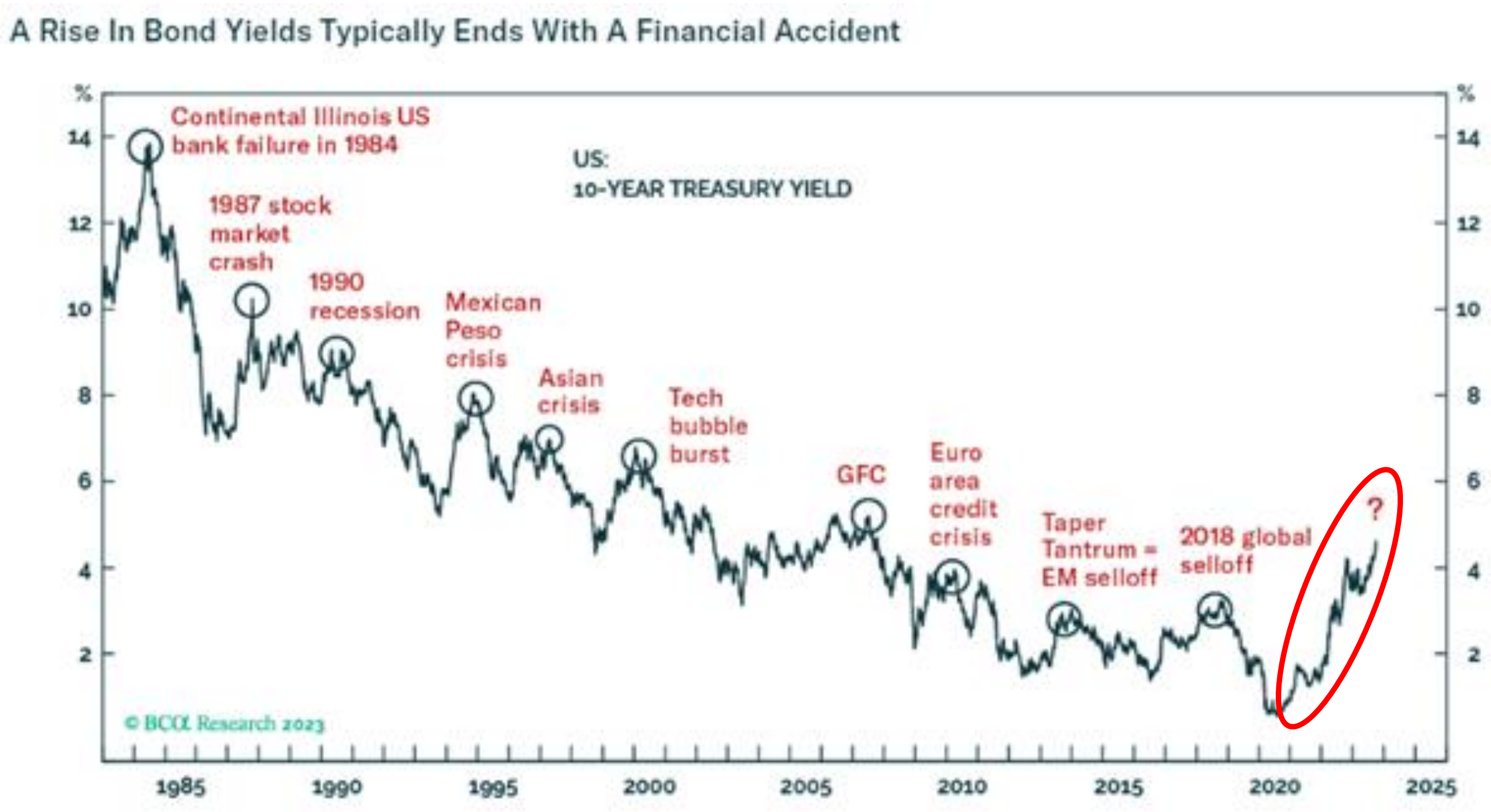
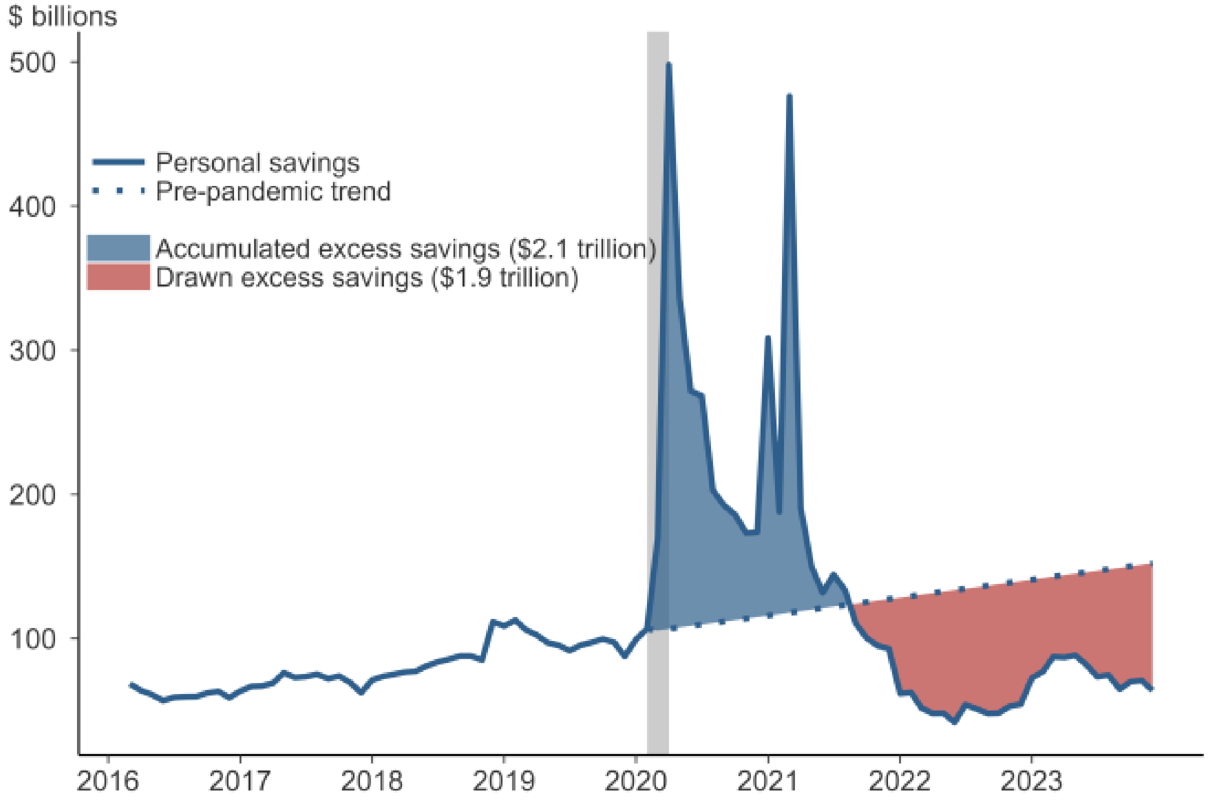
Why We Could Be Headed For A 'Hard Landing'

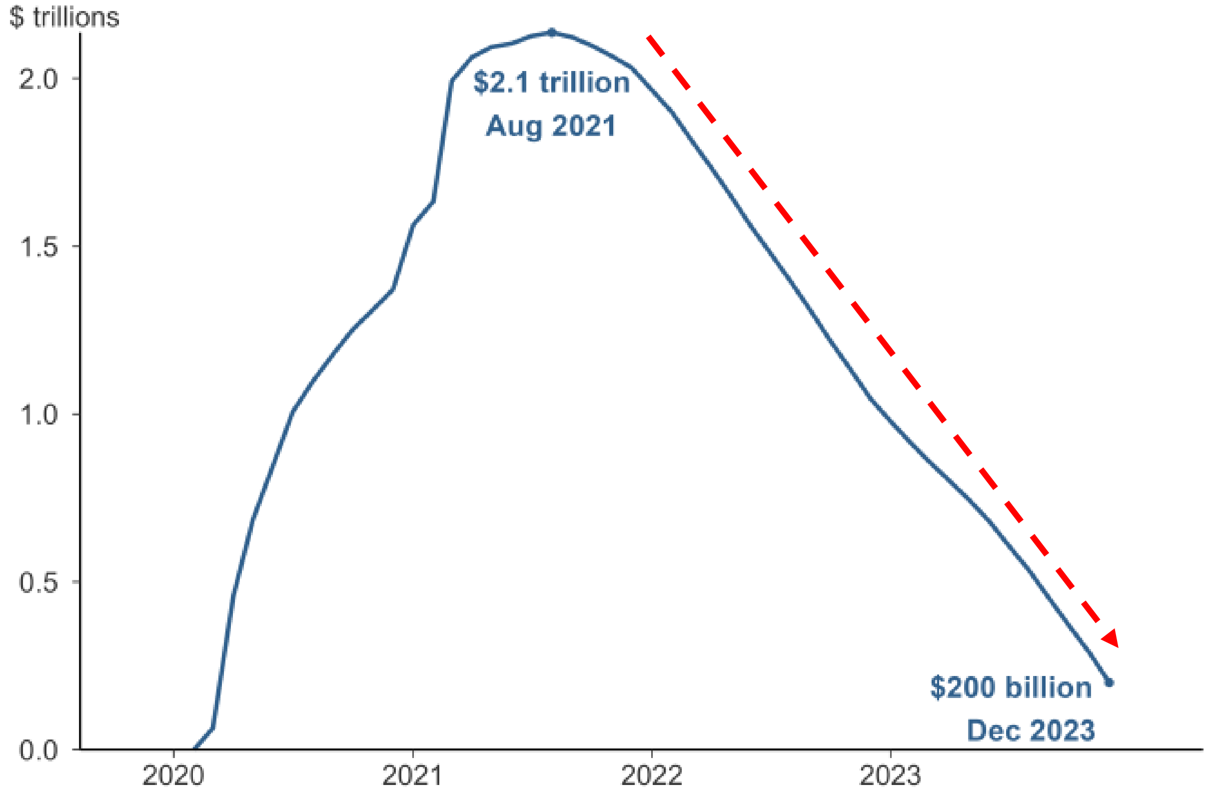
Rising interest rates have historically resulted in market dislocations. After the fastest tightening cycle since the 1980's, why would this time be any different? If the Fed holds interest rates, recession risk increases.



Excess Savings Are Almost Depleted

The **US economy** is driven 70% by consumption, and in recent years consumers have been spending their excess savings and also loading up on credit card debt. This strategy will have consequences in 2024.





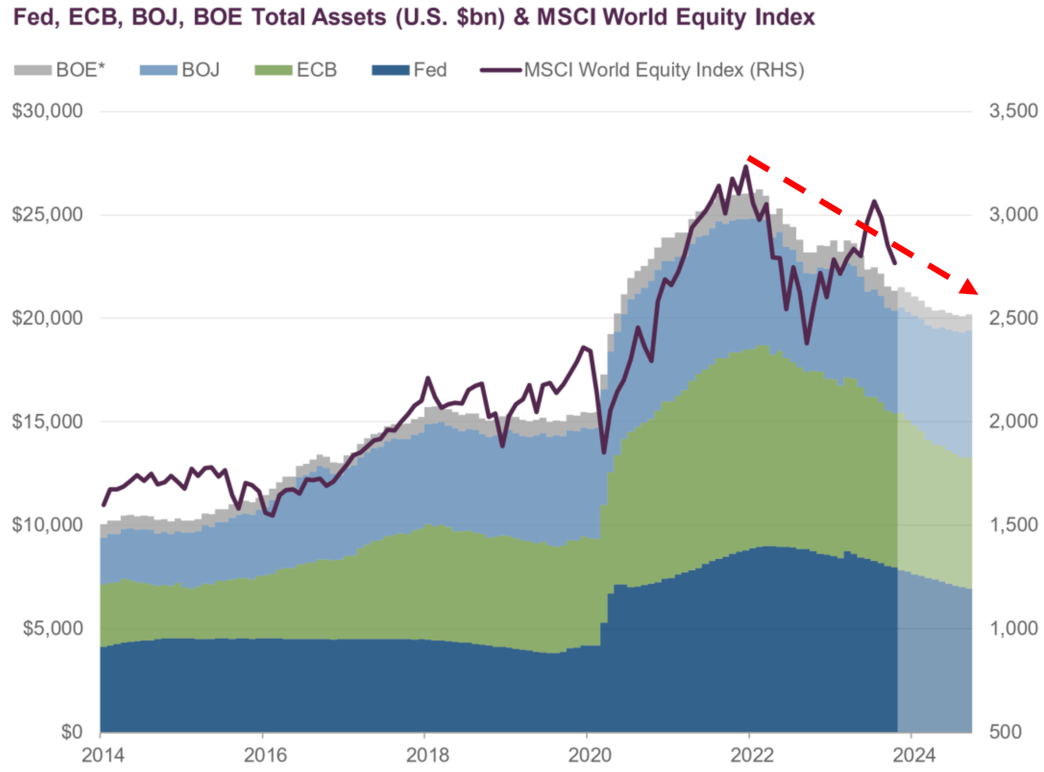
Source: Bureau of Economic Analysis

Credit Is Tightening, Liquidity Is Being Withdrawn

US Bank surveys suggest that **loan growth and loan demand** is already at recessionary levels, so credit is tightening.

Global **central banks** continue to unwind their balance sheets and will stay the course unless a recession unfolds.

Source: Bloomberg

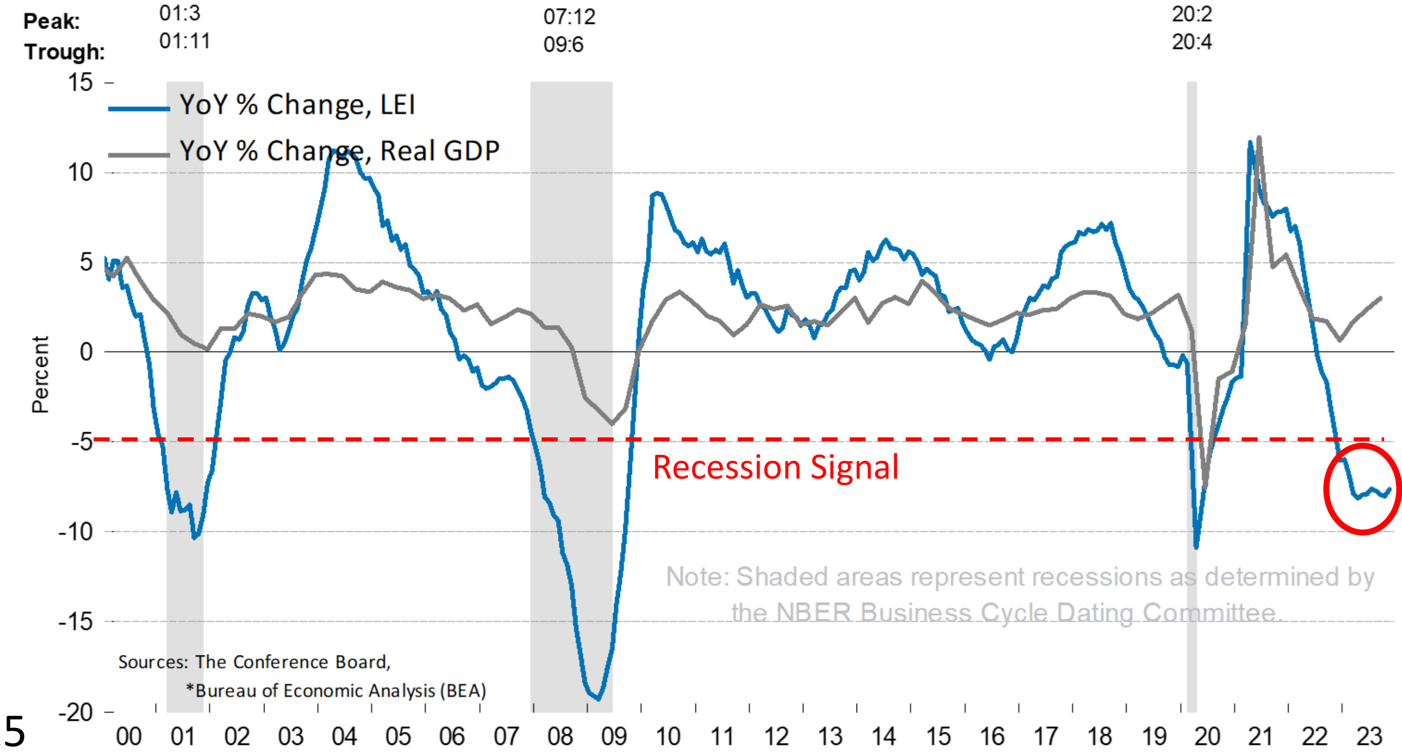


Source: Guggenheim Investments, Haver Analytics. Data as of 11.30.2023. *BOE balance sheet derived from truncated monthly data.

Traditional Indicators Still Point To Recession Ahead

A **negative yield curve** has been an excellent predictor of prior recessions (shaded grey) and is now steepening after being the most inverted since the 1980's, suggesting recession in 2024.

US **Leading Economic Indicators (LEI's)** are priced well below previous recession levels and suggest that GDP growth will turn negative in 2024.



Even A Mild Recession Could Be Painful

In each of the **past recession cycles** since 1871 stocks have declined on average 40%.

Firstly, the yield curve start to steepen (tick), then credit starts to tighten (tick) and before recession hits the Fed cuts rates.

Stocks really start to decline when rates are first cut. Company earnings trough after the recession is declared, marking the cycle low.

Unemployment peaks after recession, by which time stocks are past their low and rallying hard.

This historical playbook is still very early in this current cycle. How will 2024 play out?

Average S&P 500 Returns Around Recessionary Bear Markets Since 1871

Source: BofA Research Investment Committee, Global Financial Data, Bloomberg

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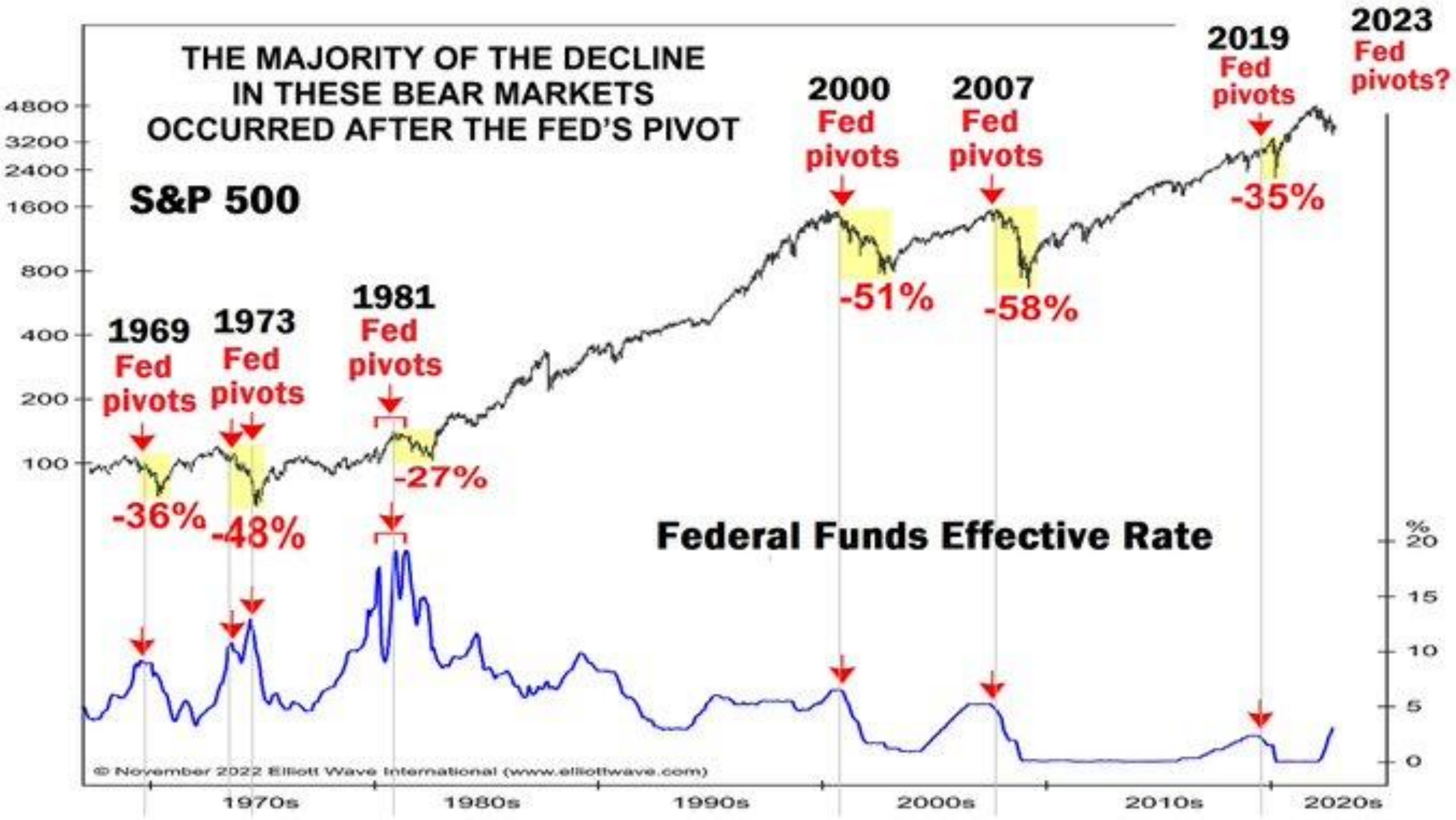
The First Interest Rate Cut May Not Be Bullish?

Despite markets rallying in the hope of **near-term interest rate cuts**, history shows that markets bottom long after the first rate cut. Why? Because the economy is typically entering a recession!



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So What Does This Mean For Markets?

Markets are priced for rates cuts in the very near term. If this happens then a recession may be avoided but we do have concerns about inflation making a comeback in 2024.

Early Fed Pivot = No recession, but a bumpy ride
Action: Selectively buy assets

In our view it will be very difficult for central banks to manage a soft-landing and avoid a recession as interest rates will be on pause for longer than markets expect.

Fed On Pause = A hard landing and Recession
Action: Stay defensively positioned

MPW Asset Consultant Macro View

- Our economic cycle clock has changed notably with 7 arrows in recession, 1 arrow in late upswing phase, suggesting that recession risk may be more imminent within 3-6-9mths rather than off in the distance.

- Our cycle matrix forecasts recession. We continue to see recessionary lead indicators which should be joined by lagging indicators (GDP, Unemployment) weakening in 2024. This suggests recession timing is coming closer.

- Our growth vs defensive asset scorecard stays at 35/36, this is the equal highest rating in 6 years and says sell equities.

- Our Equity technical timing tool stays near the highs at 46/48 and suggests reducing equity weights. This measure is now the equal most bearish, rising to levels only seen in Q4 2021 and Q4 2019, and suggests imminent correction.

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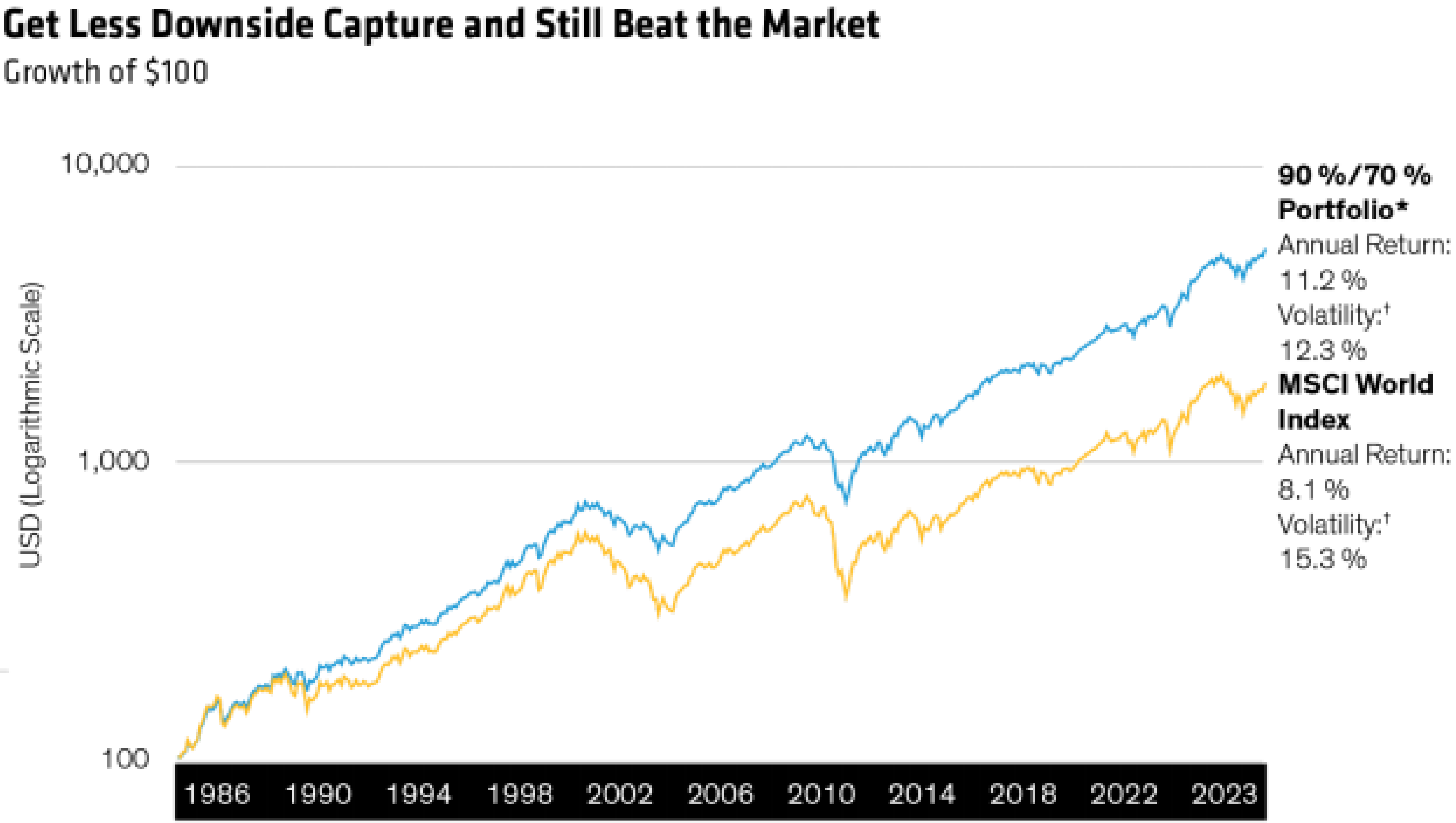
MPW Recommended Portfolio Strategy

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	Peak rates at ~4.3-4.5%, hold cash for better buying opportunities in second half of 2024
Government Bond Duration	Neutral	Long-duration yields are at attractive levels for recession, but we prefer private debt
Corporate Credit & Debt	Underweight	Listed credit will fall further into recession, but selective private credit is very attractive
Listed Property & Infrastructure	Underweight	Listed property is 'relatively' cheap but high risk, prefer to own selective unlisted assets
Listed Australian Shares	Underweight	Fair value, retain quality value bias, underweight small caps now ready to rotate into
Listed International Shares	Underweight	Not cheap, particularly the US, Emerging Markets are cheap but cautious into recession
Liquid Alternative Assets	Overweight	Selective hedge funds, 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

MPW Philosophy on Downside Protection



*Performance calculated by multiplying all positive monthly returns (0% or greater) of the MSCI World Index by 90% and all negative returns (less than 0%) by 70%; shown in logarithmic scale
†Annualized standard deviation
Data from March 31, 1986 (inception date MSCI World Index), through June 30, 2023
Source: MSCI and AllianceBernstein (AB)

Strategies that can limit downside capture (exposure to falling markets) while still participating in most market gains are the premise of MPW's investment philosophy.

The hypothetical 90%/70% portfolio would generate annual returns 3.1% higher than the MSCI World Index over this period, with less volatility.

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Vanguard Long-Term Portfolio Return Expectations

The Vanguard Capital Markets Model **return and volatility forecasts over the next 10 years** are shown below along with the Vanguard Benchmark **actual returns** for the prior 10-year period (pa) ending 31st December 2023.

	Forecast 10-Year Return Percentile					Volatility	Prior 10-Year Return
	5th	25th	Median	75th	95th	Median	Actual
Conservative	3.5%	4.8%	5.7%	6.7%	8.1%	5.7%	4.7%
Balanced	2.8%	4.8%	6.2%	7.6%	9.7%	8.8%	6.3%
Growth	1.8%	4.5%	6.4%	8.4%	11.2%	12.3%	7.7%
High Growth	0.7%	4.0%	6.5%	9.0%	12.7%	16.0%	9.1%

Source: Vanguard, November 2023

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.

Commercial Property Remains High Risk

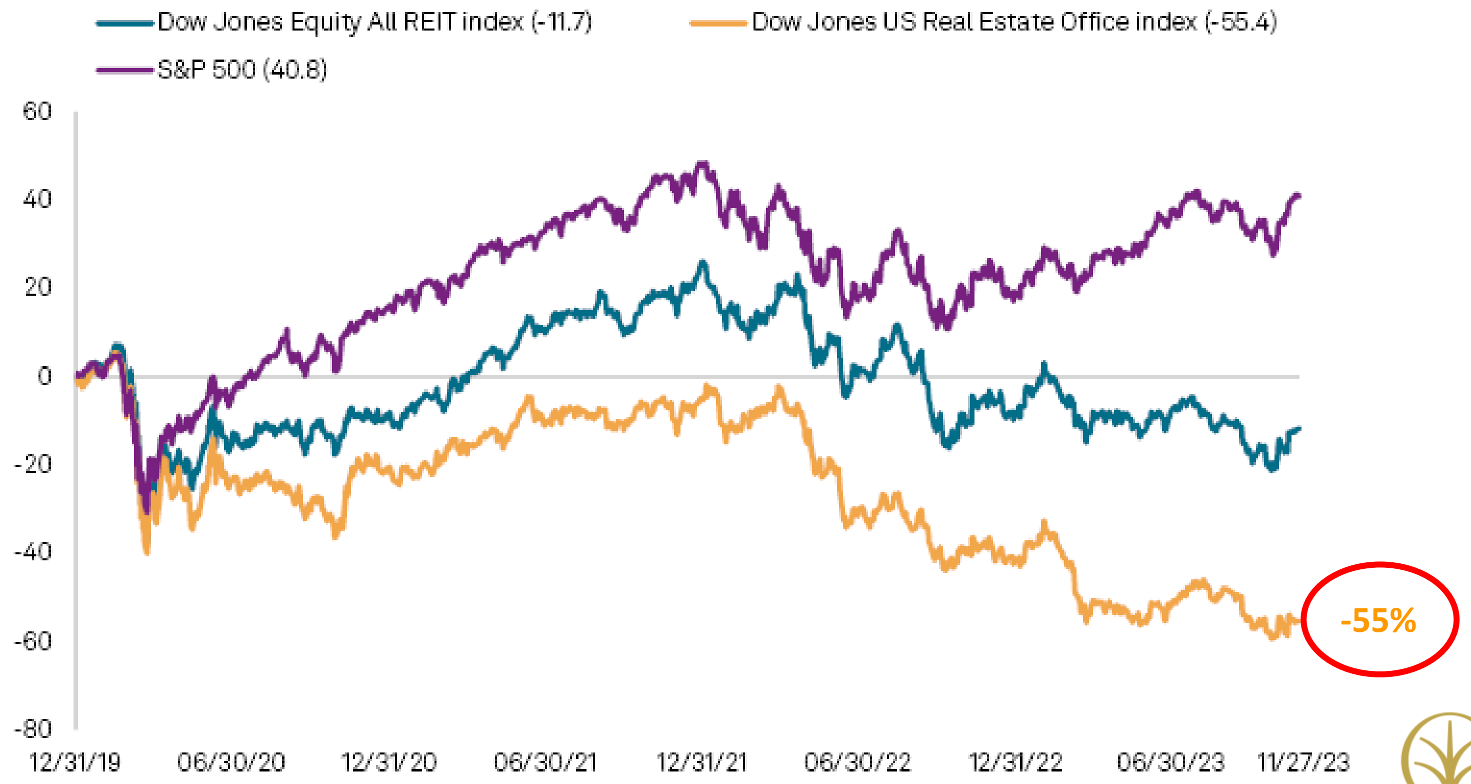
Whilst **US listed property** prices have collapsed throughout 2022-23, price discovery in unlisted property markets hasn't happened yet.

We remain cautious of valuations and US regional bank exposure to these assets.

The **same applies in Australia**, so whilst listed property looks cheap, we believe that it is for good reason and will not invest yet.

Office REIT share prices trading drastically down from pre-pandemic levels (%)

Index price change from Dec. 31, 2019, to Nov. 27, 2023



Data compiled Nov. 28, 2023.

Source: S&P Global Market Intelligence.

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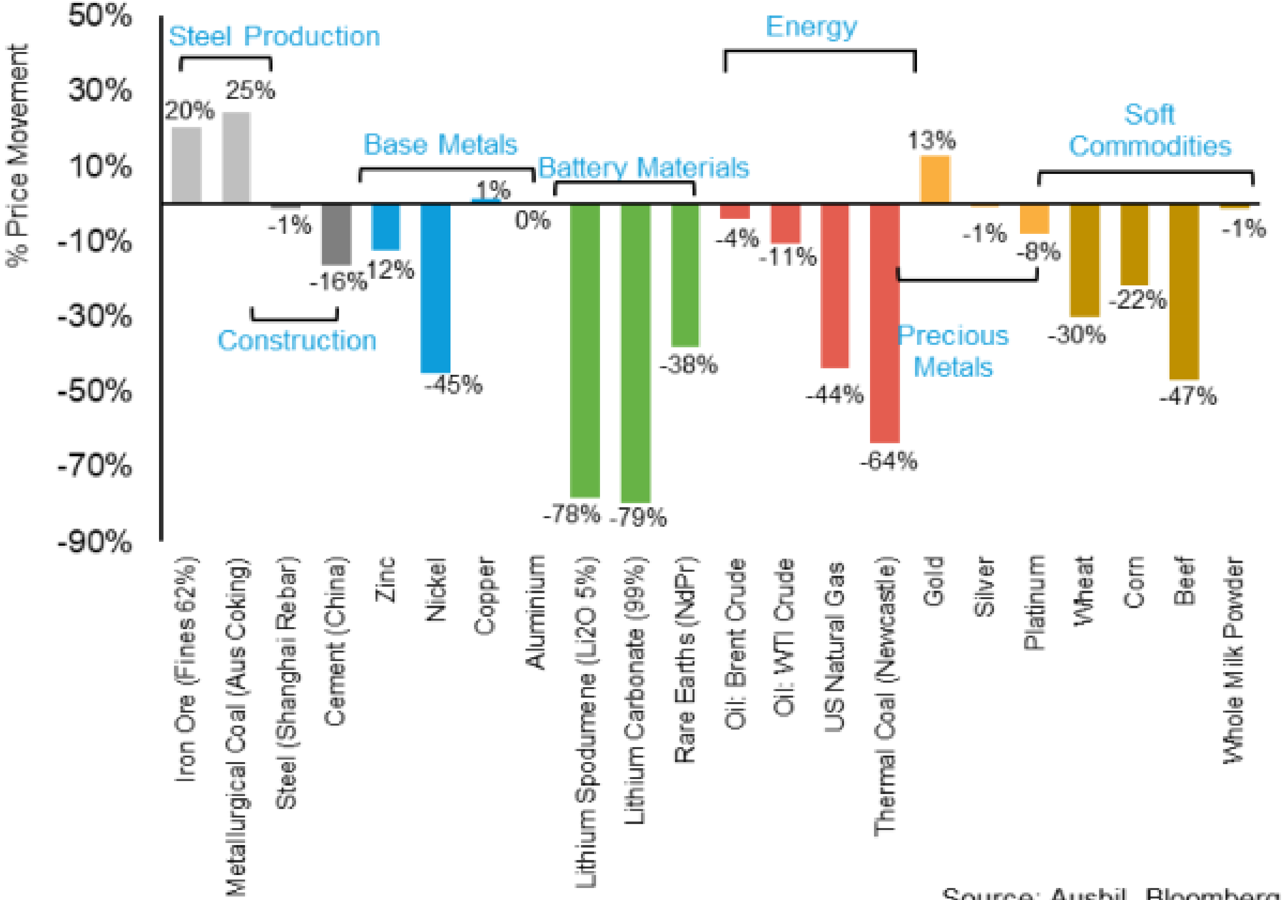
Commodity Returns Already At Recession Levels

Most **commodity markets** were smashed in the **2023 calendar year** (below) and we believe that a commodity super-cycle will develop on the back of demand-supply issues as we move out of recession in 2024.



Source: Ausbil, Bloomberg

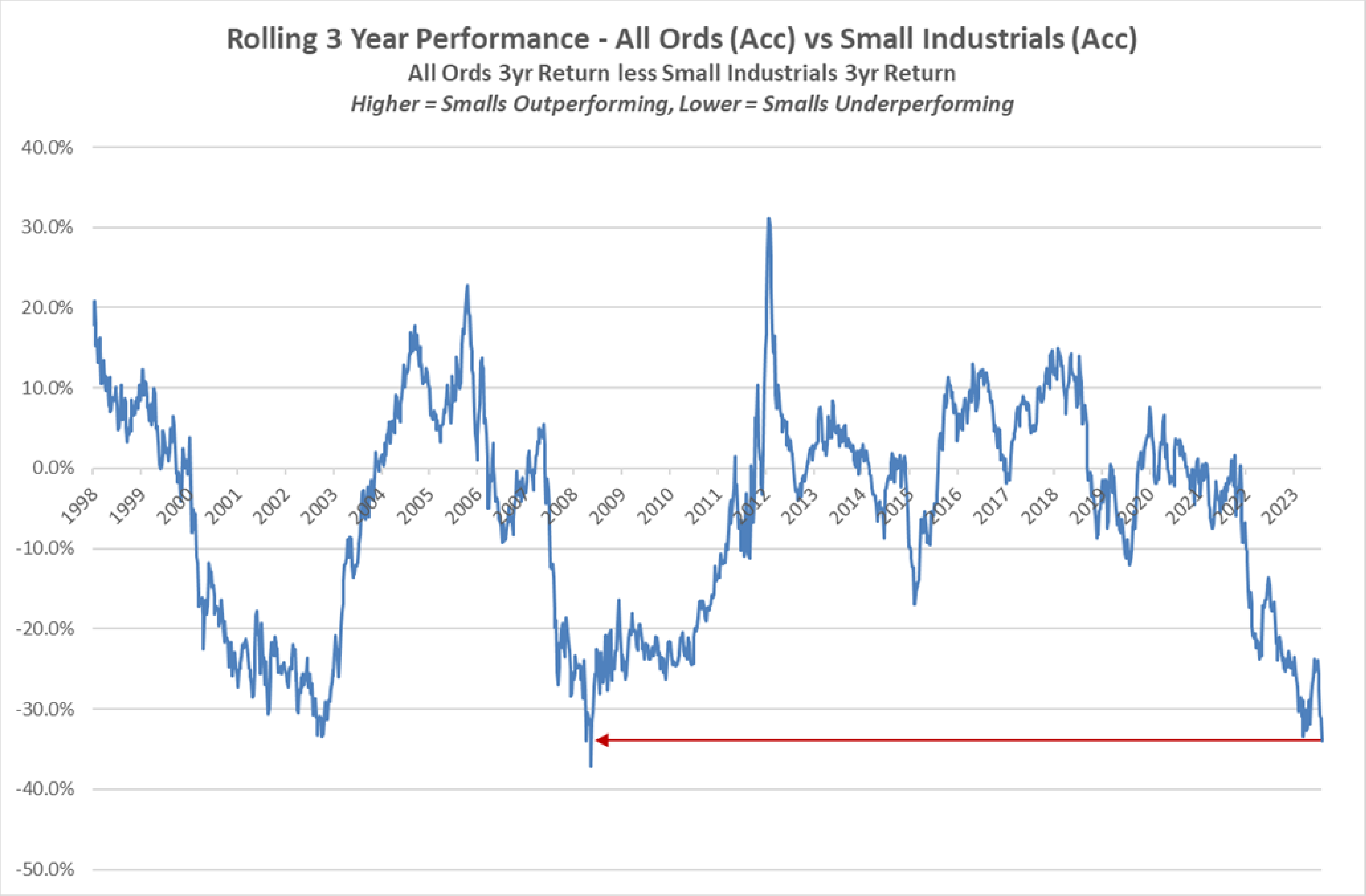
Commodities will likely be a key thematic for MPW moving through 2024.

Small Cap Stocks More Attractive Than Large Caps

The **ASX Small Industrials Index** has underperformed the broader ASX market by the most since the 2009 GFC.

When will mean-reversion present opportunities in small cap stocks?

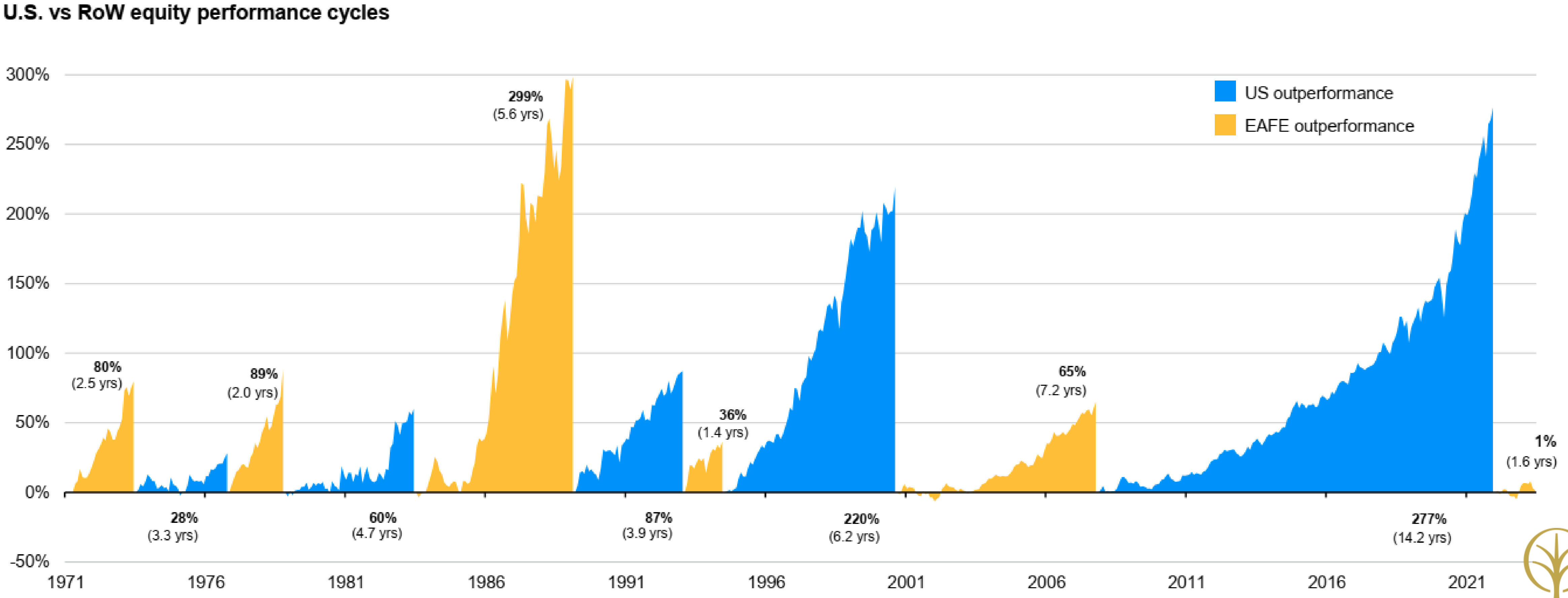
On a relative value basis we **favour small caps over large caps** both in Australia and globally.



Source - E&P Financial Group

Can US Equities Continue to Outperform?

US Equities have driven significant outperformance compared to the rest of the world equities. Can it continue?

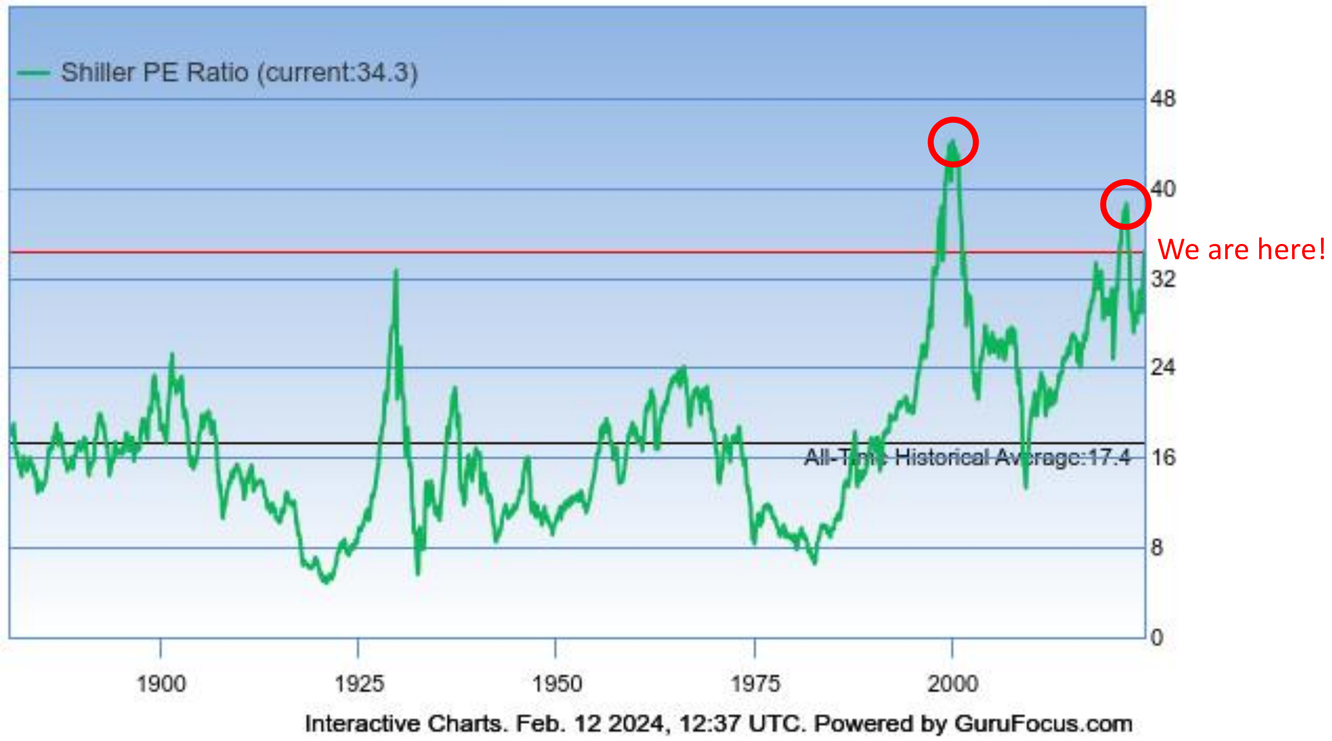


Source: LSEG Datastream, MSCI, S&P Global, J.P. Morgan Asset Management. New cycle starts after more than one year of outperformance. Past performance is not a reliable indicator of current and future results. Data as of September 2023.

The US Is Expensive & Risk Premiums Are Low

The **Shiller PE Ratio** in the US is 34.3x and it has only been more expensive twice in the last 145 years – 2000 & 2021.

This suggests that future returns will be low for US equities.



The **US Equity Risk Premium** is at a 23-year low, so investors are not being compensated for taking equity risk over risk-free bond market risk. The only worse time was the peak of the tech boom in 2000.

Source: BofA Global Investment Strategy, Bloomberg

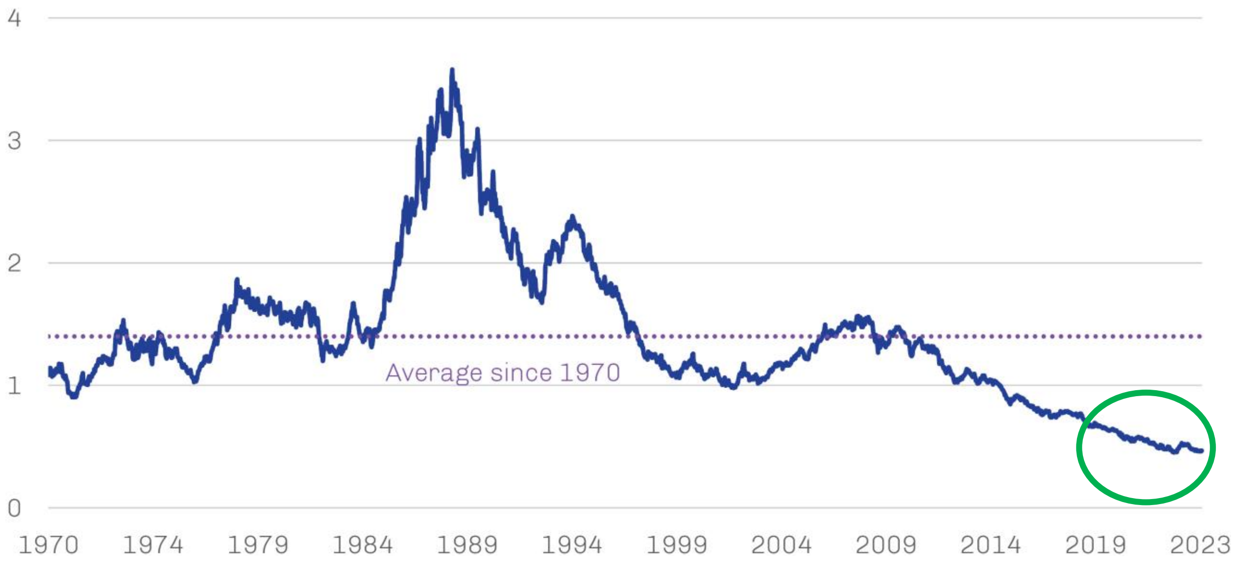
Global Equities – A Rotation Ahead?

US Growth stocks appear stretched relative to Value stocks, most of which is multiple expansion given their revenue growth difference is only 2% pa. What changes this?

The MSCI EAFE Index is trading at a 50-year low relative to the S&P 500 Index. When will mean-reversion present opportunities in value and non-US stocks?

Price Ratio of Russell 1000 Value Index to Russell 1000 Growth Index

Price Ratio of MSCI EAFE Index to S&P 500 Index



Source: Bloomberg; data as of December 31, 2023.

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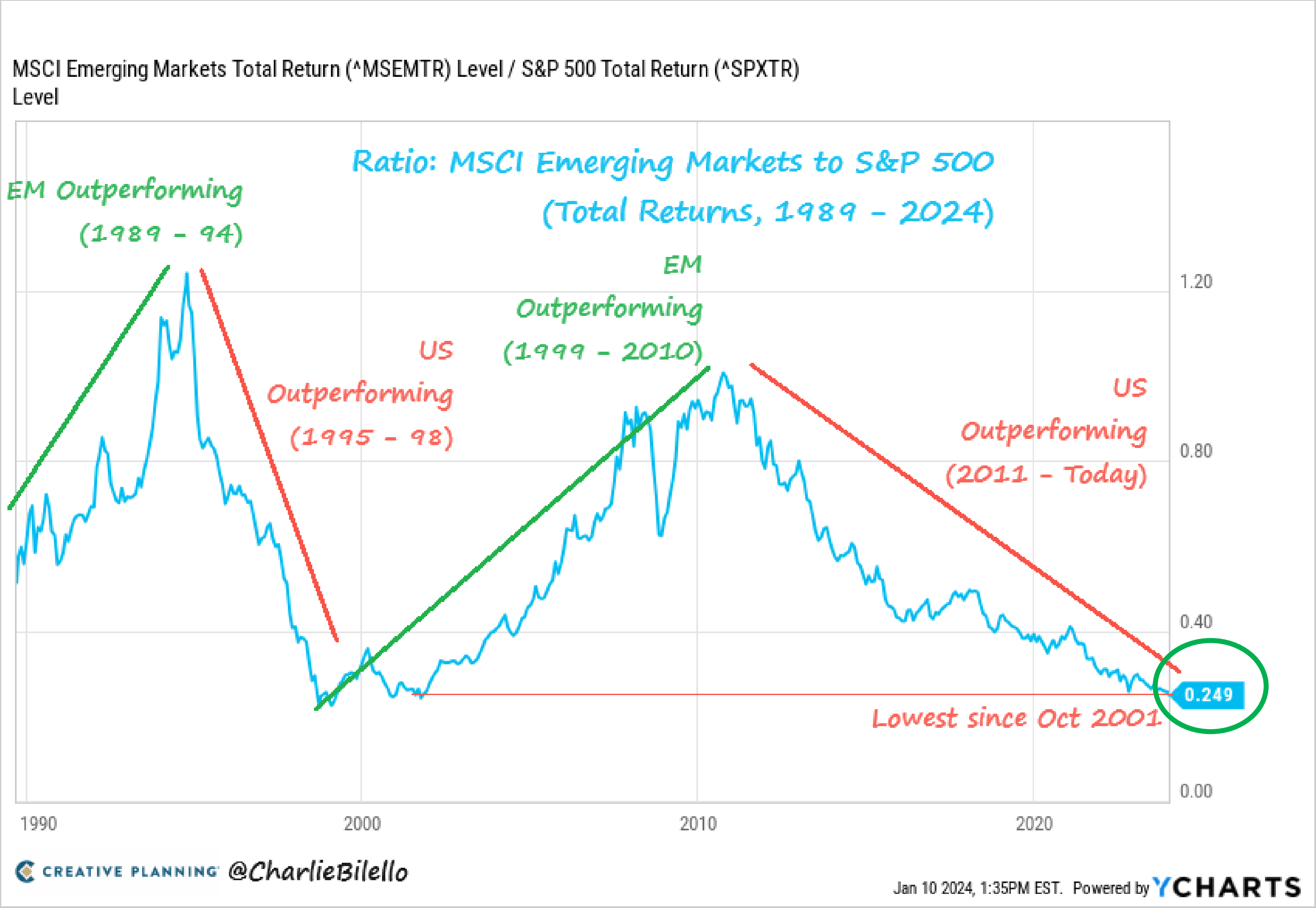
Emerging Markets Are Attractive On A Relative Basis

A peak in the USD is likely to see increased capital flows into EM's.

Whilst India looks expensive it is for good reason, and the rest of **EM is cheap** compared to the US and developed markets.



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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 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 a recession environment

Source: JP Morgan Asset Management Alternative Solutions Group & MPW

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Private Credit Characteristics

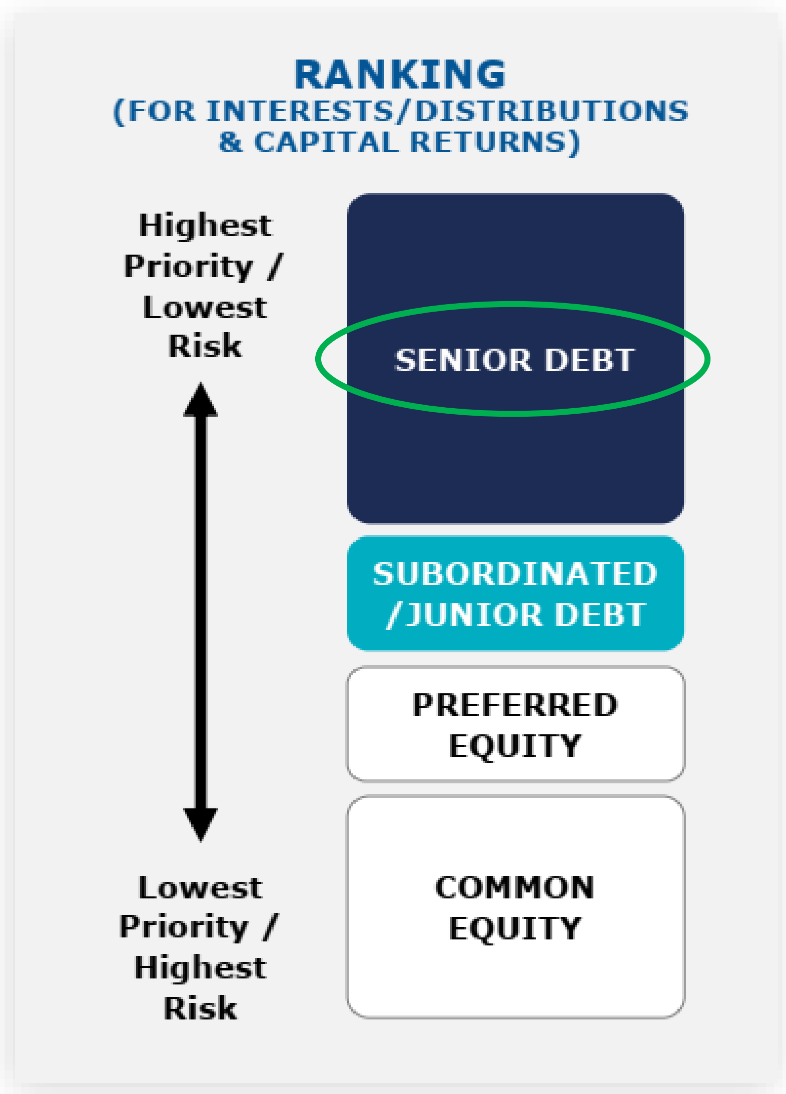
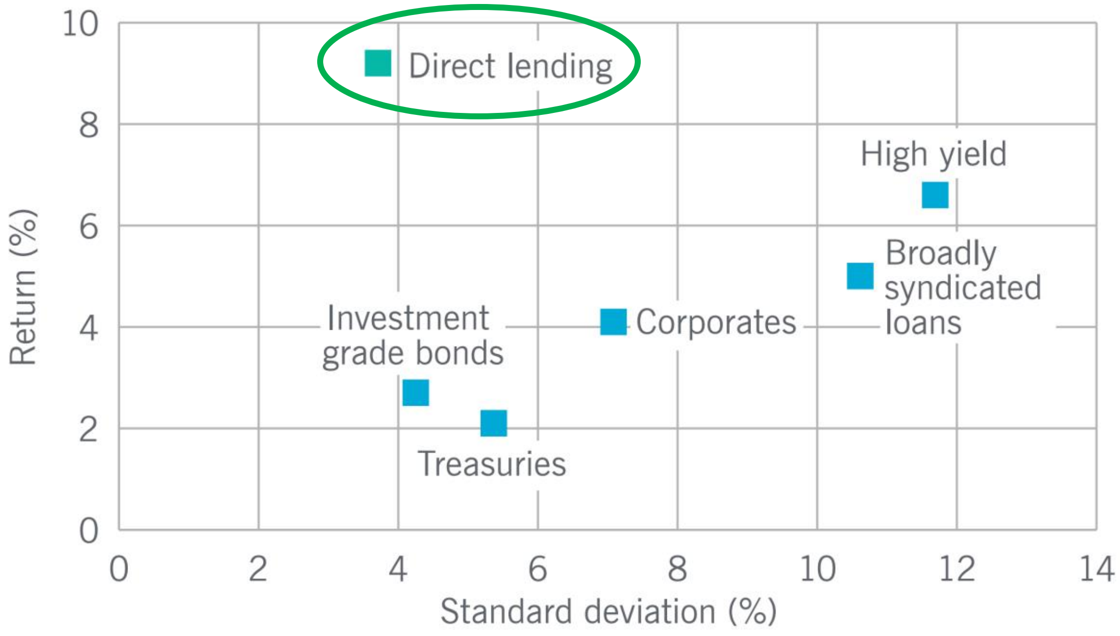


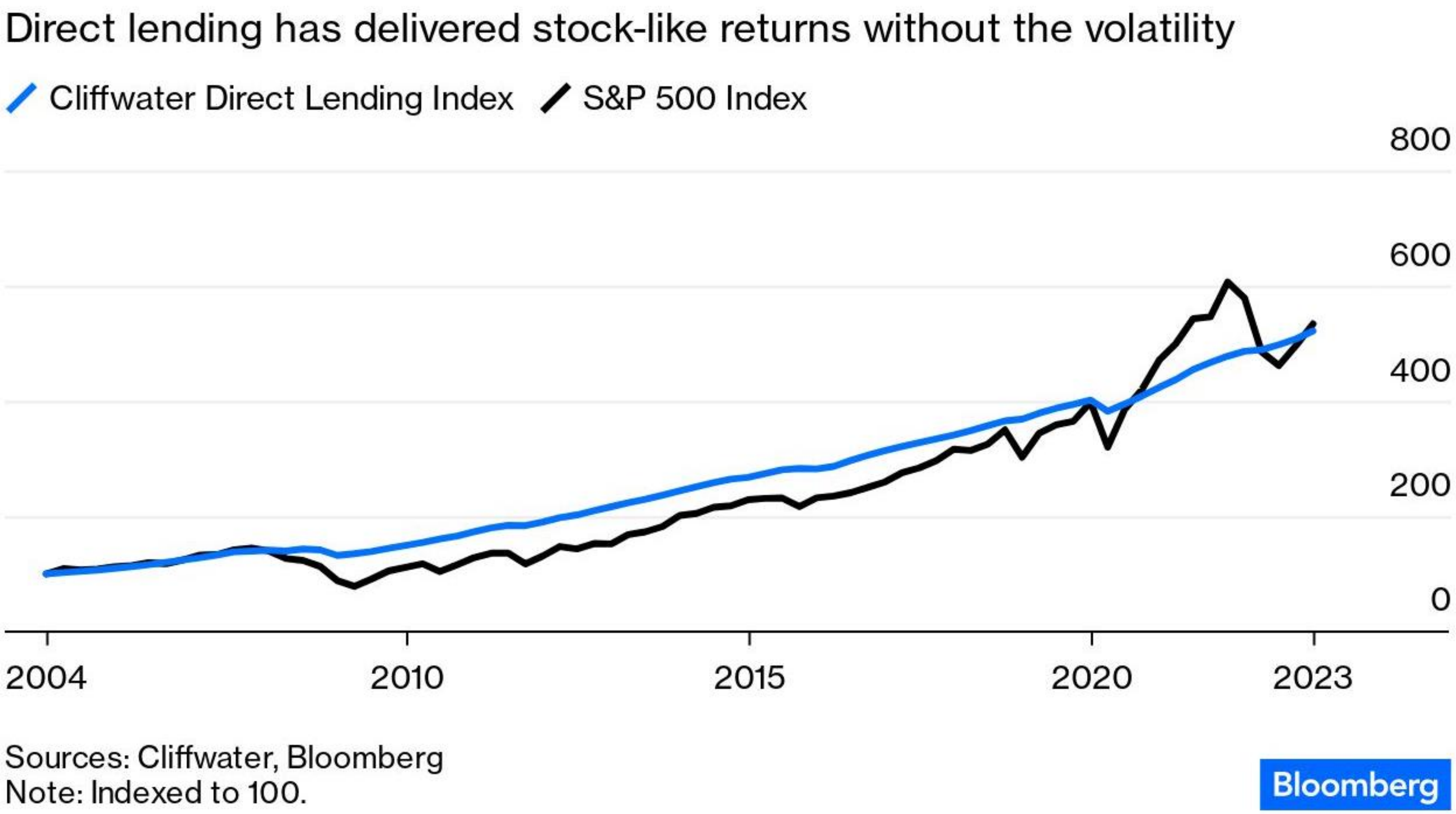
Figure 10: Direct lending risk / return analysis (10 years)



Data source: "Direct Lending" is represented by the Cliffwater Direct Lending Index. "Broadly Syndicated" is represented by the Morningstar LSTA US Leveraged Loan 100 Index. "High Yield" is represented by the Bloomberg US Corporate High Yield Total Return Index. "Corporates" is represented by the Bloomberg US Corporate Bond Index. "Investment Grade Bonds" is represented by the Bloomberg US Aggregate Bond Index. "Treasuries" is represented by the Bloomberg US Treasury Index. Data presented is as of 1Q 2023. Past performance does not guarantee future results.

Private Lending - Equity Like Returns, Lower Risk

Private lending (debt) strategies are now yielding 9-10% pa with income paid monthly/quarterly. These are equity-like returns, without the volatility and with the protection of being senior secured. This is very compelling.



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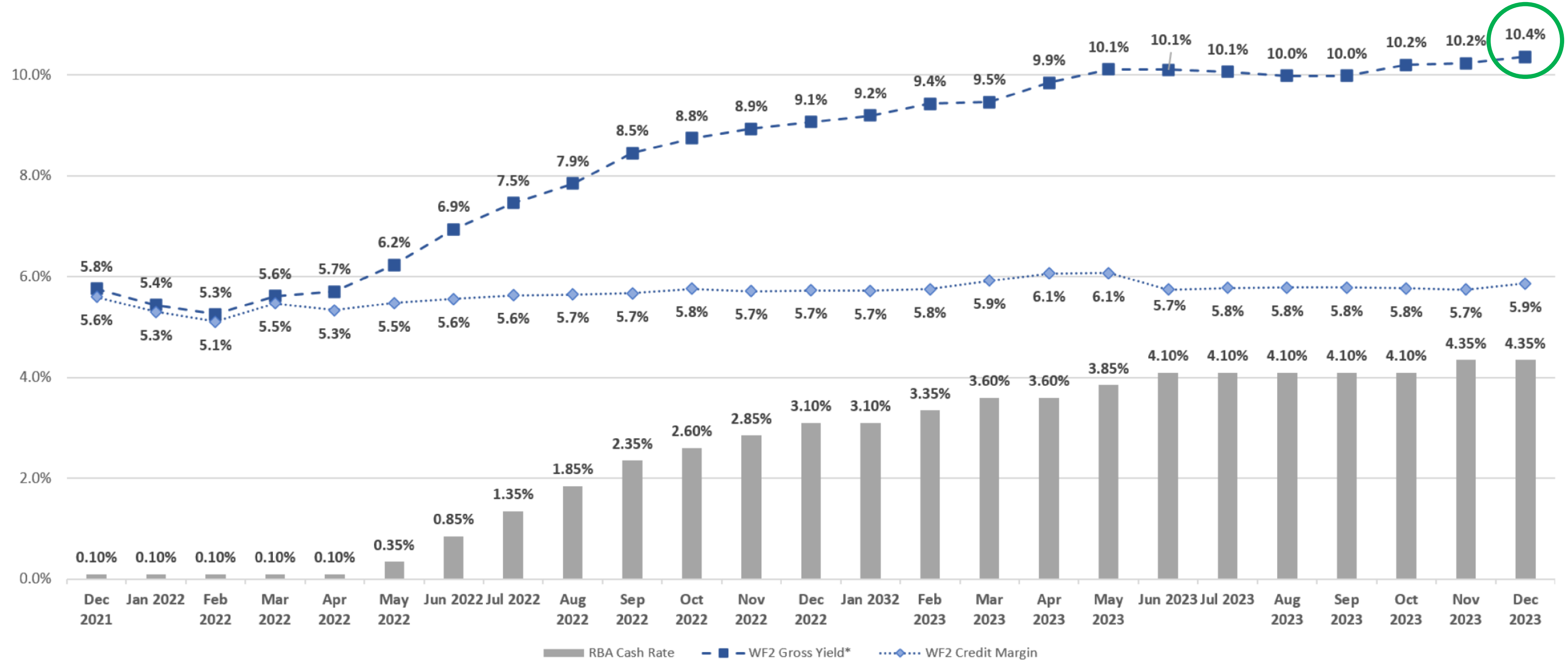
Australian Private Credit Yields Are Compelling

The chart below shows the actual **rising yield** 'journey' for an Australian Private Credit Fund, Revolution.



Source: Revolution Asset Management

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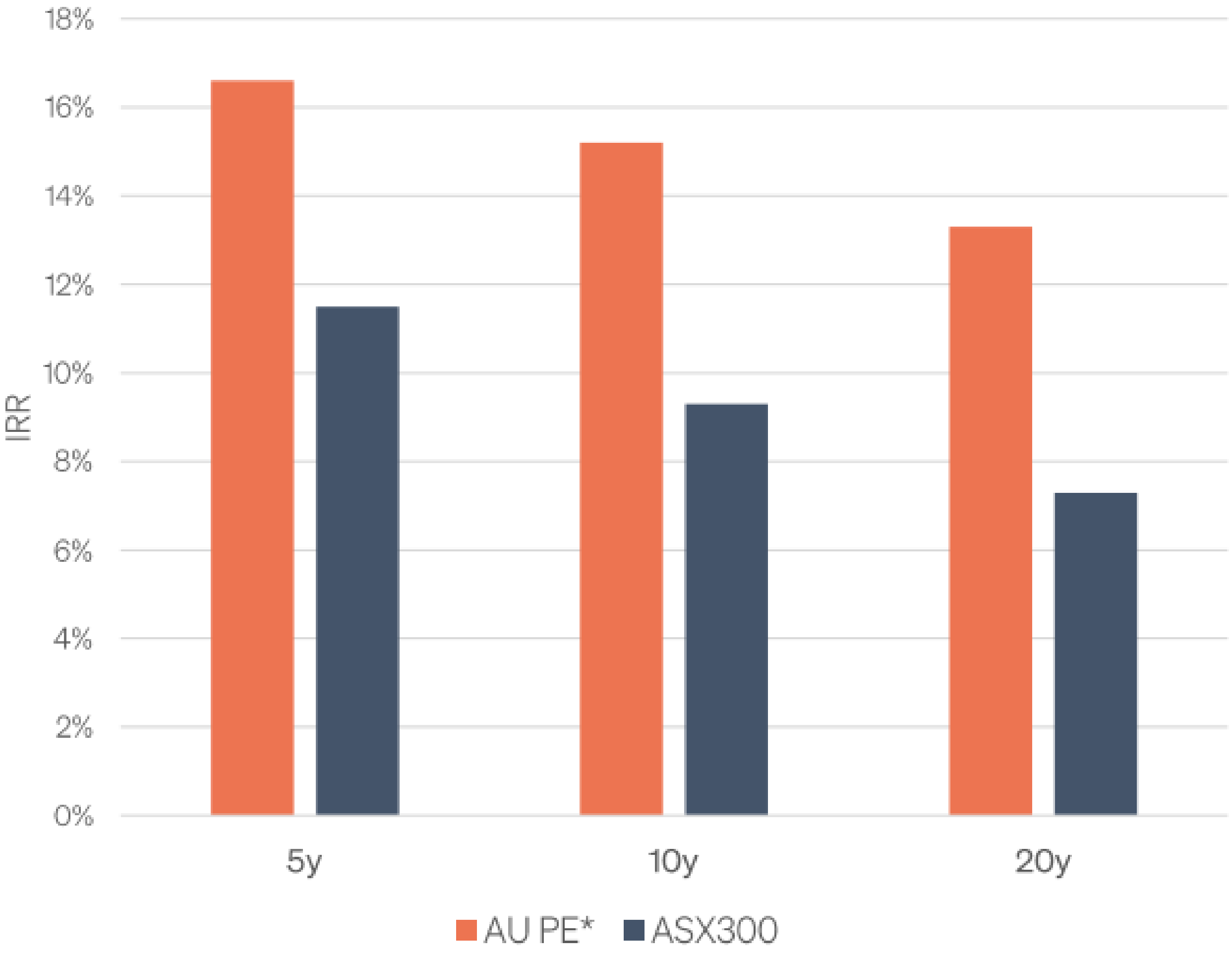
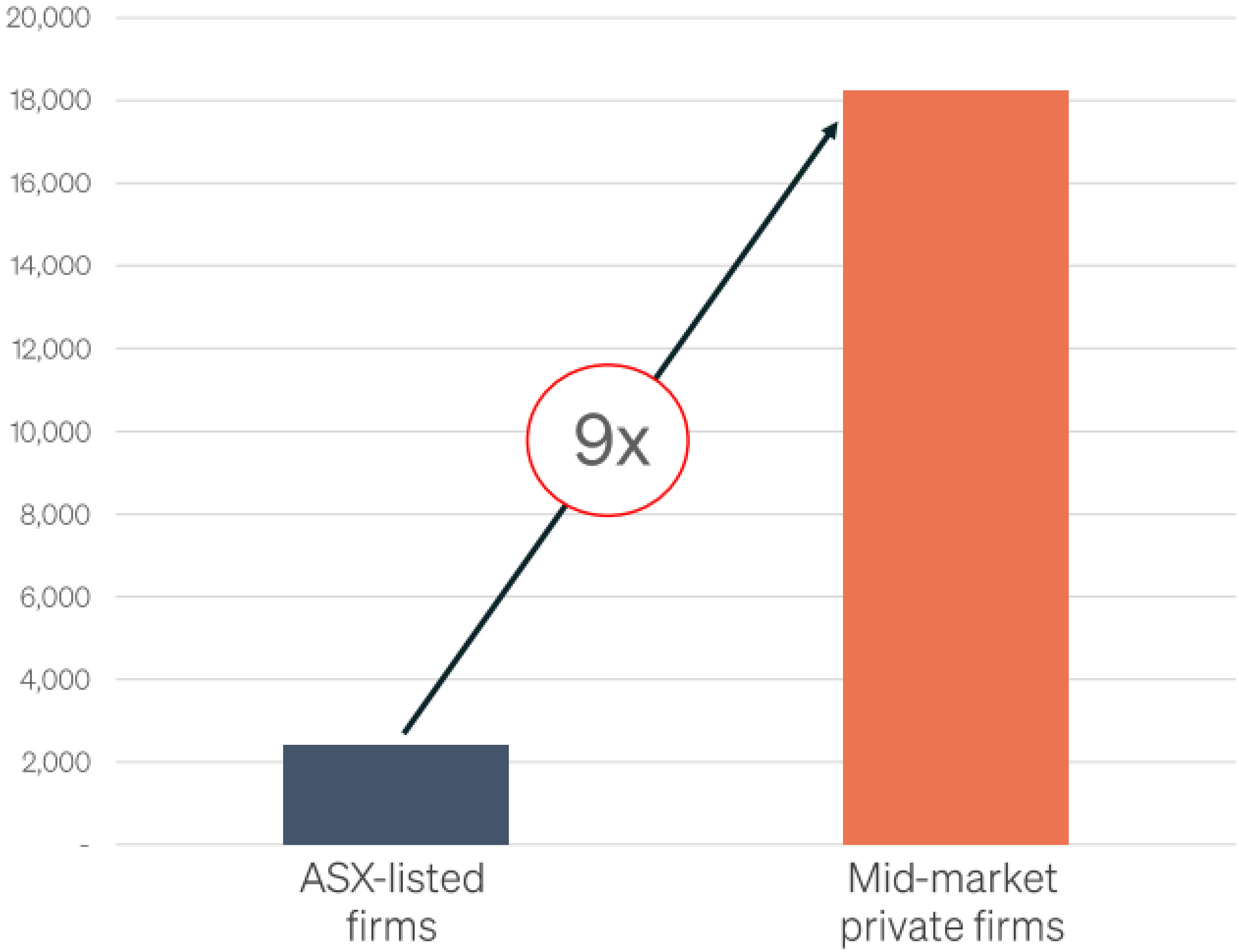
Australian Private Equity Should Not Be Ignored

Returns from Aust PE vs Listed Market



~9x larger than the ASX



*AU PE is defined to include both private equity and venture capital investments . Source: Cambridge Associates Database, QIC,

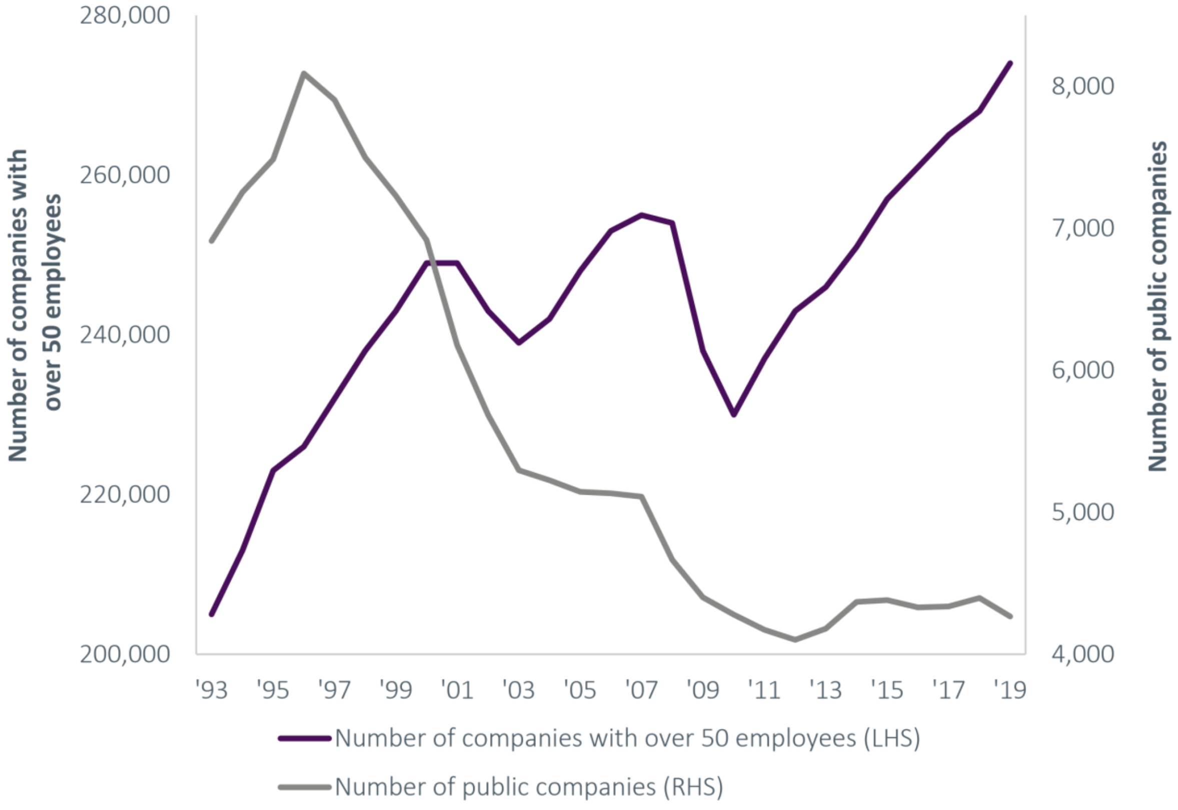
Source: S&P Capiq, Illion, BDO

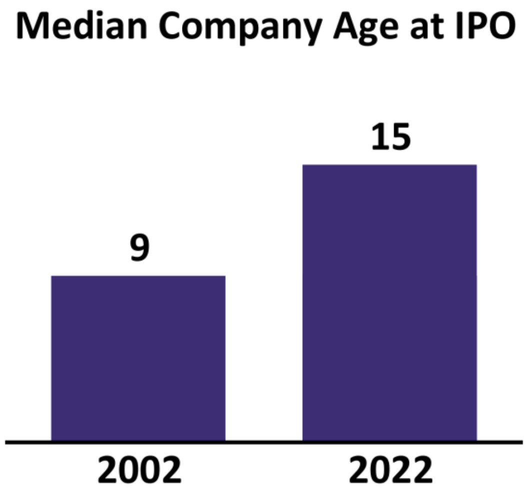
Global Private Equity Also Provides More Opportunity

Publicly traded stocks represent only a small fraction of the world's companies.

In the U.S., there are many more private companies than public ones, and the gap has been growing over time.

Companies now remain private for longer





Remaining private for longer means maximum valuation multiples can be achieved prior to an IPO.

Source: U.S. Bureau of Labor Statistics, World Bank, KKR. As of October 28, 2022.

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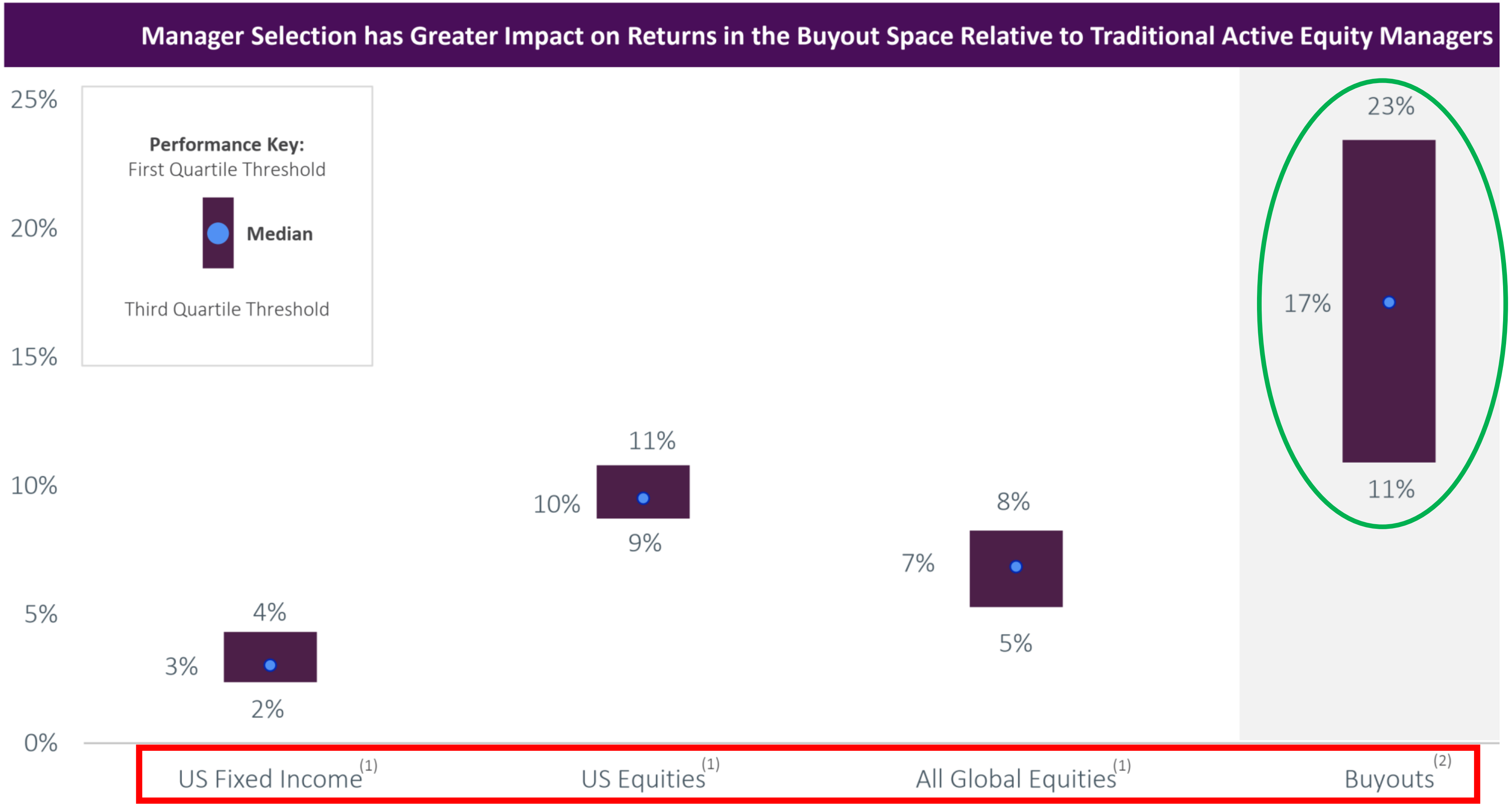
Private Equity: Manager Selection Is Critical



1) Source: eVestment Alliance database for 15-year period through September 30, 2023. US Equities include large and small cap indexes.
2) Source: Preqin online database, performance as of June 2023 (includes vintages for the 16 years to 2019), top quartile, median, and bottom quartile boundary net IRRs. Performance for later vintage funds not available/meaningful. Preqin's database is continually updated and subject to change.

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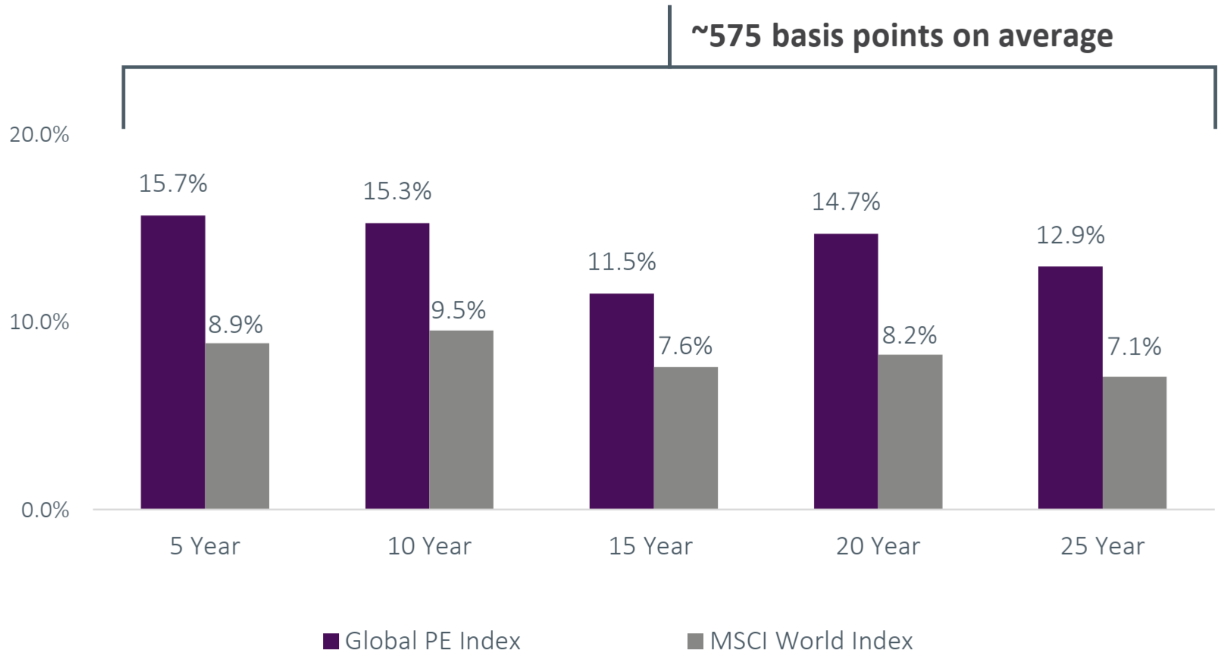
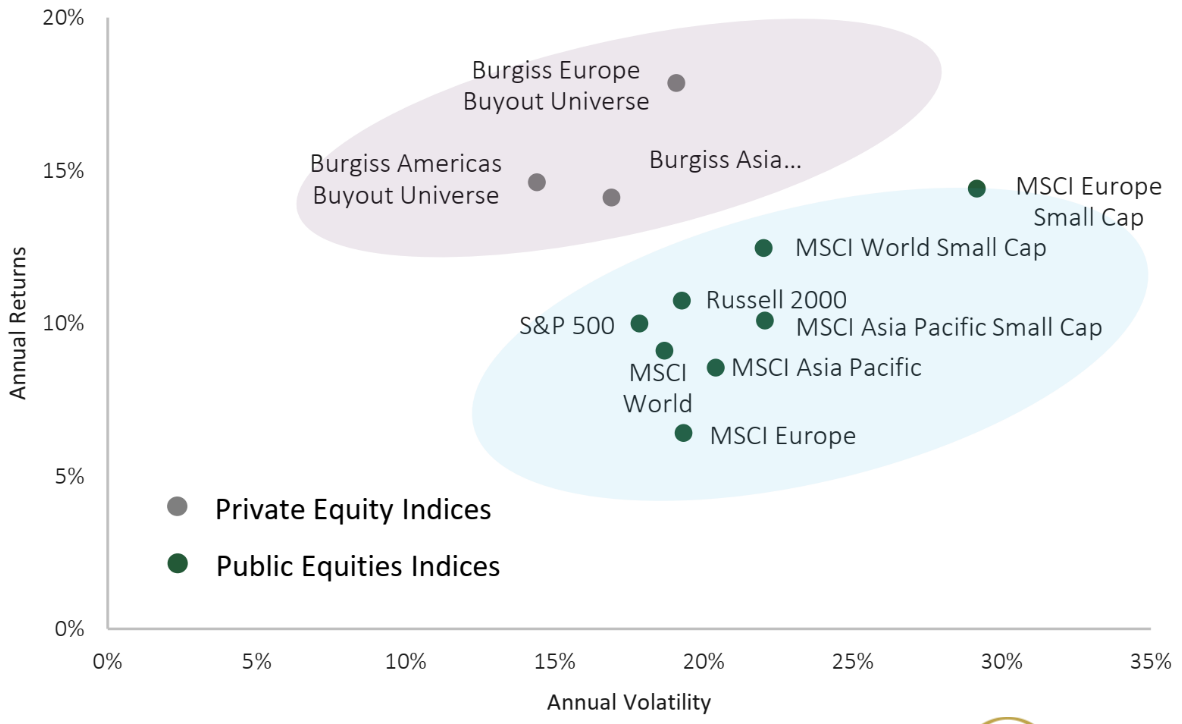
Private Equity: Higher Returns & Lower Risk

Outperformance versus the MSCI world index(1)



Superior risk/return characteristics(2)

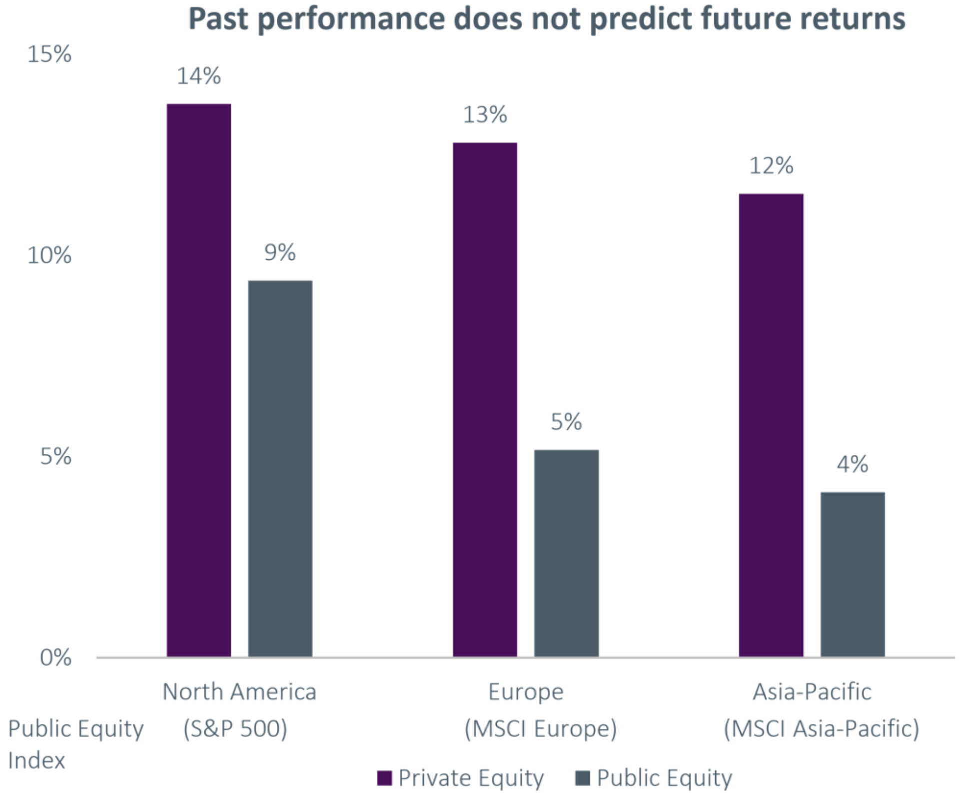


1) Cambridge Associates LLC Benchmark Statistics. June 30, 2023 data. Data reflects actual pooled horizon return, net of fees, expenses and carried interest. For funds formed between 1986-2023. Please see Important Information at the beginning of this presentation for information on market indices. 2) The quarterly appraisal process of private equity valuations tends to smooth private equity quarterly returns, reducing their estimated volatility. We instead use annual returns, a method that has been shown to partially reduce this smoothing effect that creates a downward bias in volatility estimates. 3) Data as at December 31, 2022. Source: Burgiss, KKR Portfolio Construction. Note: Alternatives defined as allocation to assets other than public equities, public bonds, or cash. Hedge fund allocations are considered Alternatives. Source: The Cerulli Report—U.S. High-Net-Worth and Ultra-High-Net-Worth Markets 2022: Shifts in Alternative Allocations, Thinking Ahead Institute, Indefi, 2022 NACUBO-TIAA Study of Endowments, ASFA, Bain, KKR GBR analysis. All data as of 2022.

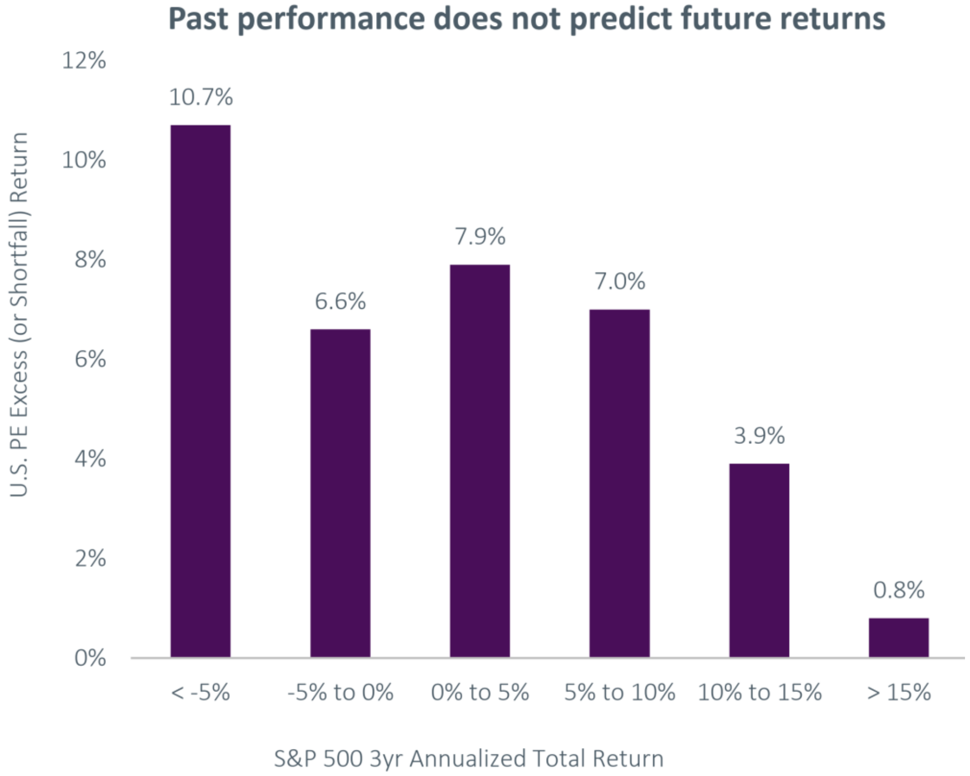
Private Equity Regional Outperformance

- Across regions, Private Equity returns have historically exceeded Public Equity returns.
- The excess return of Private Equity has been highest when Public Equity market volatility is highest.

Private vs Public Companies Universe
Net IRR Last 20 Years (as of Q1 2023)



Relative outperformance of Private Equity based on S&P 500 return regimes



Data as at 3/31/2023. Source: Cambridge Associates, Bain, Bloomberg, KKR Portfolio Construction analysis.

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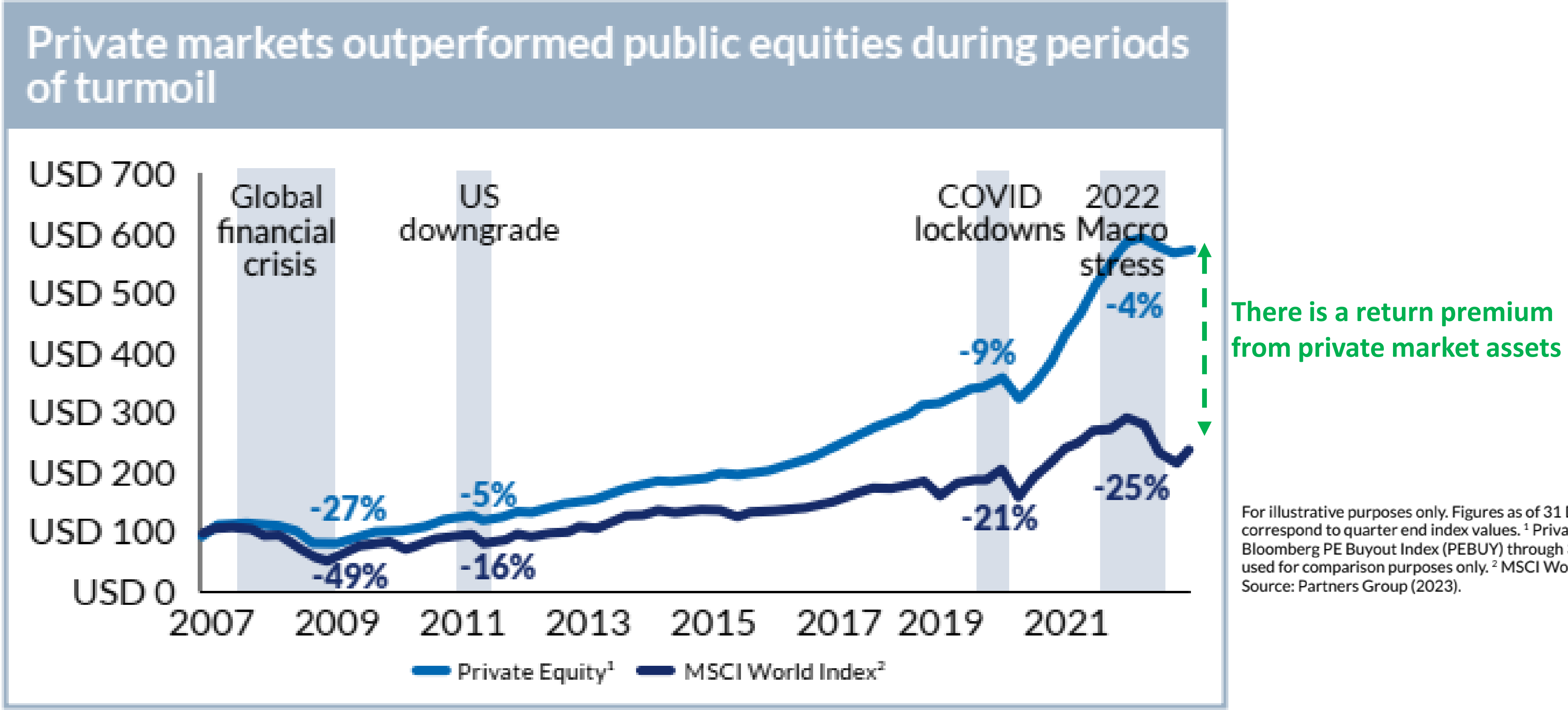
The Private Equity Experience For Investors

The chart below shows the **outperformance for a private equity investor** (light blue) compared to a public listed market investor (dark blue), with notable downside risk protection during major bear markets and recessions.



For illustrative purposes only. Figures as of 31 December 2022. Drawdowns correspond to quarter end index values. [1] Private Equity returns represented by the Bloomberg PE Buyout Index (PEBUY) through 31 December 2022. Benchmark is used for comparison purposes only. [2] MSCI World total return in USD.
Source: Partners Group (2023).

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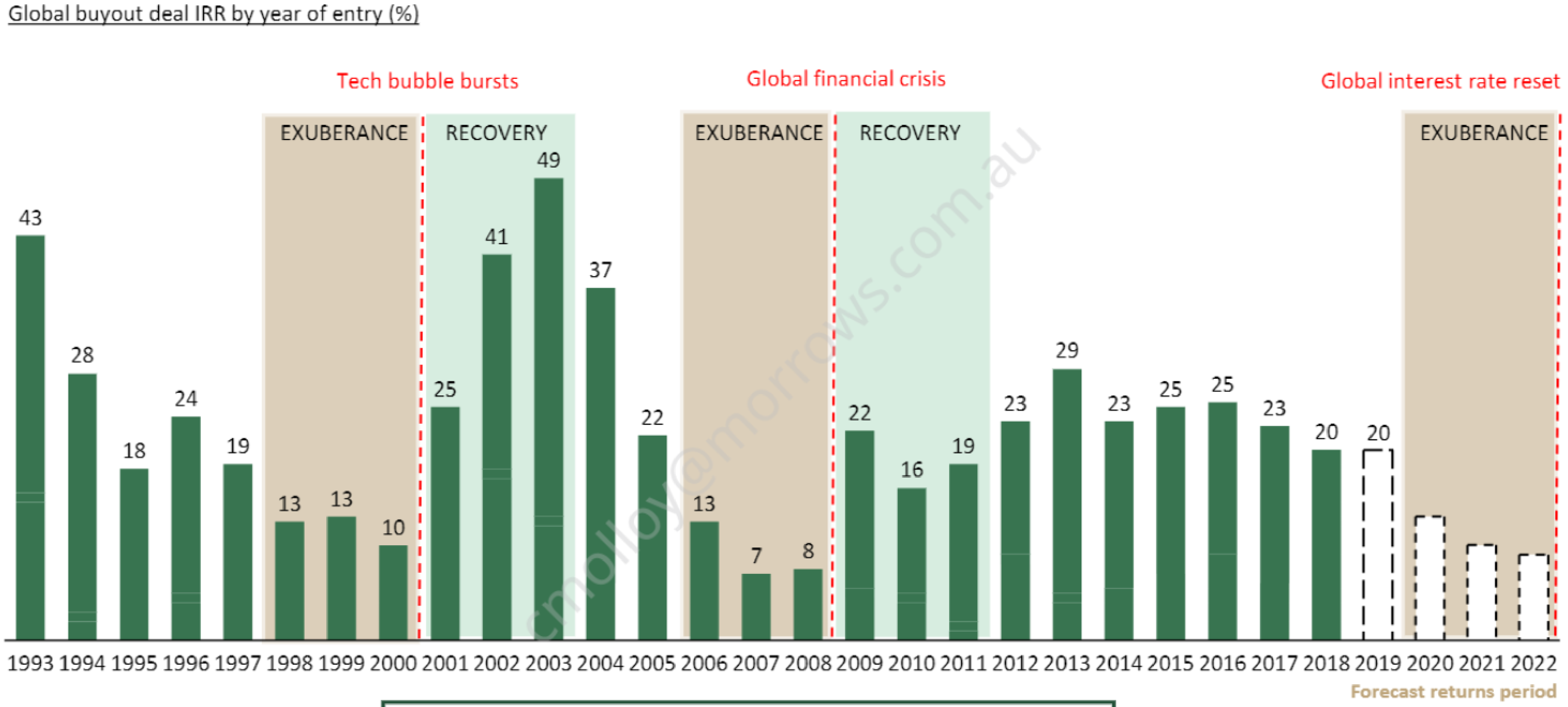
Private Equity Vintage Tailwinds Lie Ahead

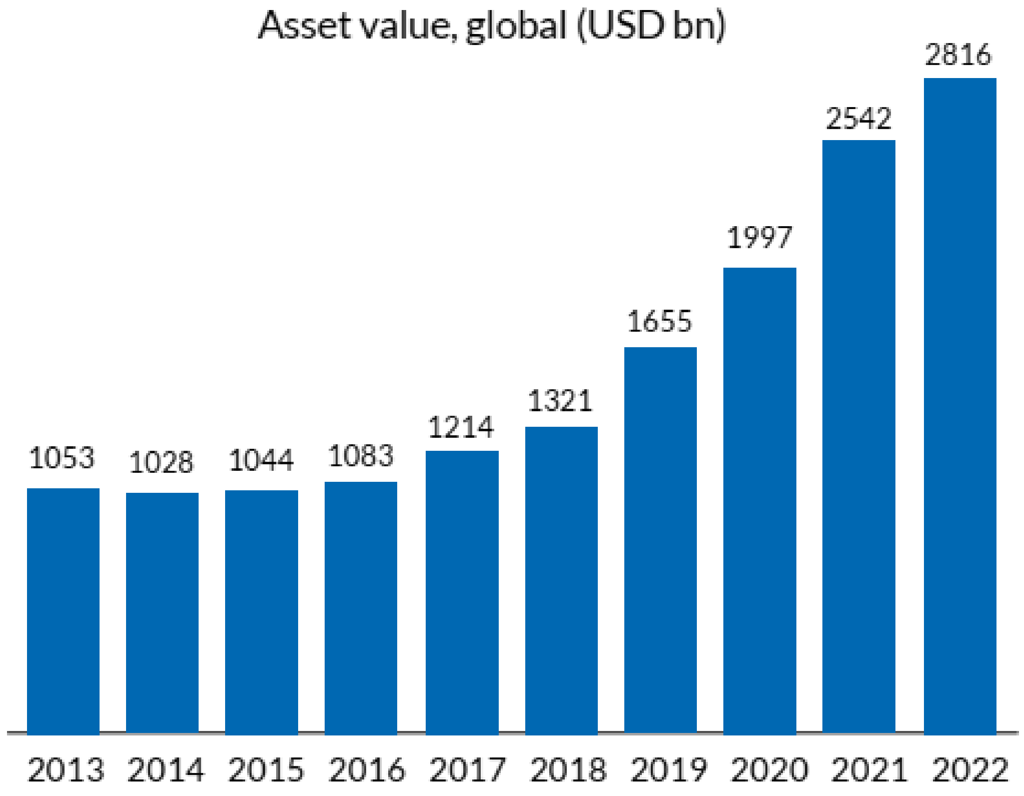


- Average annual IRR prior to major economic dislocation : **11%**
- Average annual IRR after a major economic dislocation: **29%**

Source: Global Private Equity Report 2023, Bain And Company; Whiteoak analysis

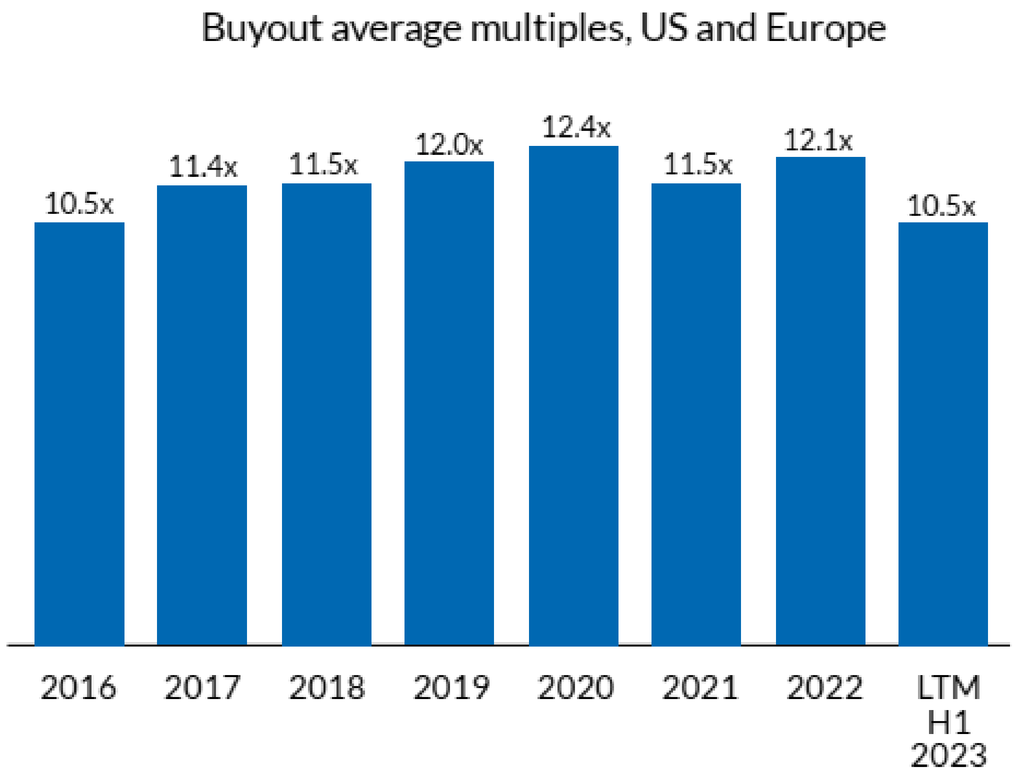
Lots of Unrealised Value & Attractive Entry Points

Unrealized value sitting in buyout funds



Source: Partners Group, Preqin (2023).

Lower private equity entry multiples

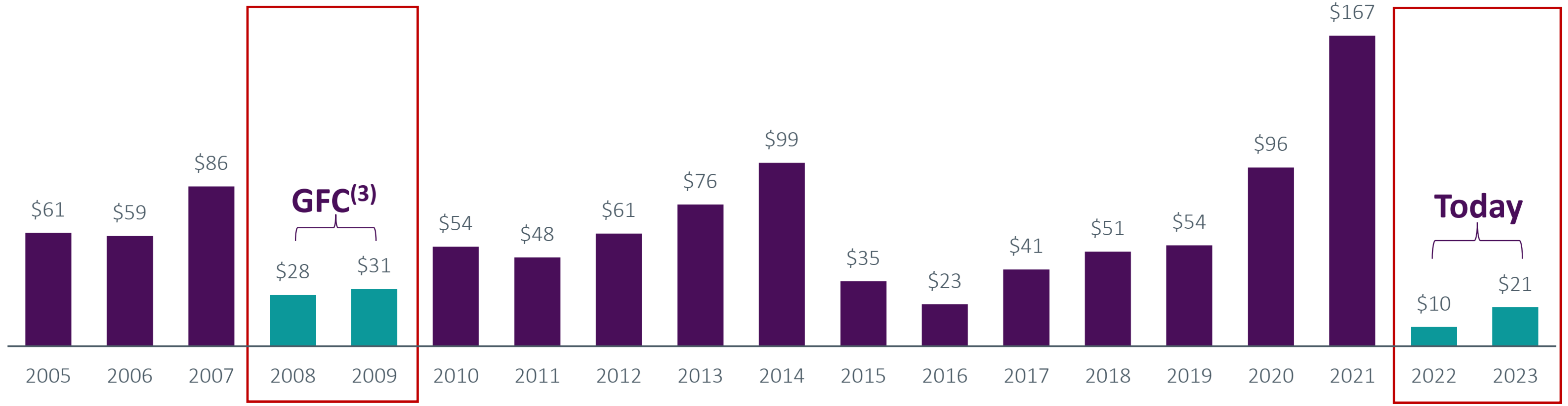


Source: Partners Group, PitchBook (2023). EV/EBITDA multiples based on disclose of 1-2% of all buyout transactions completed, including c. 60% add-ons.

Capital Markets Could Re-Open in H2 2024

IPO Markets have effectively been closed for the last two years, similar to the 2008-09 GFC period. When these markets do start transacting again there will be an influx of new IPO's and an opportunity to exit positions.

US IPO Volumes (in $Bn)[1]

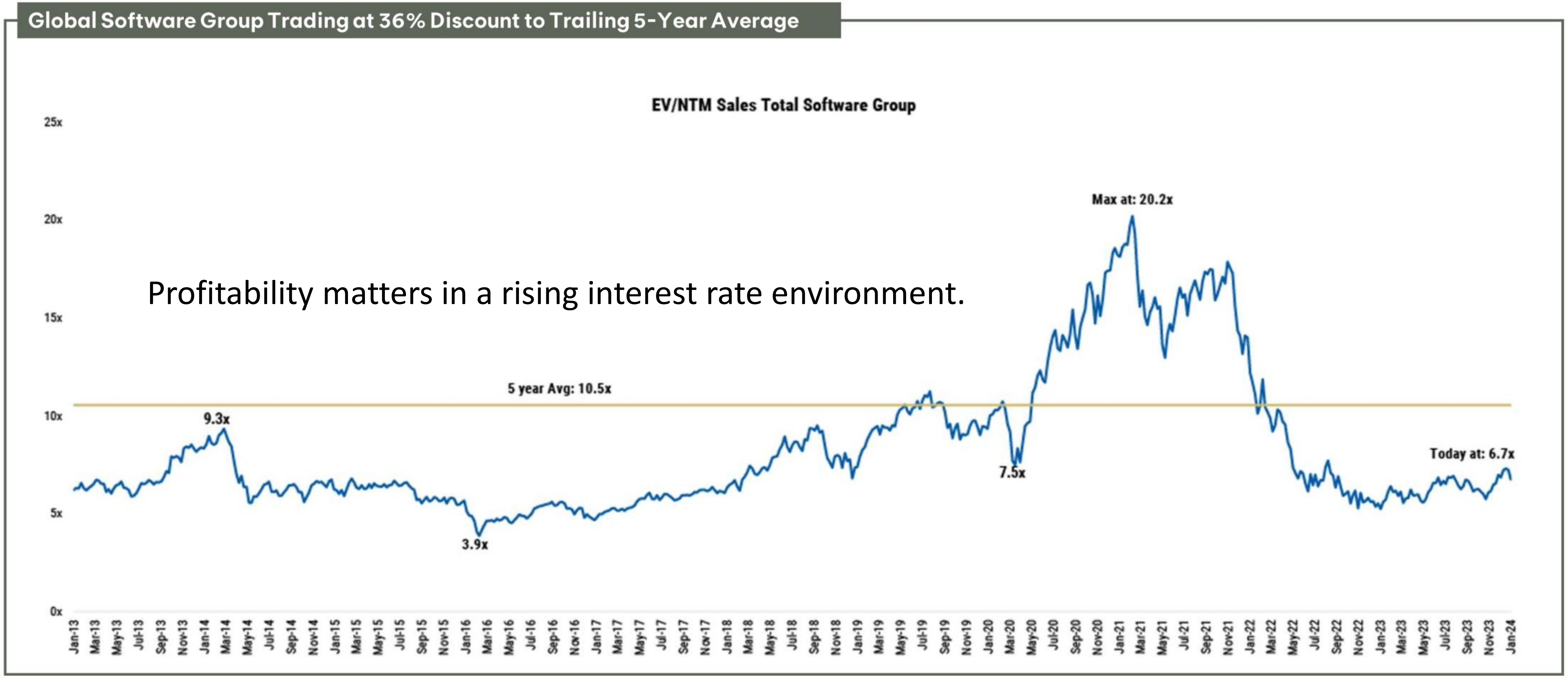


KKR

Source: (1) Source: Dealogic as of 01/05/2023. (2) J.P. Morgan North America Credit Research – Credit Strategy Weekly Update as of December 15, 2023. (3) Global Financial Crisis. There is no assurance that the trends described or depicted above will continue.

Growth At Any Cost Is Done! Profitability Now Matters

Global and Australian technology company valuations became euphoric during 2020-22 and have now come back down below their longer-term average. <u>Non-profitable</u> tech companies are still down more than 70% from the peak.



Source: Morgan Stanley Research

Venture Capital & Private Equity Stages – To An Exit

Start of Founder Journey	Pre-Launch	Early Stage Venture (Pre-Seed - Seed)	Growth Stage Venture (Series A+)	Private Equity
	Help founders build teams, identify problems and design and test solutions	Help early phase companies prove product market fit	Help growth stage companies scale effectively	Buy and improve established companies
Typical valuation ($m)	1 - 2m	4 - 8m	20 - 200m	100 - 500m

MPW Concluding Summary

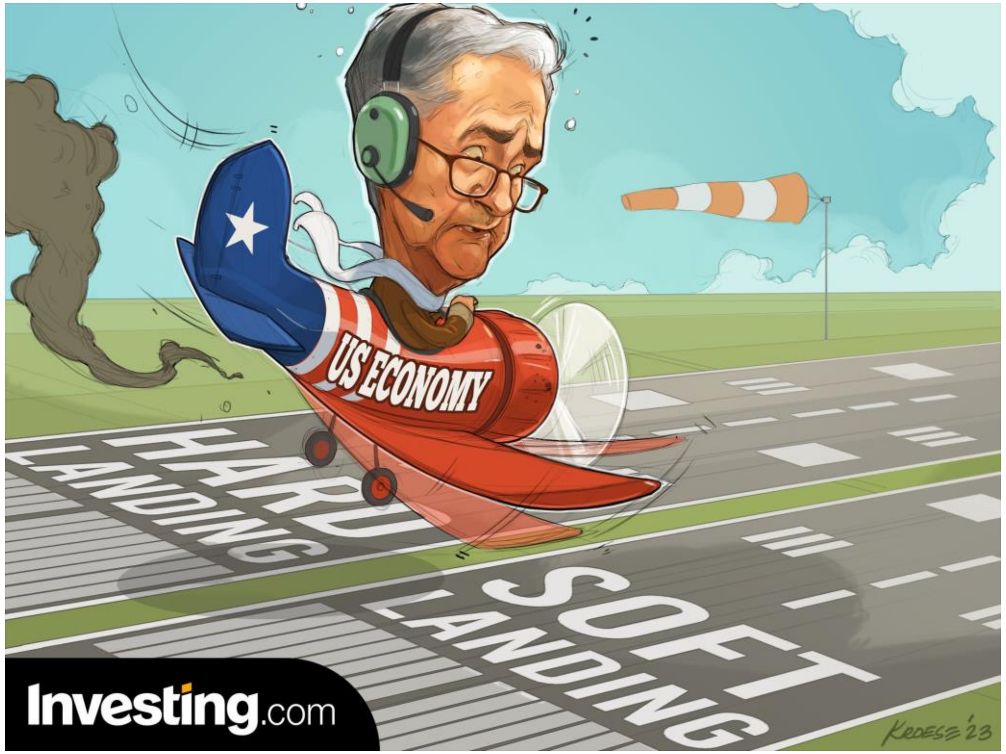
MPW Outlook: Recession risk is high and markets are not cheap, so the downside risk outweighs the upside.

<u>Soft Landing Scenario</u>: *This is the consensus view and markets are pricing this outcome, believing US interest rate cuts are close.*

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

<u>Recession Scenario</u>: *Inflation is still the Fed's priority and markets are not pricing interest rates to remain on hold for a longer period.*

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



Portfolio Implications:

- Be overweight alternative assets and private market strategies.
- Be patient, better opportunities should arise in listed markets.

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What If Our View Is Wrong?

If central banks can manage a soft landing and mild or no recession, then our portfolios are still well positioned to generate good risk adjusted returns, whilst still having downside protection in place.

<u>Defensive Assets</u> in a 'soft landing' scenario:

- We do not expect government bonds and listed credit to outperform our private lending strategies.
- <u>Private debt</u> will still be on track to generate +9% pa returns, so we shouldn't give away any upside.

<u>Growth Assets</u> in a 'soft landing' scenario:

- We expect listed equity and property markets to rise in value, but there will be significant dispersion across sectors, market caps, and countries. Those 'beaten-up' assets should outperform.
- Our <u>private equity</u> strategies will be well positioned to benefit from the IPO market 're-opening' and merger & acquisition (M&A) activity increasing. We would expect to see upward asset revaluations.
- We don't expect markets to revert back to their 2020-21 exuberance levels as we will still be in a higher interest rate environment, but private equity fundamentals can generate outperformance.

<u>Alternative Assets</u> in a 'soft landing' scenario:

- Active management can add value and we expect these strategies to contribute positive returns.


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tailored your way