September 2022
CARE QUARTERLY NEWSLETTER

EXCITING LIFE BORING MONEY

and not the other way around

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GLOBAL OVERVIEW

Over the September quarter bond, share and property markets continued to endure severe volatility within their continued downtrend. All the themes that plagued financial markets since the beginning of 2022 namely persistent inflation, further interest rate rises, invasion and supply chain disruptions due to infection, continued over the period. The S&P/ASX 200 Accumulation Index (+0.39%) performed well given the moves in share markets in the rest of the world. Much of this good performance for Australia is related to energy and coal companies. The weakness in the Australian dollar saved domestic investors with international share exposure. International shares fell by -6.3% in Australian dollar terms. In the US, the S&P 500 returned -9.4% over the month of September, driven by the stronger than expected US inflation data. It raised expectations that the central bank would need to raise interest rates by more than had previously been anticipated by market analysts. The Federal Reserve subsequently raised the official cash rate, the Fed Funds rate, by 0.75% to 3.25%. However, the FOMC dot plot which outlines what each U.S. central banker thinks will be the appropriate Fed Funds rate at the end of each calendar year three years into the future, was raised to reflect that the committee expected more tightening would be necessary. The higher rates go, the higher the probability of recession which will ultimately reflect poorly on company profits in the future. The forward paths of inflation, economic growth, interest rates, profits and valuations are changing daily with a wide distribution of potential outcomes in 2023 and it is the wide distribution of potential outcomes that is keeping financial markets volatile.

Emmanuel Calligeris
Chairman of the CARE Investment Committee

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The good news is that economic data in the US is slowing suggesting that the central bank will soon pause and assess the economy for signs of whether it has done enough to cool the economy without a recession. The Conference Board's Leading Economic Index, an indicator of what the economy will look like in 6-9 months time, declined for the sixth consecutive month in August confirming our expectation of a slowdown. Housing has been driven into a recession by the spectacular surge in mortgage rates and it is hard to believe that companies are not going to cut costs, given the surge in borrowing expenses due to higher interest rates. Whilst the labour market remains robust, it is potentially starting to show some early signs of weakness. Company job postings have fallen sharply, layoffs are creeping up and job creation has slowed to its lowest level in nearly 18 months.

Market-based indicators are also signalling that economic conditions are worsening. The yield difference between the 10-year and 2-year bond is currently -0.43%, consistent with a recessionary signal. The New York Federal Reserve's own inflation gauge is in retreat also, and the fall in commodity prices usually correlates well with a drop in inflation. The National Federation of Independent Business report, the voice for small business in the US, showed firms losing pricing power quickly and the collapse in money growth has been as significant as last year's surge. All this means that the official Fed Funds rate will pause and this may give relief to oversold asset markets.

In Australia, the Reserve Bank Board raised the cash rate by 0.25% to 2.60% at its October meeting. This was a lower increase than many expected and reflects the view that growth is slowing and the Governor's current assessment that inflation pressures, particularly wages growth are much more subdued in Australia than overseas. **The recent pulse of the housing sector was consistent with a general economic slowdown. The correction in house prices deepened and broadened across Australia.** Housing finance approvals continued to mirror the broader correction to date, with further declines across investor and owner-occupier loans signalling a clear moderation in housing credit moving into year end. On a positive note, the Westpac-Melbourne Institute index of consumer sentiment seemed to find a base over the quarter, however the Index remains at weak levels reflecting consumer cautiousness around the outlook for interest rates and increase in the fuel excise although labour market conditions appear to be providing some support.

The Chinese economy has recovered slightly due to more flexible Covid measures which have resulted in shorter quarantine periods and more localised lockdowns. It is having less impact on the labour force than the measures imposed a few months ago. Retail sales increased in the latest month to 5.4%, however, the real estate crisis will put pressure on economic growth if home sales do not pick up. To this end, some local governments have been pairing with property developers to finish uncompleted projects. However, an improvement in market sentiment will only occur if some of the larger projects are finished - and to a high standard.

Infrastructure stimulus has yet to impact growth as local government spending has been split between finishing uncompleted homes and infrastructure investment. Facing both a Covid crisis and a real estate crisis, local governments with limited fiscal resources had to prioritise what to deal with first. For most of them, the more urgent problem has been the stagnation in housing starts - and thus the drop in land auctions, which have traditionally provided local governments with the revenue they need to run their projects. This explains the delay in infrastructure projects despite completed funding for those projects. Although the central government is calling for an increase in infrastructure investment, only a few local governments have accelerated spending preferring to invest in existing projects, as opposed to new ones.

Europe remains in the grip of an energy crisis, with the suspected sabotage of the Nord Stream pipelines virtually ensuring a shortage of natural gas this winter and sharply rising costs for consumers. There is a real risk of recession, placing the ECB in a dilemma for its interest rate settings. It remains to be seen how much pain it is willing to inflict on its citizens in its pursuit of lower inflation which hit 10% in September. With the uncertainty caused by the UK front of mind, European lawmakers have seen what can happen when jittery markets are presented with poor communication, mixed messaging, and poor execution.

In the UK, the government's unfunded mini budget has put the Bank of England in a bind. The bond market reaction was so severe that the Bank of England was forced to step in to purchase bonds (print money) to stem the fall in prices and stave off a threatening insolvency of multiple pension funds. A swift about-face from the government has relieved some of the pressure on the GBP and the bond market. Things have settled down for now given the change of prime minister. Investors are pricing that the Bank Rate will reach over 5% by March 2023 (currently 2.25%) and over 1% worth of an interest rate increase is priced in for the November meeting alone. If the Bank follows through with this amount of tightening, then there's a clear risk of turbulence for borrowers. Two-year mortgage rates are over 5%, and at the very least that's likely to see a dramatic slowdown in housing transactions. The unemployment rate fell to a post-1970s low of 3.5%, while wage growth accelerated. Although long term sickness continues to draw people away from the labour market – explaining the employment picture, the Bank of England will ultimately view this through the lens of labour shortages and tighten at the cost of the housing market.

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As mentioned above **bond share and property markets all retreated in September with volatility high as macroeconomic and geopolitical concerns continued to weigh on investor sentiment.** Australian Shares fared better than international shares as the Australian dollar weakened against the US dollar. Financial markets are likely to remain volatile as investors continue to assess the risk of rising interest rates and high inflation onto 2023. While company profits, generally remain strong, rising interest rates are likely to lead to reduced consumer spending and lower demand, which will impact the profits of many

companies - particularly companies exposed to cyclical sectors such as home building (James Hardy) and discretionary retail including Harvey Norman, Wesfarmers and JB Hi-Fi.

Over the quarter, the Australian 10-year bond yield having sold off to 4.20% rallied all the way back to 3% before selling off again in September. At the time of writing, it was yielding almost 4.20% again. These are very large moves. The capital fluctuation is over 8% in each direction and typical of an uncertain inflation outlook. The bond yield reflects where the government borrows money. During Covid, governments all around the world were borrowing trillions to fund businesses that were shut down and citizens to stay at home. The money was provided by the central bank via the printing presses however this led to inflation and we are now in a period of quantitative tightening around the world. **Government debt is now large particularly in the US and Japan.** Higher bond yields mean it costs the government more to borrow and this ultimately burdens the taxpayer. Higher taxes without wage increases generally means consumers have less to spend and growth will slow as a consequence.

The Australian share market as represented by VAS in the Core and Active portfolio (S&P/ASX 300) increased as mentioned above. Australian companies that performed well within this investment over the quarter, included the lithium miners IGO, Mineral Resources and Pilbara Minerals, coal miner Whitehaven coal and copper miner Oz Minerals. Oz minerals received a non-binding indicative bid from BHP at $25 per share. Property trusts performed poorly due to higher interest rates. Goodman Group (-13%), Dexus (-13%) and Stockland (-11%) all decreased over the quarter. The Domino's Pizza share price decreased almost 24% over the quarter as the rising costs of cheese, wheat, meat and cardboard packaging in key markets, plus wage increases, hurt profitability. As markets fell and interest rates rose, three takeover bids fell over or were restructured. KKR withdrew from taking over Ramsay Healthcare, Atlas Arteria (who were in takeover discussions with IFM Investors) bought a 66.7% interest in Chicago Skyway and Dye and Durham's bid for Link was withdrawn and instead have made a non-binding offer to buy Link's corporate markets division. Meanwhile, ANZ acquired Suncorp Bank for A$4.9bn and Pendal and Perpetual entered into a scheme of arrangement to merge the two businesses.

Global share markets fared worse than the Australian market with the MSCI down 6% for the quarter dragged down by Emerging Markets (-11.5%) on the back of the surging USD and Europe. The exposure to international shares in your CARE portfolio is through the iShares Global 100 ETF- IOO, Vanguard Total US Market ETF – VTS, iShares Emerging markets ETF and the Vanguard All World ex-US ETF – VEU. There are over 3 000 international companies held within these investments. The US makes up over 50% of the global market. Companies including Netflix increased by 31% on the back of increased subscriber numbers and Biogen (+27%) which manufactures therapies for treating neurological and neurodegenerative diseases and increased its revenue guidance. Technology companies continued to be sold heavily. Google's share price decreased 12% over the quarter whilst Microsoft decreased 10% despite reporting good earnings.

The Investment Committee rebalanced the portfolios throughout the quarter. In July, the exposure to GOLD was increased whilst the exposure to US small company shares (IJR) was decreased. In the Core portfolio, hedged international shares (WXHG) was bought whilst US shares (VTS) was trimmed. Usually when share markets are heavily sold, the bond

investments of the portfolio stabilise returns. However, every so often like in 1994, it's the interest rate increases (sell off) that cause the fall in shares. This is what has happened in 2022. The Investment Committee avoided the bond market rout by maintaining exposure to Realm Investment House and Kapstream who run portfolios with only a short interest rate maturity also known as a short duration strategy where capital values fluctuate less than long maturity bonds. The strategy worked well relative to bond market returns.

Within the Enhanced International Shares portfolio, Insync and Hyperion's short-term performance suffered and we used the opportunity to rebalance into Hyperion from WDIV and then buying WDIV and selling units in the Hyperion investment following the managers shorter term outperformance. These are marginal moves but the discipline of rebalancing is important as it allows us to lock in the benefits where we can.

The WDIV investment holds companies that pay a larger portion of their profits as dividends including H&R Block and a US property company - LTC Properties. LTC Properties is a relatively new holding in the portfolio and has a dividend yield of 5.8%. Revenue is forecast to grow by 8.4% over the next year. Hyperion underperformed the benchmark. The manager's largest holding, Tesla, remained under selling pressure again despite not being able to fulfil orders for its cars. The manager continues to hold quality companies with strong growth prospects including Microsoft, PayPal and luxury goods brand Hermes International. Insync follows a similar strategy and the manager's investment process has been leading them towards companies including: Microsoft, Bookings.com and Accenture.

The Enhanced Australian shares portfolio decreased in value by 2.54% over the quarter underperforming the ASX 200 index by 2.93%. The manager remains comfortably ahead of the S&P/ASX 200 index over the year. Over the period, Link Administration and Costa Group adversely affected performance whilst Ansell and Brambles aided performance. More aggressive action by most central banks to bring inflation back within target range was the key theme unsettling markets towards the end of the quarter. The Federal Reserve sent a clear message that its number one priority is to return inflation back within its target range and is prepared to risk much weaker economic growth or a recession to achieve this outcome. Equity markets have concluded official US interest rates will move higher and stay elevated for longer than previously assumed. This translated to a selloff in bonds and a downgrade to growth and profit expectations.

The RBA has recently adopted a more cautious approach to monetary tightening and noted that while the cash rate will keep rising, the magnitude of further rate increases will be lower. Over the next 6 months, the RBA's latest statement highlighted the challenge of returning inflation to 2-3% while at the same time "keeping the economy on an even keel". It concluded the path to achieving this balance is "a narrow one and it is clouded in uncertainty". The discount rate being used by investors to value shares has returned to a more normal level following a period of artificially low interest rates over the last 2-3 years. Valuation risk is therefore less but analyst profit expectations may still be high, and this may limit near term gains.

RETURNS

BY CARE INVESTMENT STRATEGY

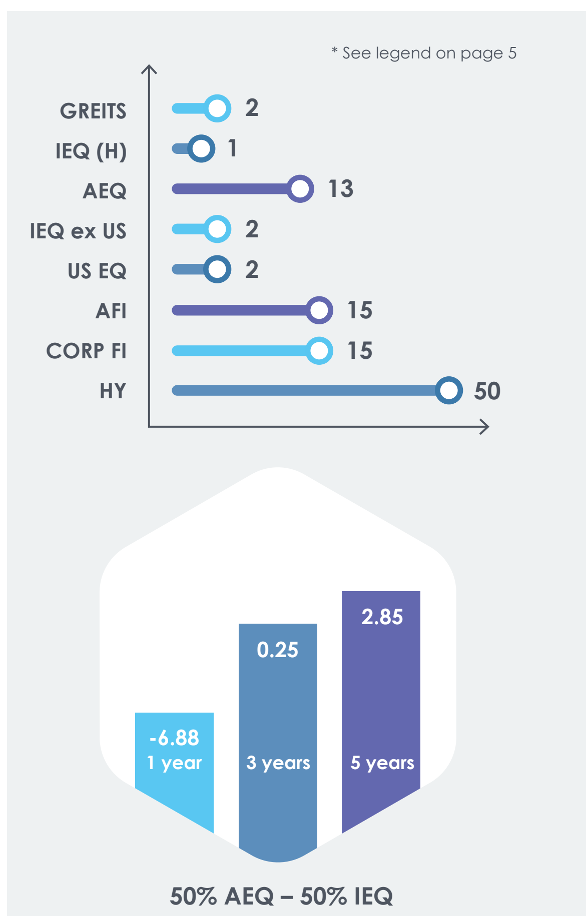
LEGEND

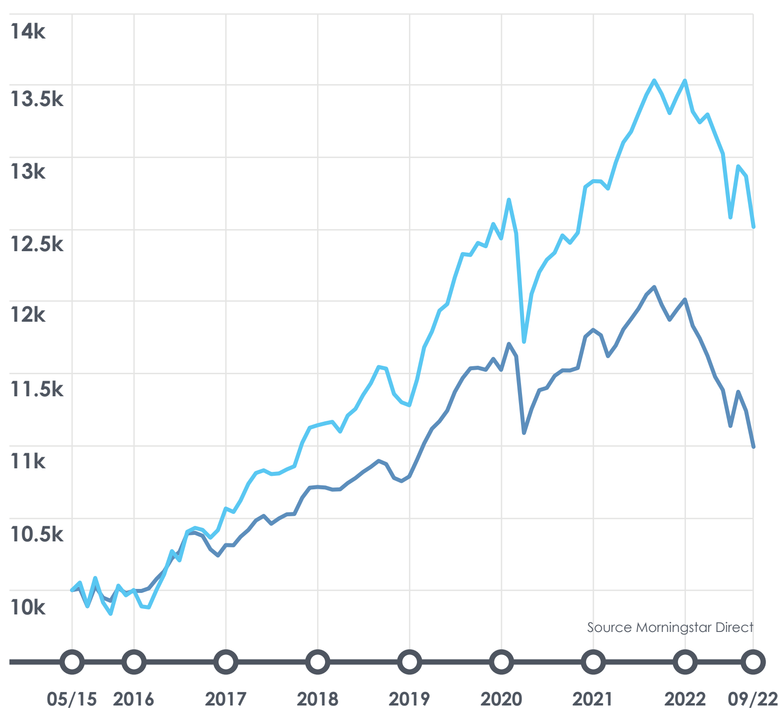
International Real Estate	GREITS	High Income	HY
International Shares (Hedged)	IEQ (H)	International Emerging Market Shares	IEM
Australian Shares	AEQ	International Small Companies Shares	Small Cap IEQ
International Shares (ex-USA)	IEQ ex US	Australian Fixed Interest	AFI
International Shares USA	US EQ	Australian Corporate Fixed Interest	Corp FI

CORE PORTFOLIO RETURNS TO THE 30TH SEPTEMBER 2022

	1 Month	3 Months	6 Months	1 year	3 years	5 years	7 years
CORE Conservative	-2.30	-0.27	-5.41	-6.76	0.27	2.58	3.26
CORE Moderate	-3.26	-0.44	-7.09	-7.73	1.05	3.63	4.44
CORE Balanced	-4.21	-0.68	-8.76	-8.43	2.17	4.71	5.70
CORE Growth	-5.30	-1.28	-10.80	-10.63	2.18	5.32	6.41
CORE High Growth	-6.49	-1.85	-12.88	-12.61	2.16	5.85	7.12

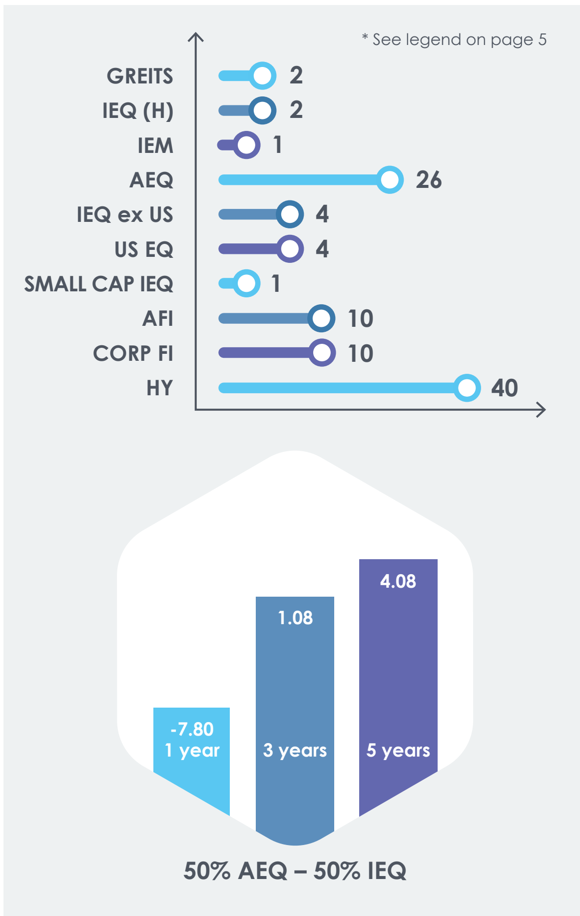
YOUR CARE PORTFOLIO CONSERVATIVE

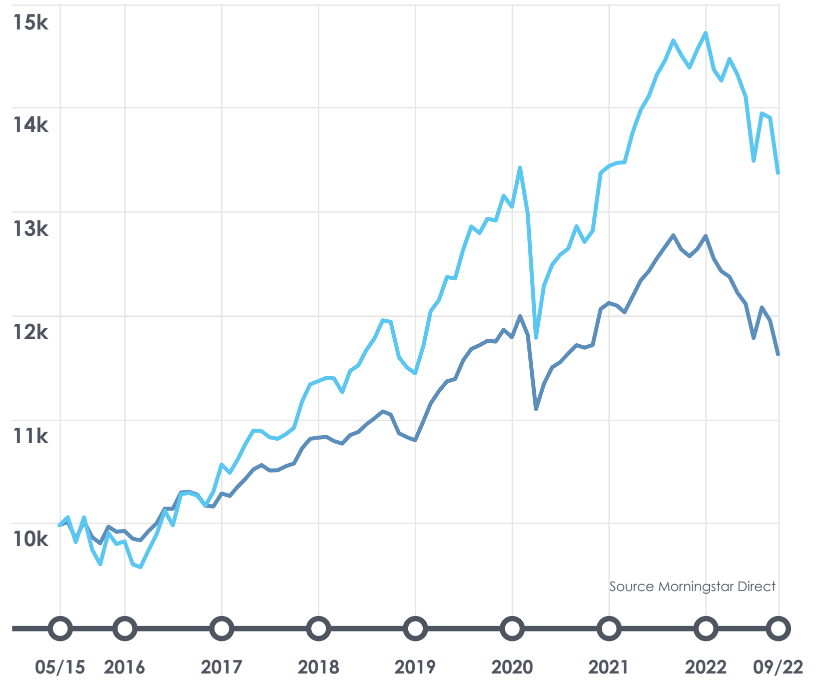




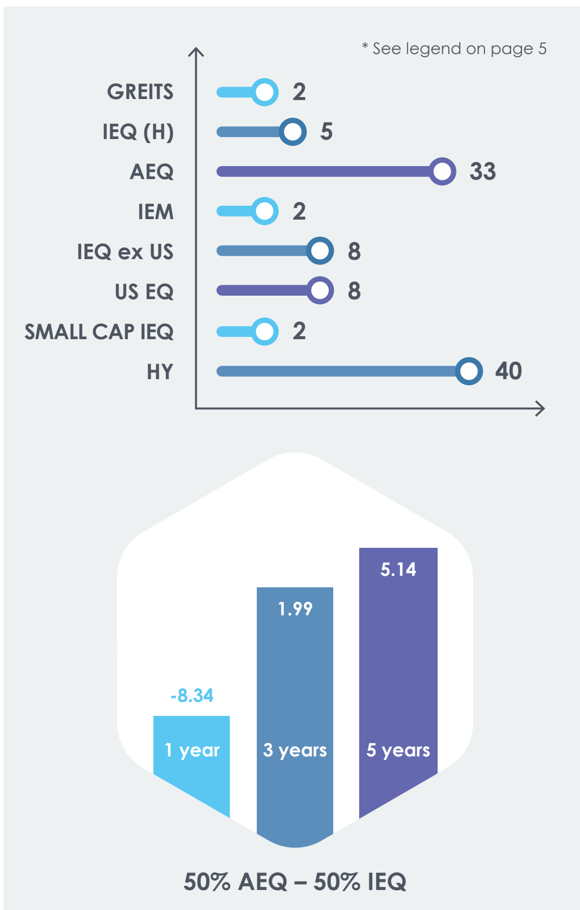
* Returns are based on model portfolio, benchmark allocation & assumes investment over 1, 3 & 5 years ending June 2022. The E (enhanced) component is assumed to be 50% Australian Equities & 50% International Equities. Past Performance is not indicative of future performance.
* The CARE portfolio Returns are before tax, Adviser fee, and Platform Fees however net of CARE Investment Committee Fee.
* Returns are based on: C,A & E only – RESERVES is not factored into the return series.

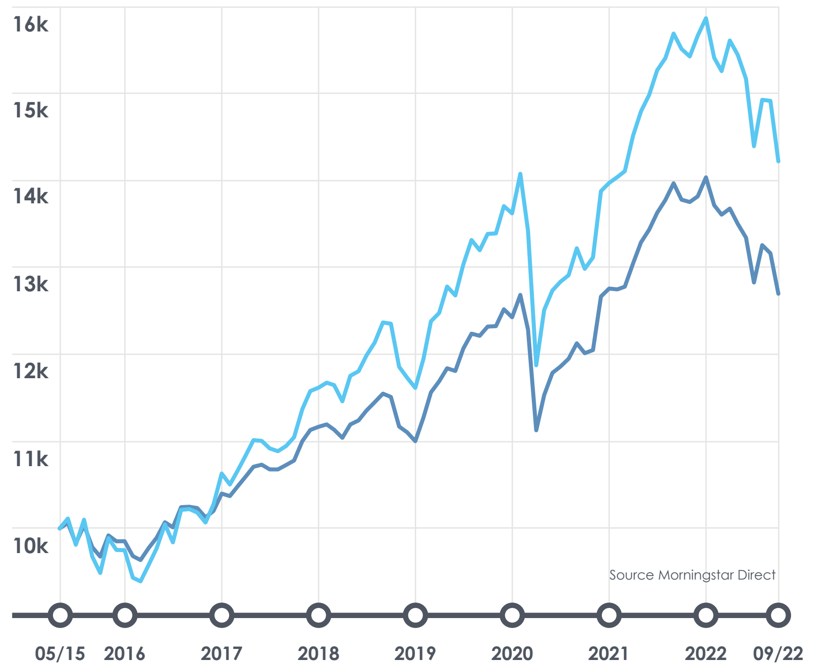
YOUR CARE PORTFOLIO MODERATE



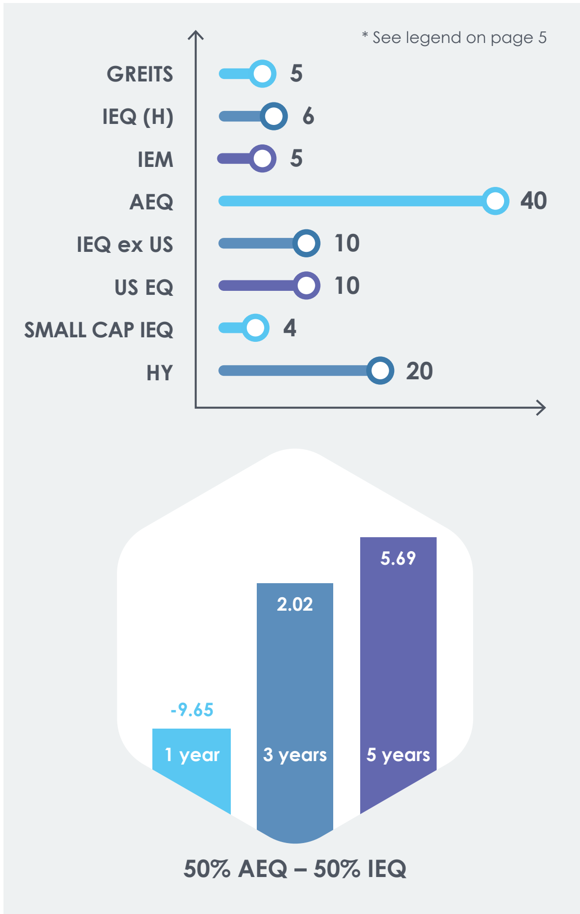


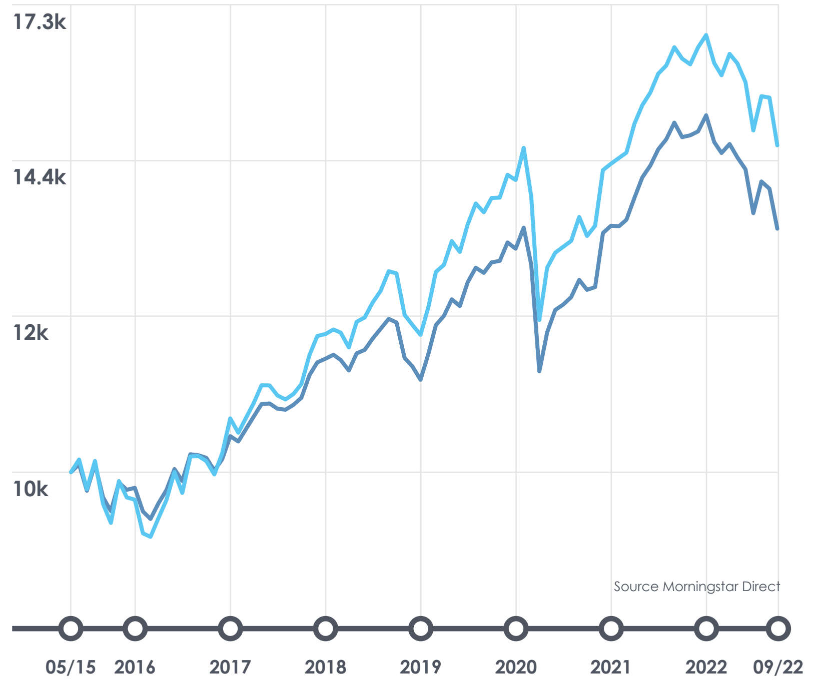
YOUR CARE PORTFOLIO BALANCED





YOUR CARE PORTFOLIO GROWTH

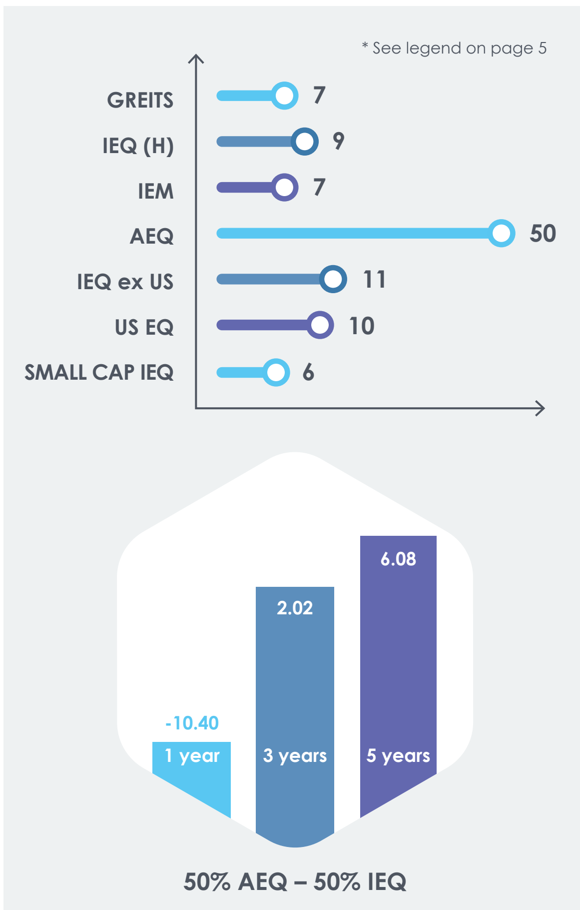


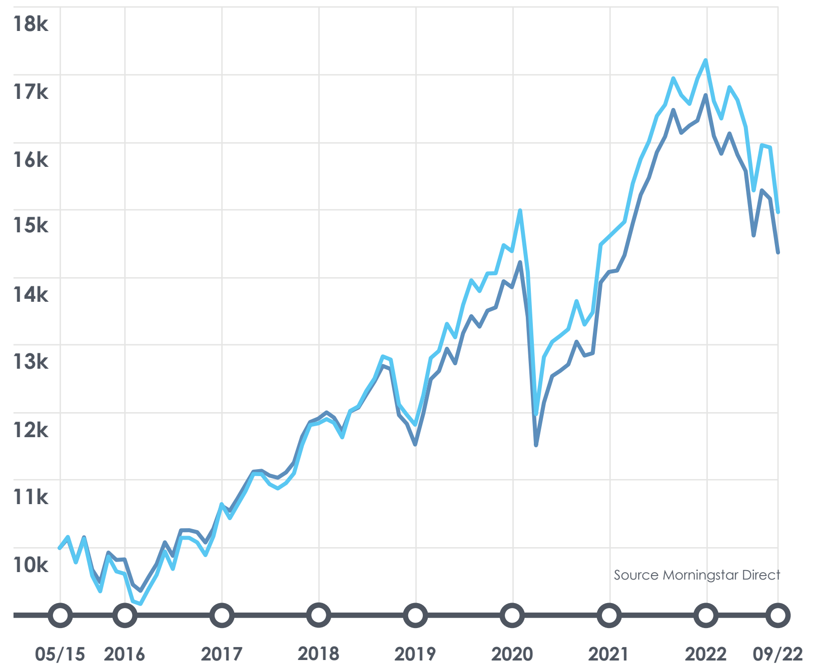


CARE Growth (50%AEQ - 50%IEQ) Total Return AUD 14.65K

Multisector Growth Investor Total Return AUD 13.29K

YOUR CARE PORTFOLIO HIGH GROWTH





CARE High Growth (50%AEQ - 50%IEQ) Total Return AUD 14.97K

Multisector High Growth Investor Total Return AUD 14.37K

MEET the CARE Investment Committee

Emmanuel Calligeris
BEc MBus (Finance)

Emmanuel is Chairman of the CARE Investment Committee. Emmanuel holds a degree in economics and previously had 20 years' experience as Chief Investment Officer for OnePath Investments (the investment arm of ANZ Bank) and was responsible for $13 Billion of funds under management.

Rob McGregor
SIA (Aff) ADFP

Rob was a founder of GPS Wealth, developed the CARE Investment Philosophy over the last 15 years and successfully managed $100m in clients' funds during the GFC.

Grahame Evans
GAICD DipSM MBA

Grahame is the Risk and Compliance member of the CARE Investment Committee. Grahame brings over 35 years of financial service industry experience.

Dr. Mark Brimble
BCom(Hons) PhD CPA FFin

Mark is an independent member of the CARE Investment Committee. Mark holds a doctorate in capital markets and is keenly interested in investor behaviour.

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