Quarterly Review of Investment Markets and Portfolio Changes

5 November 2021

StanfordBrown Private Wealth

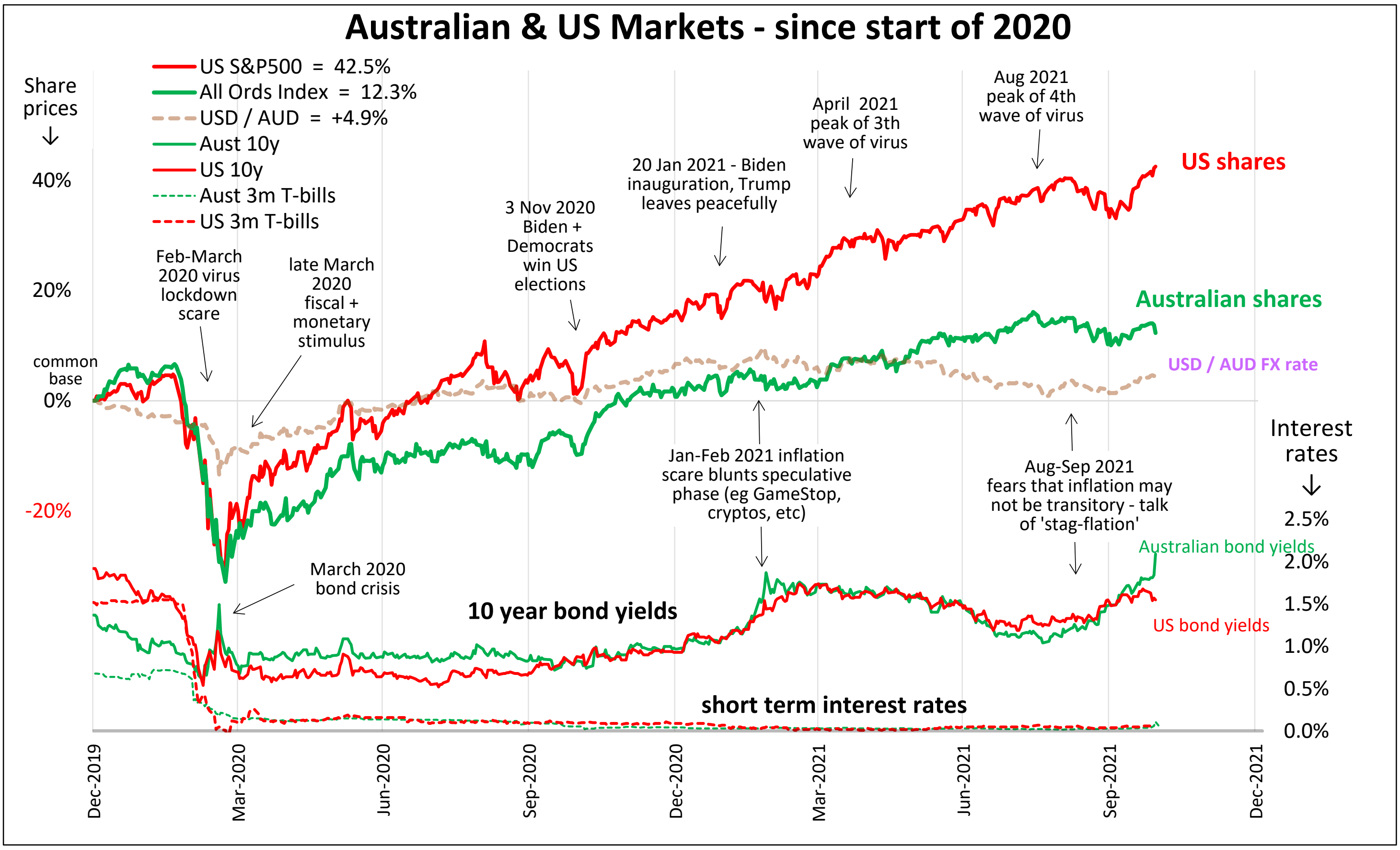
Contents

Welcome to the November edition of our regular quarterly review of markets and portfolio adjustments. This time we also focus on commodities, and energy in particular, and how we are helping investors navigate toward a lower carbon emission future.

Economic & Investment Market Conditions

In October, global economic activity and investment markets continued on their recovery paths toward, and in many cases above, their pre-Covid levels. The strong rebounds in share prices have been underpinned by better-than-expected rebounds in company profits, virtually across the board. The downside is that the bonanza of free government hand-outs and artificially cheap debt that has fuelled the dramatic rebounds in investment markets is in the early stages of being wound back.

The withdrawal of monetary and fiscal support affects different types of assets in different ways. For 'risk' assets with variable incomes – for example, companies and real estate – the recoveries in economic activity have led, for the most part, to increases in revenues, profits and capital values (prices). When interest rates and input costs rise, these cost increases can, to varying degrees, be passed on to customers and tenants. On the other hand, assets with fixed incomes – like fixed-rate bonds and term deposits – become less attractive in a world in which interest rates are rising back to more 'normal' levels.



<u>Australian shares</u>

The local sharemarket ended flat for the month overall. The main drag on the market was the iron ore price (down -12% in October), pulling BHP, RIO and FMG down further. Coal miners were also down for the month, as the global shift against coal heats up. Also weaker were transport stocks, due in part to supply chain problems including strikes, shortages and border controls. Banks were flat, with the government moving to tighten controls on housing lending to slow the housing price boom, as we foreshadowed in our 5 October 2021 report.

For the 2021 calendar year to date, the local market is up an above-average 11.5% or 15% including dividends. Leading the market have been 'consumer discretionaries' including Domino's (pizzas) +56%, Aristocrat (gambling) +50%, and also the big banks (up 25-35% each this year). However, most of the big miners are down for the year, with iron ore prices down -33%, and gold down -6%, but smaller miners were lifted by rises in industrial metals prices generally. We look at commodities markets in more detail below, as they highlight a number of broader issues facing global investment markets.

<u>International shares</u>

Global share markets were up by a combined 5% in October, more than making up for the decline in September. The US market again led the way, boosted by yet another stronger than expected reporting season. Tesla was the star, up by 44% for the month thanks to an order for 100,000 cars from Hertz, which is fresh out of bankruptcy, and hopefully will actually pay for the cars. Most of the other US 'big-tech' giants were higher for the month (Microsoft, Apple, Amazon, Alphabet/Google, Nvidia, Netflix). Facebook was the exception, falling back as it changed its name (to 'Meta') in an effort to magically appear hip again to its rapidly disappearing younger audience, and perhaps to hide from its mounting brand image problems.

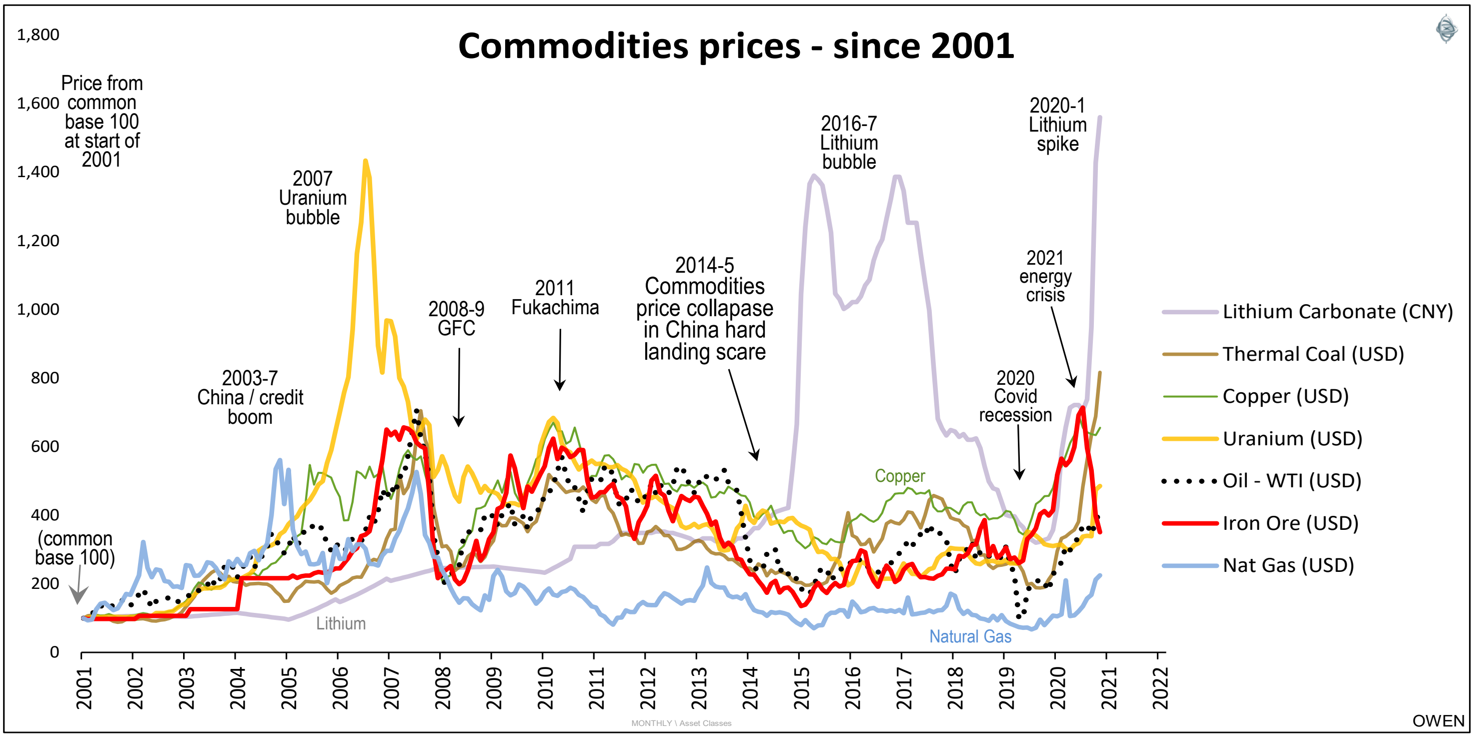
For the 2021 calendar year to date, the global market is up by an above-average 15%, or 17% including dividends, led by US big tech, and supported by profit recoveries virtually across the board. Nearly all major global markets are having a strong year.

<u>Commodities prices</u>

Commodities prices are at the heart of the current dilemma for investors – not only because Australia has always relied on commodities exports for its national income and wealth (and the price of our number one export – iron ore – has fallen heavily this year), but also because commodities prices reflect, and also directly impact, broader economic forces that are driving all investment markets globally – including shares, bonds, interest rates and currencies.

Below is a chart of some key commodities from a common base at the start of the China boom. We have included the key energy commodities – oil, natural gas, coal and uranium, plus two metals that represent the 'hot' renewables/'EV' (electric vehicles) boom – copper and lithium. Also included is iron ore because of its importance to Australian tax revenues and to Australia's largest three listed miners (BHP, RIO, FMG) which together contributed the lion's share of last year's profits and dividends from the entire 2,200 companies listed on the ASX.

For the most part, commodities prices tend to rise and fall with economic cycles – aside from some notable occasional spikes, like uranium in 2007, and lithium in 2016-7 and again this year.



In the most recent cycle, commodities prices collapsed in the 2020 global Covid recession, but have since rebounded with the economic recoveries. The exception was iron ore (red line), which surged in 2019 and 2020 after a mine disaster shut off supply from Brazil, but then prices collapsed in 2021 due to two developments in China – a clampdown on steel mills, and the property construction slowdown.

Energy prices have surged this year, driven not only by increasing demand with the economic recoveries but also by supply constraints due to several factors including Covid restrictions, floods and other unrelated problems in several countries. Oil prices were up another 11% for the month, and up 71% for the year to date, after falling -20% last year. Natural gas is up 6% for the month and up 13% for the year. Thermal coal is up 19% for the month and 177% this year. Uranium has also had a revival as a fuel source - up 2% in October, and up 55% for the year to date.

Rising energy prices have been causing power cuts and factory shutdowns in China and around the world, in turn causing major disruptions to global supply chains. (There were other causes as well, notably the global semiconductor chip shortage, caused initially by a drought in Taiwan). At the same time, the accelerating shift away from fossil fuels is igniting price spikes in metals vital to 'renewable' energy sources – in particular copper (needed in huge quantities in generators for wind and hydro, and in electric power systems generally), and lithium (for batteries) along with other metals like nickel and cadmium. Crop prices are also up strongly this year – especially wheat, corn, canola, oats, palm oil, cotton and even coffee - mostly a result of supply constraints.

Inflation

The problem is that rising energy prices are causing inflation rates to rise back above their 'target' ranges in most countries. CPI inflation is running at 5.4% in US, 4.1% in Europe, 3.1% in UK, 4.5% Germany, 5.5% in Spain, 4.4% Canada, 3% in Australia. Central banks focus mainly on 'core' or 'underlying' inflation, which excludes fuel and food costs. But these core/underlying inflation numbers are also starting to worry central bankers, because energy prices, and other industrial commodities prices feed indirectly into the prices of virtually every item we buy. For the past year, central banks have been dismissing these rising inflation rates as 'transitory', and they stuck to their promises of ultra-low rates for years. Now they are starting to realise that inflation may be more than merely 'transitory', and they are even starting to talk about the risk of 1970s-style 'stag-flation' (high inflation with economic stagnation).

We have covered the risk of inflation and stag-flation in various monthly reports and in our recent video podcasts, including the likely impacts on investment markets and returns (In short, nominal and real returns from all types of assets are lower, but company shares usually fare best). Most important is how central bankers react – in particular, whether they accelerate or delay their rate hikes. Interestingly, the usual 'inflation hedge', gold, is not reflecting inflationary fears – it was flat in October and is down -6% for the year.

Bond yields

Fears of inflation, and the increasing likelihood of possibly sooner than expected interest rate hikes, drove bond yields higher around the world in October. Yields on Australian government bonds rose the most – including at the short end up to 3 years, where the RBA had been promising to keep buying up bonds to depress rates, its target being a 0.10% peg. By the end of October, yields on 3-year bonds shot up above 1% as the RBA simply was not able to throw enough money at the sellers to maintain the peg. (The RBA recently posted a $4.3b loss for the 2020-1 financial year, including losses of $8.2b on bonds it bought in the QE bond-buying program to depress rates artificially). October 2021 was the worst month for Australian fixed-rate bonds since October 1987 (yes, the same month as the October 1987 share crash). The Australian bond market is heading for its first negative calendar year since 1999, and it is also looking like the first negative year for global bonds since 1994.

US yields also rose a little at the short end, but fell a little at the long end, reflecting fears that rate hikes in the next year or so may slow US growth further down the track. Fortunately, we have been significantly underweight fixed bonds in our portfolios. Refer to the table on portfolio positioning later in this report.

China

Aside from the threat of rising interest rates, the main issue for investment markets, global growth rates, and Australia in particular, is the immediate outlook for China. China's incredible transformation and growth over the past two decades has been driven largely by property construction, built largely with mountains of debt (and mountains of Australian rocks!). The government has been trying to shift the driver of growth from construction to consumption (as in the 'west'), but with little success. Its 'three red lines' policy aimed at reducing leverage in the property construction sector has opened up a can of worms this year, with the Evergrande crisis proving to be the tip of the iceberg that has triggered another 'China hard landing' scare. The last 'China hard landing' scare in 2014-5 resulted in a collapse in global commodities prices, which in turn caused a global 'earnings recession' due to oil/gas/steel losses around the world, including in Australia. China ended that crisis and kick-started growth in March 2016 by reverting to its reliable 'go-to' solution for all previous slowdowns: construction. This time, construction is the cause of the problem, not the solution. Turning a construction slowdown into a construction-led rebound will not be such a simple solution as it was in previous cycles. We covered this in detail in our last monthly report dated 5th October 2021.

Portfolio positioning

Our portfolios posted further modest gains in October. Current portfolio settings have been positioned for continued rises in share prices, and also rises in inflationary expectations and interest rates. In summary, we are:

- 'Neutral' on the 'Growth'/'Defensive' mix overall.
- Over-weight global shares (which have beaten Australian shares in the rebound). FX hedging is at 50% (ie neutral).
- 'Neutral' on Australian shares, with a bias toward small/mid-caps, which have led in the rebound.
- No allocations to listed or unlisted commercial property in managed account portfolios, but many/most clients have selected holdings outside their managed account portfolio.
- Defensive assets – biased toward high-grade corporate credit (which has beaten government bonds due to their shorter duration, higher interest coupons and tightening credit spreads in the rebound). The defensive side is also heavily biased toward floating rate (which has beaten fixed rate because of rising yields). We hold no 'high yield' debt.
- Outside managed account portfolios – biased toward global healthcare stocks, healthcare property, small company shares and selected private equity funds.

Summary of Major Market Risks

The table below sets out the main factors driving global investment markets. For each risk, we assess the current position on a scale between negative (orange) and positive (green) impacts on markets, and comments on changes over the past quarter. On balance it has been a mixture of improvements and deteriorations over the quarter:

FACTOR ↓	Negative for risk assets	Positive for risk assets	Change	Comments on recent activity / changes
Virus pandemic	Risk of new, more deadly strains requiring more hard lockdowns. Lower demand, supply chain disruptions, another major hit to global corporate profits	Vaccine roll-outs + new, more general vaccines – enabling a return to 'normal' freedoms and economic activity	Improvement	Infection and death rates now running well below their 4th peak in August. Vaccine levels improving, albeit mainly in high/middle-income countries. Lockdowns are being eased and infection rates being managed, rather than eliminated. Broader vaccines nearing approval.
Monetary Policy (government support via interest rates + bond-buying)	Central banks tightening ahead of expectations – scaling out of QE + rate hikes	Central banks keep rates low + keep buying bonds to keep long term borrowing rates low	Deterioration	US Fed is at great pains to assure markets that it will remain very cautious about tightening too quickly. One negative element is Elizabeth Warren's increasing attacks on Jay Powell's re-appointment as Fed Chair. RBA finally abandoning its previous promises to not raise rates until 2024. Also abandoning its 3-year rate peg. Some other central banks starting to increase rates – NZ, Norway, Singapore, and several emerging markets
Fiscal Policy (government support via deficit spending & borrowing)	Governments tightening policy more quickly than expected – via lower spending, higher taxes. Debt ceiling restrictions, or default fears, bring a sudden end to spending / borrowing	Governments supporting incomes and spending longer than expected. Debt ceiling limits extended or delayed	Improvement	US Congress has passed huge new stimulus packages. If anything, Biden is mainly under pressure to *increase* spending (Sanders faction) – not reduce it. However, tax hikes are still on the agenda, and plans are advancing. The US debt-ceiling crisis postponed once again.
Inflation	Years of ultra-loose monetary and fiscal policies led to persistently higher than expected inflation, prompting fears of, or actual, aggressive rate rises	Benign or low inflation likely to lead to lower policy cash rates or slower rate hikes	Deterioration	Rising food + energy costs due to supply constraints - Central bankers admit that the current high inflation rates may not be as 'transitory' as they had thought earlier in 2021. Bond yields kept low only by artificial QE, masking actual inflation fears. Now talk of 'stag-flation' that would require earlier rate hikes but with stagnant growth, jobs, income, demand.
Corporate profits	Profits worse than expected, or sudden major collapse in profits	Profits better than expected	Improvement	Profits continue to beat expectations – in the US, Australia, other major markets, with very few exceptions. US/Global profits already back above pre-Covid levels
Asset pricing	Expensive – not supported by fundamentals, driven by over-confidence & optimism, supported by zero interest rates, QE asset buying + fiscal support – all of which are temporary	Assets cheap relative to fundamentals, with pricing kept low by un-founded fear & pessimism	Improvement	Levels of over-pricing have improved over the past quarter as share prices risen (slightly) but profits improved strongly. Speculative fever seems to have waned since the Jan-Feb 2021 peak, although all assets are still being supported by artificial and temporary monetary and fiscal support – leaving markets vulnerable to any negative shocks.
China - Economy	China 'hard landing' - lower demand, production, employment, with social unrest, property/banking collapse, commodities price collapse, all leading to lower aggregate global corporate profits	Stability & strong economic growth maintained via stimulus spending, consumer spending & confidence	Deterioration	Evergrande crisis – missed payments, but gov appears to be moving to take action to minimise social unrest, albeit with losses to some classes of creditors. Gov also likely to extend finance to other developers due to the flight of bond investors. Rising credit spreads on emerging markets bonds. Production cuts due to energy crisis, resulting in global supply chain problems. Australia is affected by lower iron ore prices + trade restrictions.
Geo-political conditions	Sudden military action that significantly reduces global trade, investment, movement of goods, spending, profits	Predominantly peaceful ('cold war') military build-up + spending = good for business + commodities prices	Little change	Xi recently claimed the 'liberation' of Taiwan would be 'peaceful', but increased military flights into Taiwan's territory + further violent clashes in Hong Kong. Sets target of 2025 to be ready and able to invade Taiwan (and presumably win a war against US/Japan/South Korea). However, in the near future is likely to be further military build-up in region/world rather than an invasion of Taiwan.
Trade/Tech Wars	Increase in tensions, winding back globalisation, increased protection raising costs, cyber-attacks (or widespread fear thereof) causing major damage to global corporate profitability, confidence, spending	No escalation in tensions or restrictions that would negatively affect global profits	Deterioration	US/global companies continuing to reduce reliance on China, some due to supply chain disruptions, some due to protection/restrictions, others due to China's data/security laws
Regulatory attacks	Regulatory attacks to close down, break up, or restrict US 'big-tech'	Monopolies allowed to continue unaffected; or break-up not necessarily negative for aggregate profits; or competition benefits	Little change	China increasing attacks on its own tech companies, but little or slow progress in Europe & US against US tech giants. Battles are likely to be very drawn out over many years
Climate change	Worst case would be widespread permanent damage to aggregate corporate profits caused by rising global temperatures, or by radical legislation designed to cut carbon emissions	Companies adapt to changing conditions as they have always done, and/or new opportunities arise to replace profits lost in legacy industries	Little change	Companies and countries everywhere have made bold 'me-too' 'Net zero by 20xx' promises, but with very scant concrete action plans to actually reduce emissions to zero ('The next, next, next leader/CEO can worry about that!'). Supply disruptions and soaring energy costs have highlighted difficulties in shifting too quickly away from fossil fuels, now leading to more support for fossil fuel supplies, and likely to elongate the timetable and support for the transition. Australia is likely to benefit from supplying key commodities for renewables industries.

Summary of Asset Allocation Positioning & Changes

Following our regular quarterly review after the end of the calendar quarter, we re-balanced portfolios back to their target weights and also made some adjustments, described below:

Asset Class	Changes	Current position	Comments & Rationale
Australian Shares	No Changes	 Neutral	Australian shares have continued to rebound this year, underpinned by better than expected profit rebounds from last year's Covid recession, thanks largely to three main factors – the extraordinarily generous and unprecedented monetary policy (ultra-low interest rates and bond-buying); ultra-loose fiscal policy (war-time-like deficit spending) from the government (future taxpayers); and China's stimulus spending boost. Although each of these factors is now retreating – interest rates will be raised in the coming year or so; government hand-outs are being withdrawn; and China's economy and construction boom are slowing. Our portfolios are biased toward small and mid-sized companies, and these are faring better than larger companies during the rebound. The actively managed funds we use in portfolios are selected for their defensive qualities and they added value during the virus sell-off and also in the rebound.
Global Shares	No Change to overall weight but some fund changes	 Over-weight	Although portfolios are 'neutral' in their overall growth/defensive mixes, the extra allocation from being underweight property and infrastructure is being used in global shares instead. Global share prices have rebounded strongly this year, supported by the very strong rebound in global corporate profits, which continue to beat expectations. As foreshadowed in our last quarterly report, we are now reducing exposures to listed infrastructure shares, and also to 'Emerging Markets' shares. We are also reducing carbon footprint in portfolios by switching to fossil-fuel-free funds. We are also increasing exposure to small-caps, and adding another active global share fund.
Currency hedging on global shares	No Changes	 Around Neutral	Currency hedging on global shares remains at 50%. The Australian dollar is currently a little above its fundamental 'fair value', but should continue to be supported by rising commodities prices and strong inflows of foreign capital to buy AAA-rated Australian bonds. The other major driver is the question of which central bank will start to raise interest rates first. This is the biggest unknown in the equation, and the balance of likelihoods change daily, so we are opting not to take a position either way, and remain neutral. The AUD has oscillated a little during the year, but it is more or less the same level as it was in the middle of the year and at the start. We are happy to leave hedging at a neutral 50% in the current environment.
Property & Infra-structure	No Changes	 Underweight	Last year we removed our property exposures and reduced infrastructure assets. Infrastructure and commercial properties are likely to recover in time, but probably to lower levels than they previously enjoyed with their very high pre-Covid valuations. The lockdowns revealed how vulnerable retail and office properties are to closures by government edict, tenants unilaterally refusing to pay rent, and governments unilaterally removing legal rights to collect rents and outgoings. Property & Infrastructure are also expected to suffer more than shares as inflation and bond yields rise in the medium term, which is our base case.
Australian Fixed-rate Bonds	No Changes	 Under-weight	We are holding very low allocations to Australian fixed-rate debt as we have been wary of rising inflation and bond yields this year. In October, the local bond market matched its February 2021 decline (in the last inflation scare), which was the worst monthly return since October 1987, when yields jumped by more than 1% in less than a month. Our base case is that there will be several more inflation scares that affect bond returns in the medium term. Whereas fixed-rate bonds are hurt by rising inflation and interest rates, high grade floating rate bonds benefit.
Global Fixed-rate Bonds	No Changes	 Underweight	Our portfolios are also significantly underweight global fixed-rate bonds for the same reason – our outlook for rising inflation and interest rates in the medium term. The global bond market is also heading for a loss this year as a result of rising bond yields caused by fears of rising inflation and central banks raising interest rates and scaling out of their 'QE' bond-buying programs. At current prices and yields, bonds offer very little of the traditional protective qualities against share corrections that they have in past cycles.
Australian floating rate debt	No Changes	 Overweight	Traditionally, there is no allocation to floating rate securities in our normal 'neutral' model portfolios, but we have been holding significant allocations to high grade floating rate notes to reduce the portfolio sensitivity to rising bond yields, as rising global/US inflation remains a significant risk to markets. As described above, most of our defensive allocations are in high grade floating rate securities, in order to reduce the negative impact of rising inflation and to benefit from rising interest rates.
Australian Cash	No Changes	 Underweight	Our portfolios hold minimal cash levels. Instead, most of our cash allocation is held in high grade floating rate notes, which offer moderately higher interest rates with minimal volatility and negligible risk of capital loss.

Reducing the carbon footprint in portfolios

Summary – We are making changes to portfolios to reduce carbon intensity, in order to assist in providing a hedge against climate-related risks, particularly regulatory/legislative changes and structural shifts affecting fossil fuel producers. This section describes changes to the two main passive index funds for global shares in our portfolios. The change results in 20% lower carbon intensity, and 99% lower fossil fuel Reserve Emissions. This is just one step in our ongoing commitment to providing sustainable and robust portfolios to meet the needs and aspirations of our investors in a changing world.

Background

As long term custodians of wealth for our clients and their families, we must assess and plan for a host of possible risks to our clients' future capital, income, and therefore the future living standards of themselves and their families, and also their legacies. In the coming decades, investors will need to deal with risks such as interest rates, inflation, deflation, demographic shifts like aging populations and rising welfare costs, changes to economic structures, regulations, taxes, technology, whole industries dying and new ones appearing, political upheavals, trade wars, geopolitical shifts, 'cold wars', peripheral wars, and possibly even 'world wars'. One of the major risks to long term investment outcomes is going to be navigating and adjusting for impacts of rising global temperatures, and the transition away from the current heavy reliance on fossil fuels for global energy needs.

A possible 'worst case' scenario might be a future with widespread permanent damage to aggregate corporate profits caused directly or indirectly by rising global temperatures, and/or resultant weather events, and/or by radical legislation designed to cut carbon emissions. While the direct impacts of rising temperatures on plants and animals may be gradual and take many years to evolve, the possible impacts of radical government actions (like taxes or bans) would probably be more sudden and more damaging to companies and possibly whole industries. This type of 'worst case' scenario would be a world with permanently lower aggregate economic activity, incomes, living standards, and profits.

A possible 'best case' scenario might see companies and industries innovating and adapting to changing conditions, as they have always done, and/or new opportunities and companies arising to replace profits lost in legacy industries. In every structural upheaval in the past (for example: from farming to factories to offices to online careers; from candles to gas lights to electric lights; from horse-drawn carriages to trains to cars to driverless, from letters to telegraph to wired telephones and then to mobiles; from abacuses to slide rules to mainframes to laptops; from shopping malls to online sales, etc) - inevitably some companies adapt while others fail and disappear, and new companies emerge to suit, and prosper in the new conditions. Aggregate profits (including the failed incumbents that could not adapt), continue to rise, as they always have managed to do in the past. A 'best case' scenario would also require governments and legislators to act with wisdom and foresight, making far-reaching changes, quickly and decisively, taking voters with them, and with global cooperation and coordination.

The actual path will be somewhere between these two extremes. There will no doubt be many missteps along the way, especially as much depends on national and global politics, which are changing constantly. While the path and the eventual outcome in, say, 50 or 100 years is unknown and unknowable in advance, what is certain is that everyday life will be completely different in the future to what it is today. As different, or perhaps even more so, than the changes to our everyday lives over the past 50 or 100 years, or the previous 100 years.

Investors will need to navigate every step along the path, dealing with the immediate short term impacts, while keeping an eye on how the longer-term picture may be evolving.

What we are doing in portfolios

While these issues have been percolating for several years, we started making changes to our investment thinking and processes two years ago. Our diversified portfolios comprise several different types of assets – the main types being company shares, real estate, bonds, and cash. At times we have also included other types such as currencies and commodities (eg gold). Each asset class requires a slightly different approach to making them more sustainable and reducing their carbon footprint.

Changes to processes for 'Active' funds

In portfolios, we utilise a mix of 'active' and 'passive' funds. 'Active' funds have teams of skilled analysts that undertake detailed research and investigation into the companies or securities in their chosen market. This process typically involves analysts undertaking numerous visits and meetings with company management, customers, suppliers, competitors, regulators, etc, in addition to detailed analysis into the company's financial accounts, regulatory filings, tax statements, patents, litigation, and anything else relevant to the company's operations and prospects. This includes investigation into each company's 'ESG' (Environmental, Social, Governance) policies and practices, including their carbon footprint and carbon reduction programs. For inclusion in our portfolios, we require that active funds have demonstrable processes and practices on 'ESG' and the impacts of climate change in their assessment and selection of the companies in their funds. We require these before the approval of each fund, and we review them regularly. This is an ongoing process that is being enhanced progressively.

Changes to 'Passive'/'Index' funds

The role of active funds in our portfolios is to add value over a range of market conditions. In addition, we also use low-cost 'passive' / 'index' funds to reduce overall costs, and also for short/medium term 'tactical' use – ie. to increase or reduce exposures to particular markets or sectors in different parts of a market cycle (eg. over-weighting shares for rallies, under-weighting for sell-offs).

Unlike active funds, passive/index funds merely buy shares in every company in the relevant index they are tracking. For example, the 'MSCI Developed World Large/Mid-cap Shares' index currently consists of 1,500 companies around the world, and so the passive funds that track this index will simply buy shares in each and every company in the index, at its index weight, regardless of whether it is cheap or expensive, regardless of the quality of the company's management, balance sheet or earnings, regardless of its future prospects, or debt levels, and regardless of whether it is a big polluter or not. Because of their much lower costs, passive/index funds tend to be much cheaper than 'active' funds. They are also very transparent and tax-effective, hence their attraction in diversified portfolios like ours.

What we are doing in the current rebalance cycle now is shifting the core passive/index funds for international shares in portfolios from the standard versions (which contain all the shares in the designated index) to ESG/non-fossil fuel versions:

- On the AUD-hedged side of international shares:
    - from: Vanguard 'MSCI Index International Shares (Hedged) ETF' (code: VGAD)
    - to: Vanguard 'Ethically Conscious International Shares Index Fund – AUD Hedged' (VAN0848AU)
- On the un-hedged side:
    - from: Vanguard 'MSCI Index International Shares ETF' (Code: VGS)
    - to: Vanguard 'Ethically Conscious International Shares Index ETF' (Code: 'VESG')

The two existing funds we have been using in portfolios – VGAD and VGS – have the same underlying holdings as each other, except VGAD is AUD hedged and VGS is un-hedged. The two proposed funds to take their place – VAN0848AU and VESG – also have the same underlying holdings as each other (although slightly different from VGAD/VGS), except VAN0848AU is the hedged version and VESG is the un-hedged version. We use both the hedged and un-hedged versions in portfolios as a simple and cost-effective way of managing foreign exchange risk and adjusting FX hedge ratios for a rising and falling Australian dollar.

Differences in the two pairs of funds

The new pair of funds VAN0848AU/VESG are essentially ESG/non-fossil fuel versions of VGAD/VGS. The main difference is that the ESG/non-fossil funds exclude oil, gas and coal producers, and also power utilities that burn and produce primarily fossil fuels. These exclusions result in significant carbon emission reductions. Specifically, Carbon Intensity is reduced by around 20% (from 223 down to 175 metric tons CO_2e per $1m invested), and fossil fuel Reserve Emissions are reduced by at least 99% (from 1,900 down to 6 metric tons CO_2e per $1m invested).

In addition to the exclusion of fossil fuel producers, these funds also have a set of 'ESG' filters that screen out companies based on how they rate on several Environmental, Social and Governance measures. For example, the funds exclude tobacco producers (removes Philip Morris, Altria/Marlboro, BAT, Imperial Brands, etc), gambling (eg. Sands, Evolution), animal testing (eg. JNJ), civilian firearms (eg. Walmart), alcohol (eg. LVMH, Diageo). For further details on the funds, see the links above.

Differences in investment returns

Our research has shown that the removal of stocks on the basis of these ESG screens (aside from the fossil fuel exclusions) has made very little or no material difference to investment returns over time. However, the exclusion of fossil fuel producers does impact investment returns. A link to our more detailed report on the financial impacts on returns is available in the email sent with this report. In summary:

- Although the fossil fuel sector is a relatively small part of the overall global share market (around 3%), the return differences from excluding fossil fuels can be material at times.
- There are two return effects in play: the first is cyclical, and the second is structural.
- The energy sector is very cyclical and is essentially a leveraged bet on oil prices (operational leverage from high levels of fixed costs in energy producers, and financial leverage from their gearing). Energy stocks beat the broad market when oil prices are rising (generally in economic booms and recoveries), but lag the broad market when oil prices are flat and especially when oil prices fall sharply (which is generally in recessions and global slowdowns).
- In the 2020 covid recession, energy stocks were sold off heavily as oil prices collapsed. In the March quarter of 2020, the broad global share market fell by -20%, but the energy sector fell by -45%. As a result, non-fossil fuel funds beat the broad market funds (including energy).

- However, over the past 18 months, the oil price has risen strongly in the global economic recovery. With rising oil prices, energy stocks have beat the broad market, and therefore non-fossil fuel funds have lagged the broad market. For the 12 months to the end of September 2021: The broad global market is up +29% (total returns including dividends), but the energy sector is up by +70%, because the oil price is up by +87% (with similar spikes in gas and coal). The non-fossil fuel index is up by +28% - ie it is lagging the broad market by 1% for the year.
- Therefore, the exclusion of the fossil fuel sector that represents just 3% of the global market, led to a 1% lag in returns over the past year. Investors should expect this to occur from time to time due to the cyclical swings in energy prices.
- In addition to this cyclical effect that leads to short term performance differences with rising and falling oil prices, some longer-term structural shifts are likely to affect returns from the fossil fuel sector. There is a strong case that fossil fuel companies will continue to decline in profitability over time – due to increasing costs of capital (debt and equity) as a result of being shunned by lenders and investors, in addition to high costs of conversion/transition to renewables, escalating clean-up bills for contaminated sites and spills, and the costs of dismantling and disposing of 'stranded assets' (like obsolete oil rigs, coal mines, power stations).

On balance, the shift to the non-fossil fuel portfolios makes sense - for reasons of both principle and profit in the long term. Given the recent surge in fossil fuel prices (and fossil fuel producer share prices with them), it may turn out to be an ideal time to make the switch. (At the same time, our 'active' managed funds are also taking these types of factors into consideration in their stock-picking processes).

Renewable energy sources and technologies

While reducing investment in fossil fuel companies makes financial sense as they face increasing problems, costs and hurdles, picking winners in the 'renewables' sector is much more difficult. With any shift to new methods and new technologies, there are many losers for every winner, and even the 'winners' often don't last long before being replaced with a new 'winner'. For example, in the transition from movies on TV, Betamax was the next 'big thing', but it was challenged by VHS. The great VHS -v- Betamax battle was fought out in head offices, factories and lounge rooms all over the world for a decade. Betamax lost and VHS won, but within a few years VHS was replaced by DVDs. Then DVDs were replaced by 'streaming'. Young people today ask 'what is VHS?, Betamax?, DVD?'. The next generation probably will ask 'what is streaming?, what is Netflix, Stan, etc '. Remember Friendster? Remember MySpace? Remember Facebook? (Mark Zuckerberg is now helping accelerate the decline of that brand!).

Picking winners from the inevitable losers in new, alternative, 'renewable' energy industries is made even more difficult by huge market distortions created by government policies, government subsidies, and governments trying to pick winners. Even with solutions that turn out to be winners, there are likely to be tremendous speculative bubbles and busts – like the nickel bubble in the late 1960s and early 1970s, the uranium bubble in the mid-2000s, and many more throughout history. The underlying themes were legitimate, but huge numbers of investors are lured into hundreds of speculative schemes conjured up by sharp promoters to harvest money from eager investors. Even where the technology is sound, companies are destroyed by poor management and over-investment. For example, solar panels have been tremendously successful in creating solar power, but countless billions have been lost in companies across the solar panel supply chain, in Australia and around the world.

While reducing fossil fuels in our core model portfolios, we are also approaching the much more difficult terrain of 'renewable' energy sources and new energy technologies by helping investors with additional funds and approaches outside managed accounts portfolios. As a start, we are adding the following funds to the menu:

Code	Fund	Web site	Hedged/ un-hgd	Brief description	Suitability
ETHI	BetaShares Global Sustainability Leaders	Link	Un-hedged	Substantial reduction in fossil fuel production and usage. Broad and deep ESG exclusions resulting in a tech-heavy 200-stock portfolio that as screened out most of the major global household names	Suitable for a minority of investors – with particular interests and risk tolerance
HETH	BetaShares Global Sustainability Leaders - Hgd	Link	Hedged		
ERTH	BetaShares Climate Change Innovation	Link	Un-hedged	Substantial reduction in fossil fuel production and usage. Concentrated portfolio based on alternative energy - covering the whole supply chain from generation (solar, wind, etc), storage, transmission, transport, components, building products, through to end consumer products (eg. Tesla)	Suitable for a minority of investors with a specific interest in green energy, and high risk tolerance to greater risk of loss and greater volatility

The first two are hedged and un-hedged versions of the same strategy – which is a more targeted and concentrated approach to ESG and renewable energy. The third is a very concentrated portfolio of companies across the renewables sectors. These funds are not for everybody because they are much more concentrated (ie less diversified) and are much more volatile than the funds we use in model portfolios. Please talk to your advisor for more information about these funds, including what types of investors they may suit, and how they might be used in the context of your overall portfolio and your specific needs and interests.

These are passive funds that track specific, specialist indexes. In addition to specialised index funds, we also will be including additional 'active' funds to this list of preferred funds.

In addition, we are also making the following changes to managed account portfolios – within the 'global shares' asset class.

Removing Magellan Infrastructure fund (hedged)

The Magellan Infrastructure fund has been a successful long term holding in our portfolios during the period of declining inflation and bond yields (the post-GFC 'QE' boom), but is now not considered a core holding in the scenario of rising inflation and interest rates in the medium term. Listed infrastructure stocks (including this fund) thrived during the post-GFC 'QE' boom with declining interest rates and bond yields. The fund beat its infrastructure index, and it was also beating the overall global share index until the covid crisis, which hit infrastructure revenues particularly hard.

Listed infrastructure (and also listed property trusts as a group) have acted as 'bond proxies' for many years. What this means is that, over long (decade-plus) periods, they have returned about the same as the broad share market, but infrastructure consistently out-performs the broad share market when bond yields are falling (for example in recessions and slowdowns), but lag shares when bond yields are rising (for example in economic recoveries and booms). This has been a very distinct pattern over numerous past cycles in recent decades – in Australia and globally. Our base case over the past year has been that 2020 will turn out to be the low point for bond yields and negative inflation, and that inflation, bond yields and interest rates will rise in the medium term. If that is the case, then infrastructure (as well as listed property) are likely to lag shares in a rising rate world. In short, infrastructure (and the Magellan fund) rode the tailwind of declining interest rates over the past decade, but are now likely to face headwinds of rising interest rates in future.

In its place on the 'currency hedged' side of global shares, we are adding an international small companies index fund – refer to later section on fund changes.

Removing iShares 'IEM' to reduce passive emerging markets exposure

'Emerging Markets' is a term used by index houses (like S&P, MSCI, FTSE, etc) to refer to countries with higher economic growth rates but lower incomes per capita than so-called 'Developed' markets (ie US, Japan, Western Europe, Canada, Australia, NZ). 'Emerging Markets' include China, most of South Asia (including India), Latin America, South East Asia and Eastern Europe (including Russia). (South Korea, Taiwan, Hong Kong and Singapore can be classified as either 'emerging' or 'developed' in different indexes). China makes up by far the largest proportion of emerging markets indexes.

Emerging markets shares as a group have traditionally behaved in a very consistent pattern over several decades. Emerging markets shares as a group are essentially a 'high-beta', 'pro-cyclical' barometer of global investor sentiment and confidence. As such, emerging markets shares as a group almost always outperform 'developed' markets shares in global rallies and rebounds, but they almost always suffer worse than developed markets in global sell-offs. This pattern has been consistent over many cycles regardless of local pricing or local conditions in each country. (The same is true for 'small cap' stocks as a group).

In our portfolios, we have utilised this 'pro-cyclical' pattern successfully in the past – by over-weighting emerging markets for rallies, and then reducing or removing them for sell-offs. For example, we removed IEM for the late-2018 sell-off, then added it back for the 2019 rebound, and the pattern worked like clockwork. However, for the 2020 covid sell-off we retained IEM (which was unusual for us in a sell-off) because we felt that China/Taiwan/Korea tech stocks were likely to be less affected by the lockdowns. IEM did in fact hold up better than the broad market in the 2020 Covid sell-off, because China, South Korea and Taiwan had tackled Covid early, and also because the East Asian tech stocks benefited from the online spending boom in the lockdowns. IEM remained ahead of developed markets as a group during the subsequent global recovery into early-mid 2021.

However, we have now decided to remove the index fund 'IEM' from portfolios. This time it is not because we are shifting to under-weight global shares, but because of changes in the index composition and likely relative performance of the sector. Emerging Markets share indexes have come to be dominated by Chinese tech/online/social media stocks, which are increasingly been driven by political/geopolitical risks (eg Chinese government' capricious regulatory / retaliatory actions, for a variety of reasons including data access and the 'common prosperity' drive). This may result in the sector losing its traditional role as a standard pro-cyclical, high-beta play. Given the 'lumpy' nature of the emerging markets index funds and the unusual political risks facing Chinese stocks which dominate the index, we prefer to rely on active management (via our active global share funds in portfolios) rather than passive index funds that just buy everything in the index, regardless of merit.

We are replacing IEM with an additional active global share fund – Capital Group New Perspective Fund - refer to section on fund changes.

Soteria Model Portfolio Returns

As at end: October 2021		Neutral Growth/ Defensive Mix	Total Returns (net)					Inception Date
Portfolio	Long-term Return Goal		1 Month	3 Months	1 Year	3 Years (p.a.)	Since Inception (p.a.)	
Soteria Dynamic Active **High Growth**	CPI + 5.0%	95/5	0.92%	1.96%	25.74%	9.63%	9.04%	January 2017
Soteria Dynamic Index **High Growth**	CPI + 5.0%	95/5	0.56%	1.85%	27.72%	10.22%	8.06%	October 2018
Soteria Dynamic Active **Growth**	CPI + 4.5%	80/20	0.59%	1.46%	21.76%	8.24%	7.86%	January 2017
Soteria Dynamic Index **Growth**	CPI + 4.5%	80/20	0.30%	1.29%	22.85%	8.42%	6.72%	October 2018
Soteria Dynamic Active **Balanced**	CPI + 4.0%	65/35	0.30%	0.92%	17.03%	7.69%	7.13%	January 2017
Soteria Dynamic Index **Balanced**	CPI + 4.0%	65/35	0.07%	0.77%	18.12%	7.84%	6.42%	October 2018
Soteria Dynamic Active **Moderate**	CPI + 3.5%	50/50	-0.01%	0.49%	12.84%	6.53%	6.09%	January 2017
Soteria Dynamic Index **Moderate**	CPI + 3.5%	50/50	-0.19%	0.25%	13.15%	6.90%	5.84%	October 2018
Soteria Dynamic Active **Conservative**	CPI + 3.0%	30/70	-0.40%	-0.31%	6.74%	4.88%	4.61%	January 2017
Soteria Dynamic Index **Conservative**	CPI + 3.0%	30/70	-0.25%	-0.21%	7.29%	5.23%	4.64%	October 2018

Links to the portfolio factsheets which detail returns and asset allocation can be found in the email that was sent with this report.

Soteria Dynamic ***Active*** portfolios contain a mix of active and passive funds in each asset class and sector

Soteria Dynamic ***Index*** portfolios contain only passive index funds and exchange-traded funds (ETFs), which are generally lower cost than active funds but do not have the potential to add value through active stock-picking

Both versions are **Dynamic** in the sense that we make adjustments to holdings as market conditions change.

Notes:

- Individual client returns will vary depending on their own portfolio customisation, contributions, withdrawals, and timing differences.
- The above returns are net of underlying fund manager fees and Soteria's model fees.
- Portfolio inception date for the Dynamic Active accounts was Jan 1st 2017.
- Portfolio inception date for the Dynamic Index accounts was Oct 1st 2018.
- Past returns are not a guarantee or indicator of future returns.

Summary of Portfolio Changes

In the portfolio rebalance in November 2021, all portfolio holdings were rebalanced back to their target weights, and the following asset allocation changes were made. Portfolios remain neutrally positioned in their overall growth/defensive mix.

Changes to Dynamic Active portfolios:

Changes made in November 2021

Asset Class	Fund	Dynamic Active Conservative	Dynamic Active Moderate	Dynamic Active Balanced	Dynamic Active Growth	Dynamic Active High Growth
Global Shares	iShares MSCI Emerging Markets ETF (IEM)	-2.0%	-3.0%	-4.0%	-5.0%	-5.0%
	Vanguard MSCI Index International Shares ETF (Un-Hgd) (VGS)	-	-3.0%	-4.0%	-4.0%	-4.0%
	Vanguard Ethically Conscious International Shares Index ETF (VESG)	+2.0%	+6.0%	+8.0%	+9.0%	+9.0%
	Magellan Infrastructure Fund (Hgd)	-2.0%	-3.0%	-4.0%	-4.0%	-5.0%
	Vanguard International Small Companies Index Fund (Hedged)	+2.0%	+3.0%	+4.0%	+4.0%	+5.0%
	Vanguard MSCI Index International Shares (Hgd) ETF (VGAD)	-6.0%	-10.0%	-13.0%	-16.0%	-18.0%
	Vanguard Ethically Conscious International Shares Index Fund Hgd	+4.0%	+6.0%	+8.0%	+9.0%	+10.0%
	Capital Group New Perspective Fund Hedged (AU)	+2.0%	+4.0%	+5.0%	+7.0%	+8.0%

Changes to Dynamic Index portfolios:

Changes made in November 2021

Asset Class	Fund	Dynamic Active Conservative	Dynamic Active Moderate	Dynamic Active Balanced	Dynamic Active Growth	Dynamic Active High Growth
Global Shares	Vanguard MSCI Index International Shares ETF (Un-Hgd) (VGS)	-5.0%	-10.0%	-14.0%	-16.0%	-20.0%
	Vanguard Ethically Conscious International Shares Index ETF (VESG)	+5.0%	+10.0%	+14.0%	+16.0%	+20.0%
	iShares MSCI Emerging Markets ETF (IEM)	-2.0%	-3.0%	-4.0%	-5.0%	-5.0%
	BetaShares Global Quality Leaders ETF QLTY	+2.0%	+3.0%	+4.0%	+5.0%	+5.0%

Investment Research

This quarter we have added the following funds to managed account portfolios. A brief summary of each fund is below.

Capital Group New Perspective Fund AUD-Hedged (CIM0008AU)

Capital Group is a large, US-based, management/staff-owned, global investment house established in 1931. Their 'New Perspective' fund was started in 1973 and has been available in Australia since 2015. Its brief is to identify multi-national companies that have more than 20% of their revenues and profits outside of their home markets, with superior management and growth potential. Stock selection is generally biased toward companies that display 'quality' (high return on equity, low debt, consistent earnings growth), and 'growth' characteristics. The fund comprises eight global portfolios that are each run by portfolio managers and teams located in various offices around the world (LA, San Fransisco, London, Hong Kong, and Singapore), with each fund having its own distinct perspective and contribution to the overall strategy.

The fund has a long track record of out-performing the broad global stock market (after fees), including adding value in most downturns, as well as in most rallies and rebounds. It has displayed consistently higher returns, with lower volatility, superior defensive qualities, and lower costs than peer funds. The fund incorporates ESG factors in-stock selection.

A fact sheet for the fund can be found here. The Production Disclosure Statement can be found here.

Vanguard Ethically Conscious Int Shares Index Fund - AUD Hedged (VAN0848AU)

Vanguard Ethically Conscious International Shares Index Fund (AUD Hedged) seeks to track the return of the FTSE Developed ex-Australia Choice Index (with net dividends reinvested) hedged into Australian dollars (AUD) before taking into account fees, expenses and tax. The Fund provides exposure to many of the world's largest companies listed in major developed countries. It offers low-cost access to a broadly diversified range of securities that excludes companies with significant business activities involving fossil fuels, nuclear power, alcohol, tobacco, gambling, weapons, adult entertainment and a conduct related screen based on severe controversies.

Also refer to the earlier section of this report.

A fact sheet for the fund can be found here. The Production Disclosure Statement can be found here.

Vanguard Ethically Conscious International Shares Index ETF (VESG)

This is the un-hedged version of VAN0848AU – refer above.

A fact sheet for the fund can be found here. The Production Disclosure Statement can be found here.

Vanguard International Small Companies Index Hedged (VAN0022AU)

Vanguard International Small Companies Index Fund (Hedged) seeks to track the return of the MSCI World ex-Australia Small Cap (with net dividends reinvested) hedged into Australian dollars Index before taking into account fees, expenses and tax. The Fund provides exposure to small companies listed in major developed countries. It offers low-cost access to a broadly diversified range of securities that allow investors to participate in the long-term growth potential typical of the international small companies sector. The Fund is hedged to Australian dollars so the value of the Fund is relatively unaffected by currency fluctuations

A fact sheet for the fund can be found here. The Production Disclosure Statement can be found here.

BetaShares Global Quality Leaders ETF (QLTY) - being added to Dynamic Index portfolios

QLTY aims to track an index (before fees and expenses) that comprises 150 global companies (ex-Australia) ranked by highest quality score. The quality score rankings used to select the stocks in the index are based on a combined ranking of four key factors – return on equity, debt-to-capital, cash flow generation ability and earnings stability. The Fund's focus on quality aims to produce superior long-term performance compared to benchmark global equities indices.

A fact sheet for the fund can be found here. The Production Disclosure Statement can be found here.

Underlying Fund Returns

12 months to 31st October 2021

Asset Class / Funds	Fund return	Benchmark	Benchmark return	Comments
Australian Shares		All Ords Accumulation Index		
Greencape Capital Broadcap Fund	25.8%	All Ords Accum	29.0%	Factor/Style Neutral
Fidelity Aust Equities Fund	27.0%	All Ords Accum	29.0%	Large-cap broad.
Bennelong ex-20 Aust Equities	38.7%	ASX300 ex-20	26.0%	A mid-cap fund that tends to avoid big banks and miners.
Ironbark Karara Small Co Fund	17.8%	ASX Small Ords	31.0%	Small-cap fund.
Vanguard Aust Shares ETF - VAS	28.3%	All Ords Accum	29.0%	Low-cost passive index fund.
Allan Gray Australia Equity – Class B	39.9%	All Ords Accum	29.0%	High conviction contrarian value fund.
VanEck Australian Equal Weight ETF – MVW	25.3%	All Ords Accum	29.0%	Equal weights the 85 largest ASX stocks, resulting in a mid-cap bias.
Vanguard 'VSO' – small companies ETF	31.5%	ASX Small Ords	31.0%	Low-cost passive ETF of small ASX companies.
Global Shares - AUD Un-Hedged		MSCI ACWI (All Countries World Index) $A Unhedged		Unhedged foreign shares out-perform hedged when the AUD declines.
MFS Global (Un-Hgd)	29.2%	MSCI ACWI UnH	28.4%	A growth-oriented fund that has outperformed in recent sell-offs.
Magellan High Conviction (Un-Hgd)	15.6%	MSCI ACWI UnH	28.4%	Concentrated portfolio with the same philosophy as Magellan Global.
Vanguard Ethically Conscious Int. Shares Index ETF (VESG)	28.9%	MSCI ACWI UnH	28.4%	Low cost passive diversified index fund for developed stock markets.
BetaShares Global Quality Leaders ETF - QLTY	24.9%	MSCI ACWI UnH	28.4%	Low-cost ETF for Emerging Markets, 30% in China, 40% other Asia.
Global Shares - AUD Hedged		MSCI ACWI (All Countries World Index) $A Hedged		Hedged foreign shares out-perform un-hedged when the AUD rises.
Capital Group New Perspective Fund Hedged (AU)	41.0%	MSCI ACWI Hgd	36.2%	Listed global infrastructure fund.
Vanguard International Small Companies Index Fund (Hgd)	44.1%	MSCI ACWI Hgd	36.2%	
Vanguard International Shares (Hgd) ETF - VGAD	38.7%	MSCI ACWI Hgd	36.2%	Low cost passive diversified index fund for developed stock markets.
Real Estate		50% A-REIT TR + 50% G REIT TR (Hgd AUD)		
VanEck Vectors Australian Property ETF - MVA	32.0%	ASX200 A-REIT	30.9%	Equal weighted Australian listed property ETF that has outperformed the index and most active managers in recent years.
Australian Fixed Rate		Bloomberg Australian Composite Bond Index		Fixed-rate bonds benefit from falling long term interest rates – usually in anticipation of economic slowdowns.
PIMCO WS Aust Bond	-4.9%	B'erg AusBond	-5.3%	An active broad investment-grade bond fund
Vanguard Australian Fixed Interest Index VAF	-5.3%	B'erg AusBond	-5.3%	Passive investment grade gov, semi-gov & corporate debt
VanEck Corporate Bond ETF PLUS	-3.0%	B'erg AusBond	-5.3%	High-grade AUD corporate bonds
Australian Floating Rate		Bloomberg AusBond Credit FRN		Floating rate notes benefit from rising rates (whereas fixed-rate are hurt by rising rates)
Perpetual Wholesale Diversified Income Fund	3.6%	B'Berg Credit FRN	0.5%	Active diversified mostly investment-grade floating-rate notes fund
Janus Henderson Tactical Income Fund	0.3%	B'Berg Credit FRN	0.5%	Active high grade debt fund. Mostly corporate floating rate with some exposure to longer duration government debt.
Ardea Real Outcome Fund	-0.8%	B'Berg Credit FRN	0.5%	Australian government bond fund with an 'absolute return strategy. Low interest and credit risk.
VanEck Australian Subordinated Debt ETF	2.5%	B'Berg Credit FRN	0.5%	Passive ETF of investment grade, Australian dollar, bank subordinated debt.
BetaShares Australian Bank Senior Floating Rate Bond ETF	0.1%	B'Berg Credit FRN	0.5%	Passive ETF of investment grade, Australian dollar, senior floating rate notes issued by Australian banks.
VanEck Vectors Australian Floating Rate ETF	0.5%	B'Berg Credit FRN	0.5%	Low-cost passive floating rate fund
Global Fixed Rate		Bloomberg Global Aggregate Hgd AUD		A mix of Government, Semi-Gov, Corporate investment-grade fixed-rate bonds across the US, Europe and Asia
Colchester Global Government Bond Fund	-2.0%	Global Agg	-1.0%	Active government bond fund that takes positions on bonds & currencies
Vanguard Global Treasury ETF (Hgd) VIF	-2.5%	Global Agg	-1.0%	Low-cost passive fund of global Inv Grade government bonds
Vanguard Global Corp/Semi-Gov ETF (Hgd AUD) VCF	-0.4%	Global Agg	-1.0%	Low-cost passive fund of global Inv Grade Semi-gov /corporate bonds

Notes:

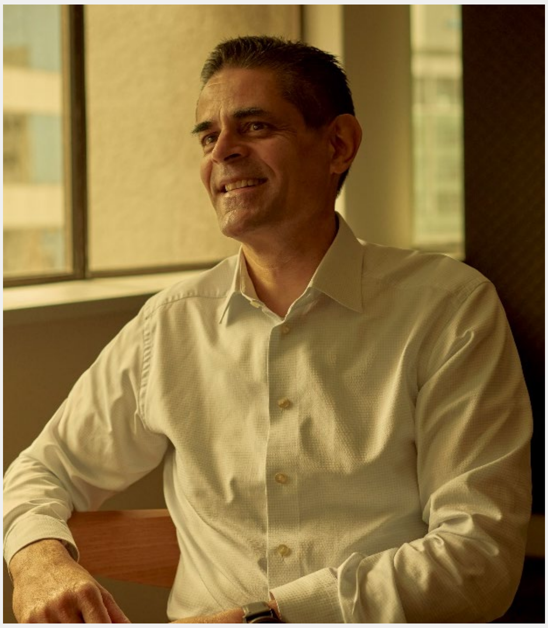
- The above table does not include funds that clients may hold outside the Soteria Managed Account portfolios
- The weights of each asset class differ in each of the Model Portfolios. Refer to separate reports for each portfolio.

  Care should be taken when interpreting returns over short periods. Each of the active funds have demonstrated long histories of outperformance over many years and through many types of market conditions, but they will all underperform from time to time

Ashley Owen

Chief Investment Officer

CFA, LLM, BA, Grad. Dip Applied Finance



Ashley is one of Australia's leading portfolio managers of diversified investment funds for long term investors. His mission is to manage portfolios that provide investors with confidence that their investments will generate the wealth they need to live the life they wish to lead for the rest of their lives – for themselves, their families and as a legacy for future generations.

His primary focus is protecting investors from losses and risks, rather than chasing high returns from the latest hot funds or fads.

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