

Quarterly Review of Investment Markets and Portfolio Changes

1 February 2022 (review after December quarter 2021)



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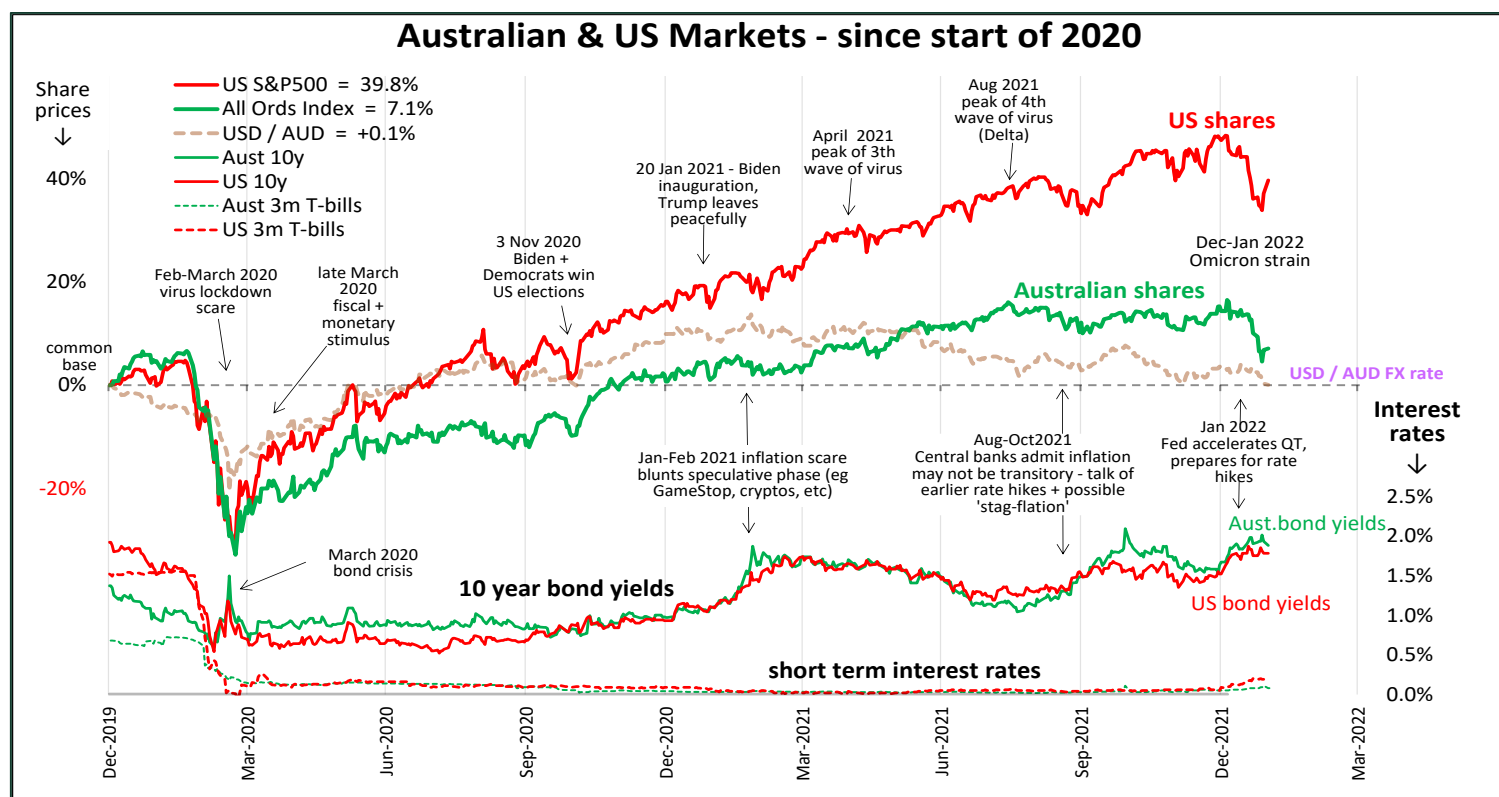
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Market Snapshot

Welcome to this edition of our regular quarterly review of markets and portfolio adjustments, following the December quarter. Although the review period was the December quarter 2021, our commentary also refers to events during January 2022.

The first chart shows share price indexes for Australia and the US from the start of 2020; the USD/AUD exchange rate (which broadly follows share prices); and the lower section shows bond yields and short term interest rates in both markets.



Since the coronavirus lockdown crisis in early 2020, there have been two major phases for investment markets:

In the first phase - from late March 2020 to January-February 2021 - aggregate global corporate profits fell by 40%, but share markets rebounded strongly, driven by extraordinary 'monetary policy' (central banks cutting short term interest rates to zero, buying up bonds to depress medium and long term rates, plus a variety of ultra-cheap loan programs), and equally extraordinary 'fiscal policy', in the form of massive, war-time-like deficit spending programs by governments to support incomes and jobs in the lockdowns. These enormous hand-outs led not only to a boom in online spending, but they also fuelled buying frenzies in a host of speculative assets – including speculative IPOs, 'SPACs' (listed cash-boxes), crypto-currencies, 'NFTs', and social media 'pump & dump' raids on 'meme-stocks'.

This speculative first phase peaked in early 2021 (eg. Netflix, Tesla, Apple, Tencent, Alibaba all peaked in late January with the GameStop/Reddit/Wall Street Bets frenzy), and Bitcoin/cryptos/NFTs peaked in mid-April with the Coinbase listing/peak. The primary trigger for the end of this speculative phase was bond yields rising sharply, due to fears of inflation (and impending interest rate hikes) from the tidal waves of free money from governments and their central banks. Those rate hike fears were a year too early, but they did end much of the speculative frenzy.

In the second phase – from early 2021 to the end of 2021- share markets overall resumed their advances – but this time led by non-speculative (defensive/value) stocks - consumer staples, industrials, banks, oil/gas, underpinned by strong profit rebounds, rather than speculative fever. Aggregate global profits soared back above pre-Covid levels, and share markets reached new highs. In this second phase, inflation did arrive, as feared by investors, but it was dismissed by central bankers, who stuck to their promises to ignore it, and to not hike interest rates for years.

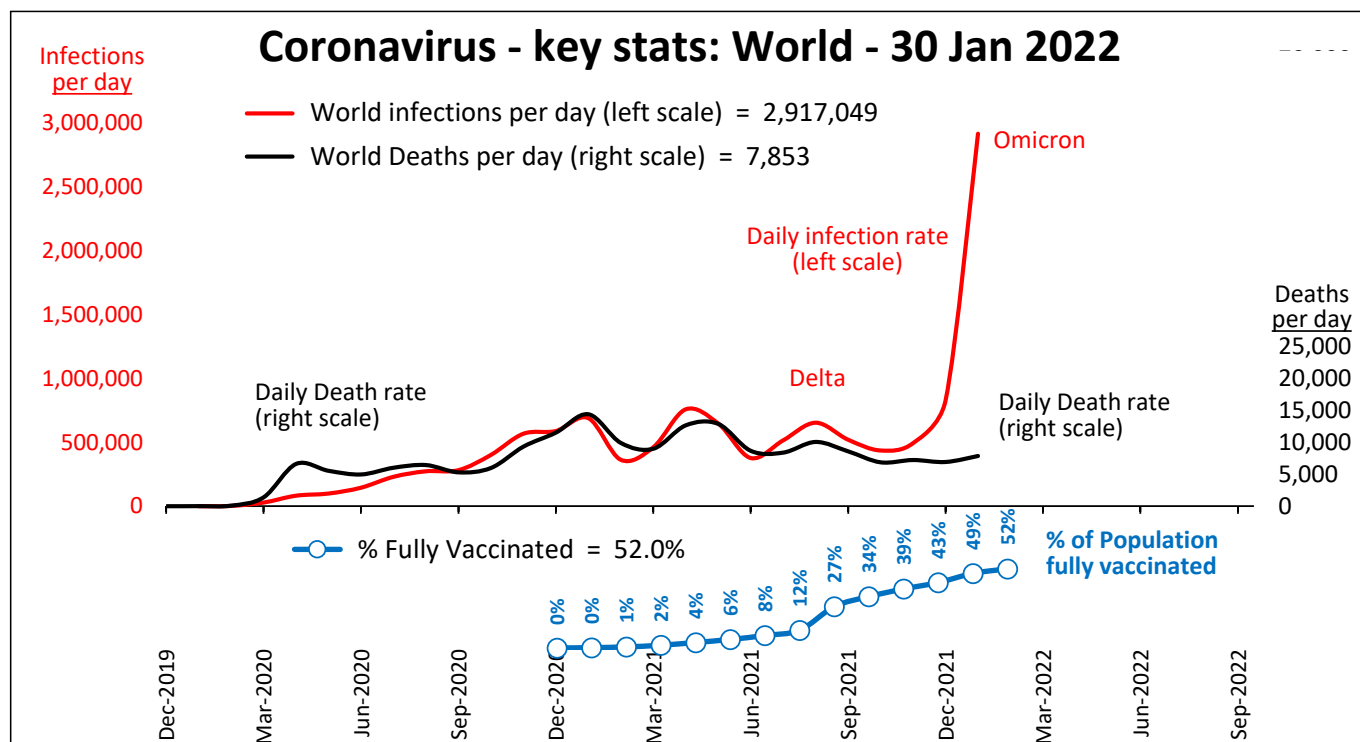
This second phase ended near the end of 2021, when rate hike fears returns again. This time central bankers finally admitted inflation was not 'transitory' and had to be met with interest rate hikes much sooner than they had thought. We are now into a third phase – of rising interest rates to attack inflation.

The two main themes affecting investment markets are the Coronavirus pandemic, and inflation/monetary policy.

Coronavirus

This time last year, infection rates and death rates were still increasing rapidly, but vaccinations were starting to be rolled out, so it looked like it may be the beginning of the end of the crisis. Unfortunately, a year later, new strains of the virus have kept wreaking havoc on healthcare systems, people's lives, and livelihoods around the world.

Our up-dated chart below (to 30 January 2022) shows global daily infection rates (red line), death rates (black) and vaccination rates (percentage of total population double vaccinated, in green). We are now in a fourth wave, which is still worsening. The three previous peaks were: – early January 2021 (before vaccinations took hold), late April 2021 (after lockdowns were eased), and late August (the 'Delta' strain). Now, the fourth wave ('Omicron' strain) has seen infection rates souring to new highs of around 3 million new infections per day, globally.



While infection rates are soaring, death rates (black line) have remained around flat, at around 7,800 per day. Vaccinations have not slowed the spread of infection, but they do appear to have led to lower rates of hospitalisation and deaths, at least against Omicron.

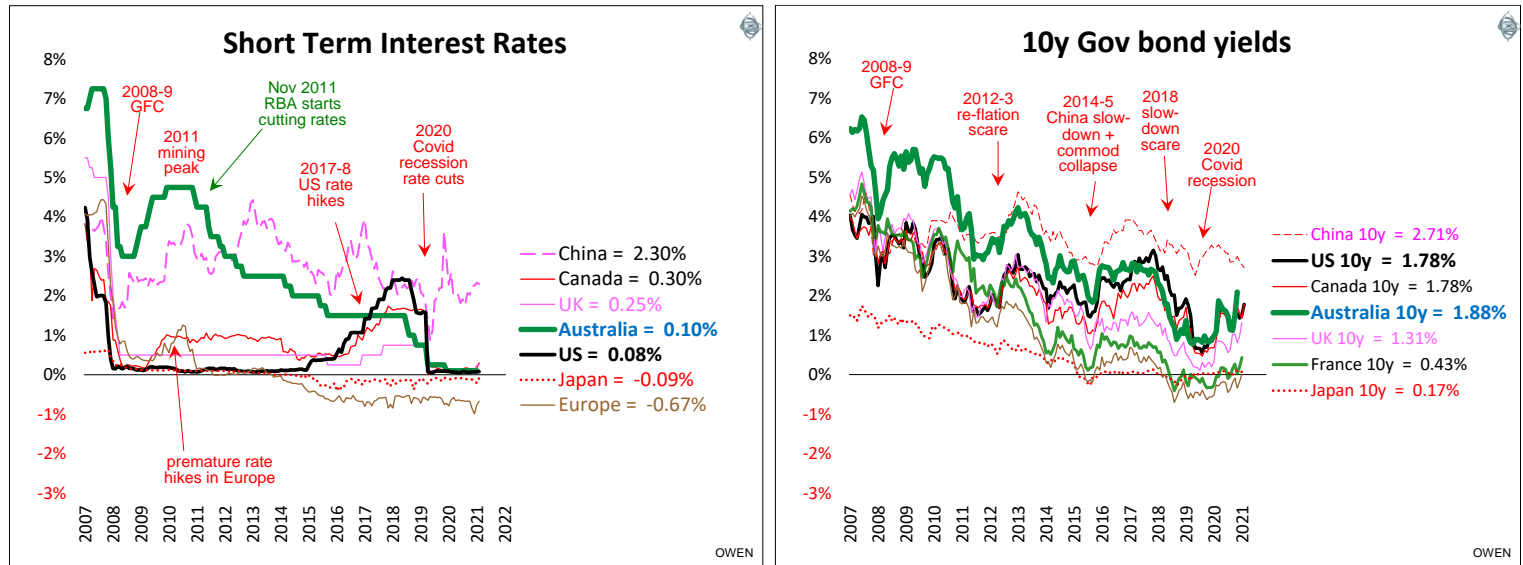
The main problem is that global vaccination rates are still relatively low on the whole. The proportion of total population double-dosed is now 71% in the UK, and 63% in Europe and the US, but the pace of vaccination appears to be slowing in most markets. Australia is now up to 78% after a slow start, and overtook the US, UK and Europe in October 2021. Only a handful of countries have higher vaccination rates than Australia (including Singapore, Japan, China, Canada, Spain, Italy). However, the total world population is still only 52% fully vaccinated. The main problem is in relatively poor, high-population regions, especially in Africa.

Our base case since the start of the crisis has been that new strains are likely to appear and cause problems until broader vaccines are developed in the coming years, and implemented universally. The world will not fully re-open until all countries are on top of the problem, including low income countries.

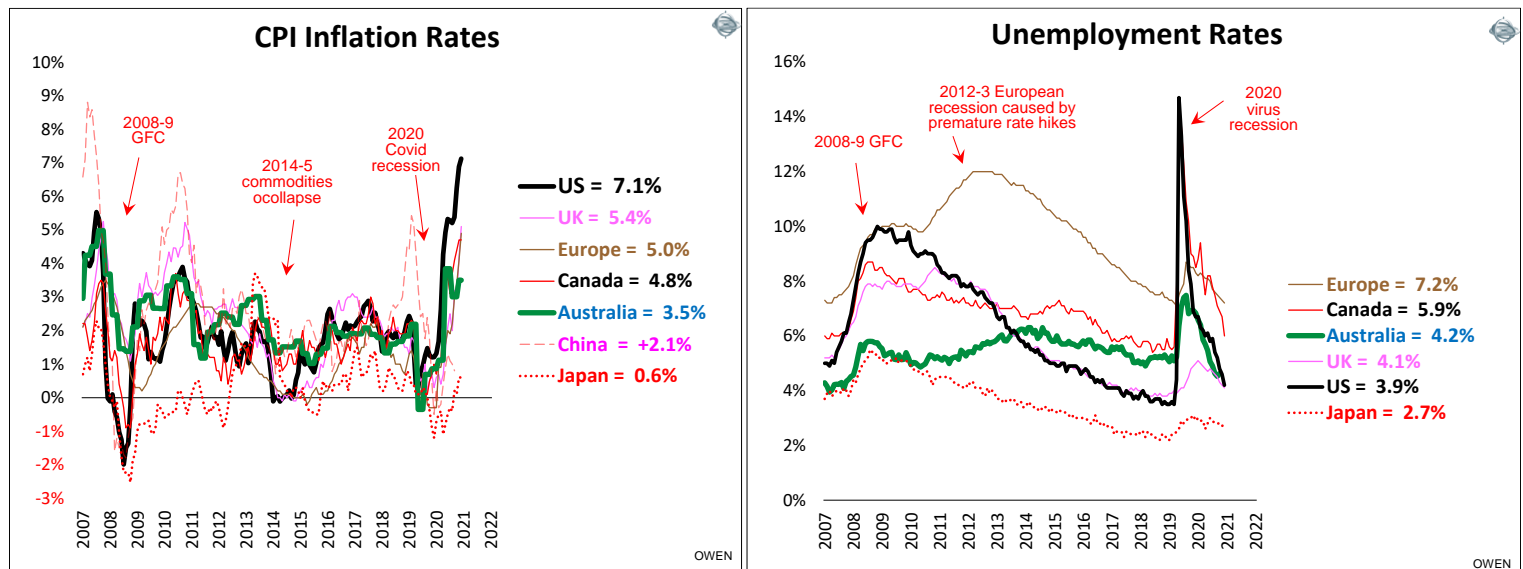
For investors, the issue is that, until the problem is effectively minimised, we are relying on government fiscal and monetary support for household incomes, which flow through into company revenues, profits, dividends, share prices, and to other asset markets like real estate (especially housing), and commodities. Fiscal and monetary support also fuels inflation, which is now running so high that central banks everywhere are now moving to withdraw monetary support.

Economic & Market Conditions – inflation and interest rates

More central banks lifted cash rates in the past quarter, notably the Bank of England. The RBA and US Fed are yet to start, but they have accelerated their scaling out of 'QE' bond buying, the precursor to starting to raise cash rates.



Bond yields (above right) have been rising since early 2021, fearing the return of inflation, which has now arrived. Bond yields rose further in January across virtually all markets, and yields have even turned positive in Japan and Germany!



Inflation rates (above left) were briefly negative in most markets during the 2020 recessions (including Australia) but have now soared to multi-decade highs due to a combination of supply constraints and demand (and even positive again in Japan).

The Fed has now abandoned its view that the current price inflation is 'transitory'. Unemployment rates (above right) are now in 'full employment' territory, and this is now flowing through to wage inflation. This is not yet fully reflecting in broad wage numbers yet, but is certainly increasingly problematic in a rapidly expanding range of industries.

Real Interest rates the key

One key monetary policy indicator for central bankers is the level of real interest rates (ie after deducting inflation).

Before getting into real interest rates, we must first discuss what is the 'normal' (or 'natural', or 'neutral') cash rate for an economy. Of all the questions I receive, two of the most common questions over the past year have been: (1) when will interest rates start to rise; and (2) how high will they go?

The answer to the first question is: very soon – ie next few weeks or month or two in the US, and probably not much later in Australia. For the second question: – rates are heading back to their 'normal' levels (we cover this next) but they always swing higher than that – because interest rates, like shares, housing and everything else, always swing from under-shoot to over-shoot, and back. They never settle for a nice stable middle, or 'fair' level or price!

What, then is the 'normal' or 'neutral' interest rate for an economy? We focus here on the US market as it is the main driver of world markets. (The answers below are very similar for the Australian market.)

Ordinarily, short term interest rates should generally be running, on average, at around a level that is the sum of (a) the long term target rate for inflation, plus (b) the long term expected rate of real growth for the economy. In the case of the US, medium/long term economic growth is expected to be around say 2-3% pa (from a combination of population growth and productivity growth of say 1% pa or so each), and the medium/long term inflation target is 1-2%, then the average cash rate in the US should be around 4%. Any lower for a sustained period is inflationary; and any higher for a sustained period stifles growth and jobs. (The average cash rate in the US has been 3.5% since WW2, and 4.4% up to the GFC – ie near our 4% 'normal' rate).

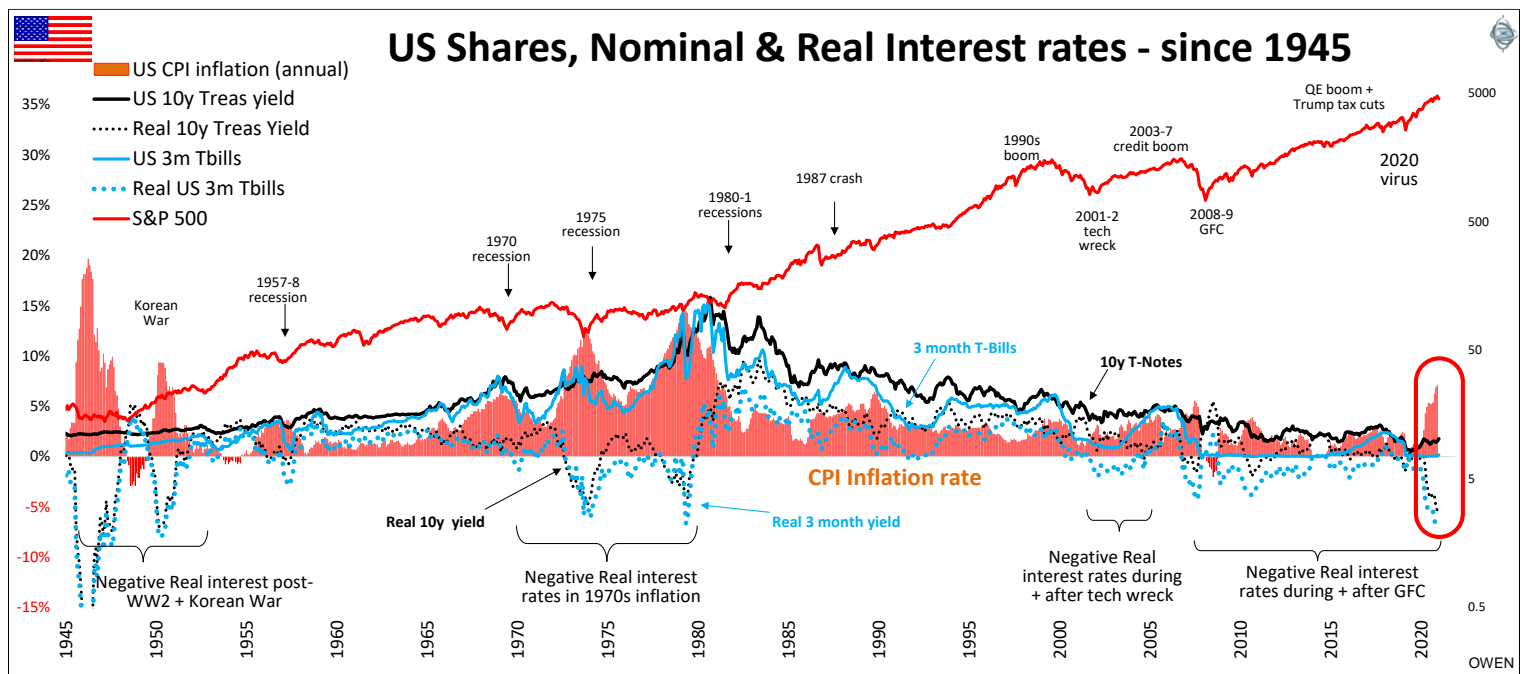
This gives us a 'real' cash rate (ie a 4% 'neutral' cash rate, less 1-2% inflation) of around +2-3% above inflation. (The average real cash rate in the US has been +0.7% since WW2, or +1.2% pre-GFC. These are a little lower than expected because of some bouts of high inflation, and we will see the link below).

Usually, the cycle works like this: – when economic activity slows (eg from Covid lockdowns, or a banking crisis like the GFC, or any other cause of disruption), central banks cut interest rates below 'normal' to stimulate activity (spending, borrowing, hiring, investment), and this is usually when inflation is also low (for example the Fed cut rates to zero in the 2020 Covid recession when economic growth contracted sharply and inflation was negative). Then, as economic activity recovers, interest rates are increased back to their 'neutral' or 'normal' rate again. Inevitably, because of the time lags between policy decisions and the resultant changes in activity turning up in measurements, activity runs ahead, and inflation rises above target. Central banks then have to increase rates above 'normal' to slow activity to bring inflation back down again. It is an endless cycle of inflation and interest rates oscillating above and below their long term average levels. The time lags result in central bankers almost always acting too late and too hard, and this causes the endless cycle of swings above and below 'neutral'.

The problem is that in the current cycle, central bankers have missed a step. Zero interest rates, plus additional cheap loan programs, introduced in the 2020 Covid recession (along with war-time-like government deficit spending programs), have seen inflation shoot up well above their target zones in 2021, but central bankers are still sitting on zero interest rates, and still printing more free money via their 'QE' programs (although now reducing).

As a result of this mis-match, with high reported inflation, and cash rates still sitting at zero, real interest rates are now running well below zero – and that means big rate hikes are going to be needed – to get inflation back below target ranges, and get interest rates back to a level that is not inflationary. (Don't forget that fiscal policy – deficit spending – is still extremely loose as well).

This chart shows the position in the US (the key market for global interest rate and share markets), since 1945.



The *real*/cash rate in the US (light blue dotted line) is now minus 7%, highlighted in the lower right of the chart. This is the worst it has been since the post-WW2 inflation spike in the late 1940s, and as low as the two double-digit inflation spikes in the 1970s. Inflation (orange bars) is now running at levels not seen since the late 1970s spike. To kill off the 1970s inflation, Fed chair Paul Volcker had to hike rates above 15% to induce deep, painful recessions and high unemployment (above 10% in 1982). (Actually, Volcker used money supply controls to dramatically tighten the supply of money, and 15%+ interest rates was the outcome. Now, central banks directly control the price of money – ie interest rates – making the quantity of money an outcome. While the mechanics is different, the outcomes are the same – severe contractions and high unemployment to reduce wages, spending and prices).

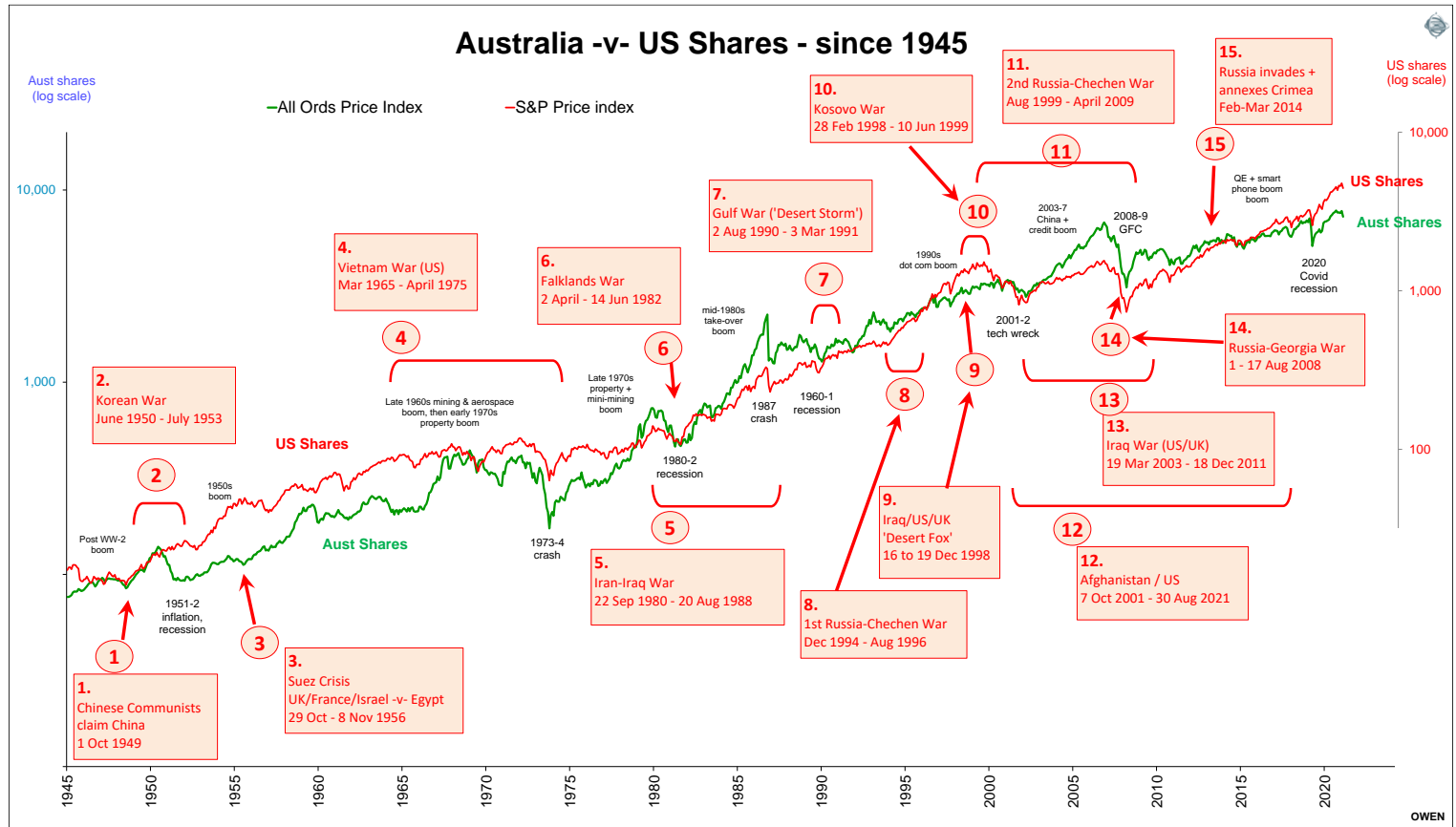
While it is true that the current headline inflation rates are probably over-stated a little because of some temporary elements (covid lockdown supply chain issues, semi-conductor chip shortage, adverse weather, etc), this will still leave inflation well above target, and real interest rates still deep in negative territory, until rates are raised by a significant margin to slow inflation.

There is one more problem. In the last battle against inflation, there was a clear trade-off between inflation and jobs. The way to reduce price inflation was to reduce incomes and spending, and to do that you had to increase interest rates to slow business hiring and slow wage growth, and that also inevitably caused business failures, which helped reduce jobs, wages and spending. The accepted price of winning the war on inflation was high unemployment and widespread business and personal bankruptcies. What is different now is that it seems governments seem overly keen to run up war-time-like deficits and debts to support the very businesses, jobs and incomes that central bankers are trying to crush to attack inflation. In short, this time around, neither the Fed nor the government are likely to want to see unemployment reach double-digit levels again to kill inflation.

Our base case is that central bankers and government will be quick to lose their resolve to fight inflation. Instead, they are likely to pause and even reverse course at the first sign of trouble, perhaps in the form of big job losses, corporate failures, or even falling share prices! (as the Fed did at the end of 2018). The likely outcome is a longer, drawn-out stop-start battle with inflation lasting perhaps many years, instead of a short sharp dose of tough medicine like the early 1980s recessions in the US/UK (or the 1990-1 recession in Australia).

Russia-Ukraine War?

With Russia seemingly on the brink of invading the rest of Ukraine it has not already taken, it is worth taking a look at the impacts of military activity on share markets. An initial knee-jerk reaction might be to say, 'Wars are bad, so it would be bad for share markets', or perhaps 'Wars are scary, so I'd better stay out of the market for a while', but in reality these fears have rarely been realised. This chart shows share price indexes for Australia (green) and the US (red) since 1945, highlighting several military conflicts during this post-WW2 era.



The common pattern has been that military activities result in increases in demand, spending, profits, and commodities demand & prices, all of which are generally good for share markets. The downside is that wars are almost always inflationary, and that is where investors need to be careful. In most cases, military flare-ups and wars triggered surges or rebounds in share markets, or, at worst, had no impact on market rallies at the time.

Probably the best example of military spending driving commodities and share prices was the Vietnam War which, along with the US-USSR 'space race', kick-started Australia's phenomenal mining boom from the mid-1960s. However, it also drove the build-up of inflation here and around the world from the mid-1960s and into the 1970s. Another example is the Iraq War (13). The start of war marked the start of the tremendous 2003-7 mining/credit boom for shares, especially in Australia.

There were only two conflicts that were not accompanied by rising share prices. The first was Korea (2 in the chart), where the US share market powered through it, but Australia was hit by hyperinflation (from a doubling of wool prices, our main export), and this was countered by savage fiscal and monetary tightening, and a sharp recession, to contain inflation. The other exception was the Russia-Georgia war (14 in the chart) which was right in the middle of the US sub-prime collapse, and share prices were heading down anyway.

This pattern applies to earlier, larger wars as well. For example, in WW2, governments (including in Australia) had to set limits on profits and share prices to try to reduce war profiteering. On the other hand, WW1 was far less favourable for Australia as it cut off vital shipping lanes. This sudden war-time isolation led to a rapid acceleration of protectionism in Australia and to the growth of protected local manufacturing industries. The resultant heavy protection from competition was a drag on Australia's growth, and was thankfully dismantled in the 1980s.

There are two main military themes driving what is probably a global commodities 'super-cycle' – the US-China build-up, and Russia re-building its empire. On the first, China knows it not yet ready to take on the US, but the gap is closing very quickly, and Xi has set a timetable for a Chinese takeover of Taiwan by 2025, by force if necessary. This would probably be opposed by the US and its allies (Japan, South Korea, probably Australia, but perhaps not NATO), and Xi has promised 'heads bashed bloody against the Great Wall of Steel forged by 1.4 billion Chinese people' for anyone who opposes (Xi's speech at the Communist Party 100 year anniversary, Beijing, 1 July 2021). He says the 're-unification' will be 'peaceful' – presumably as 'peaceful' as Tibet, Xinjiang and Hong Kong.

Rather than an all-out US-China war, our base case is for a long drawn-out build-up, not unlike the 'Cold War' with USSR in the 1950s to the end of the 1980s, and with probably several peripheral wars along the way, like the Korea and Vietnam (The US did not win either of those wars, but it still won the Cold War as the USSR ran out of money.)

The second theme is Russia rebuilding its empire lost after the break-up of USSR in 1991. Russia has three main motivations – (a) rebuilding a buffer zone against US/NATO, (b) restoring some dignity and trying to re-capture and re-live its past glory days as a major 'European' power, after the humiliation of the collapse of the Soviet empire; (c) re-uniting ethnic Russians in the former (but now independent) buffer states; and (d) building pipelines through compliant client states into Europe, making Europe dependent on Russian oil/gas, and therefore less likely to oppose Russia's expansion.

There have been a succession of Russian interventions to achieve these joint aims since the fall of the Soviet empire in the early 1990s – some by political means (acting overtly or covertly to back Russia-friendly coups and regimes), and others by direct military force. The first military win was in Chechnya – after losing the First Russian-Chechen War (December 1994 to August 1996), but finally winning the Second Russian-Chechen War (August 1999 to April 2009), which ended with Russia gaining control and starting to build oil/gas pipelines through to Europe.

Then, in the Russia-Georgia War (August 2008), Russia invaded and took back two more territories of its old Soviet empire - South Ossetia (in middle of Georgia on Russian border), and Abkhazia (western part of Georgia on the Black Sea). Then, in February-March 2014, Russia invaded and annexed Crimea from Ukraine.

In each case, US/NATO did not step in with military action to prevent or reverse Russia's ambitions (although they did impose some sanctions). Because of Russia's extensive pipelines into Europe, it has Europe become reliant on Russia for 30-40% of its oil/gas supply. This has been exacerbated by the 2021 'energy crisis'. This dependence on Russia is starting to show up in political influence in Western Europe, for example in Germany's reluctance to oppose Russia's latest moves on Ukraine.

Our base case is not for any major all-out war in Europe, but for more gradual expansion by Russia to achieve its four aims, emboldened by US/NATO's reluctance to act, and by Russia's support from China. Either way, the build-up is good for commodities demand and prices, but adds further to the inflationary pressures globally.









Summary of Major Risks

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

RISK ↓	Negative for risk assets	Positive for risk assets	Changes	Comments on recent activity / changes
Virus pandemic	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 return to ‘normal’ freedoms and economic activity	Deterioration	Vaccine levels are improving, albeit mainly in high/middle income countries, but the Omicron strain has sending infection rates soaring, hampering the lifting of restrictions. Broader vaccines are now being developed, which may decrease the impact of Omicron and future strains.
Monetary Policy (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 but still highly accommodative	US Fed and RBA both accelerating exit from QE and preparing for rate hikes in early-mid 2022. However, they are probably going to be quick to pause or reverse at the first sign of distress to economies or share markets. Several other central banks have started to raise rates.
Fiscal Policy (government deficit spending & borrowing)	Governments tightening policy more quickly than expected – via lower spending, higher taxes. Debt ceiling restrictions, or default fears, bring sudden end to spending / borrowing ▲	Governments supporting incomes and spending longer than expected. Debt ceiling limits extended or delayed ▲	Little change – still positive	US Congress has scaled back Biden’s plans but is still very supportive of massive spending programs. Some fiscal ‘tightening’ as some one-off payments are not repeated, but still extremely supportive. Tax hikes are still on the agenda, but progress is likely to be slow. The perennial US debt ceiling crisis was 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 have now abandoned their view inflation is merely ‘transitory’. Bond yields are still being kept artificially low by QE bond buying, but this is now being ended quickly. Central banks now moving more quickly to raise rates to fight inflation.
Corporate profits	Profits worse than expected, or sudden major collapse in profits ▲	Profits better than expected ▲	Improvement	Profits continue to beat expectations in US, Australia, and other major markets, with few exceptions. Global profits already back well above pre-Covid levels, and still rising strongly, supported partly by deficit spending, but also by genuine pent-up demand.
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	Deterioration	Levels of over-pricing have increased a little over the past quarter as share prices have risen further. 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. (NB. January correction brought pricing levels back)
China	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	Some improvement in responses	In the Evergrande /property crisis – government moving to take control to minimise contagion and social unrest, albeit with losses to shareholders and bond holders. Production cuts due to energy crisis, resulting in global supply chain. Australia affected by lower iron ore prices + trade restrictions, although is exporting more LNG to China. Falling prices of Chinese/Emerging Markets USD bonds – due to impending rising US interest rates and USD.
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	Some deterioration	Xi moving toward planned ‘liberation’ of Taiwan, with increased military activity, plus further violent clashes in Hong Kong. Xi sets target of 2025 to be ready and able to invade Taiwan (and presumably win a war against US/Japan/South Korea/Australia). However, near future is likely to be further military build-up in region/world rather than military invasion of Taiwan. Xi-Biden meeting ambiguous. Russia likely to invade Ukraine, as it did with Crimea in 2014, with the US again unlikely to go to war to defend it.
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	Little change	US/global companies continuing to reduce reliance on China, several tit-for-tat bans and restrictions from both sides. However, despite on-going diplomatic rhetoric, soaring sales of Apple iPhones bought by Chinese inside China.
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 (for internal political purposes), but little or slow progress in Europe & US against US tech giants. Battles to break up the US monopolies 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 transition. Australia likely to benefit from supplying key commodities for renewables industries.

Summary of Asset Allocation Positioning & Changes

At our regular quarterly review after the end of December 2021, we made no changes. We confirmed our current stance, in which portfolios are positioned for: a) continued, but declining monetary and fiscal support; (b) resulting in relatively strong incomes, employment, spending and corporate profits; which in turn lead to (b) rising inflation and interest rates.

Asset Class	Changes	Current position	Comments & Rationale
Australian Shares	No Changes	 Portfolio weight Neutral	Australian shares continued to rebound in 2021, underpinned by better than expected profit rebounds from the 2020 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. Our base case has been that each of these factors is now retreating – interest rates will be raised in the coming year; government hand-outs are being withdrawn; and China's economy and construction boom are slowing. Our portfolios are biased toward concentrated stock-pickers, biased toward small and mid-sized companies. The actively managed funds we use in portfolios are selected for their defensive qualities and they added value during the Covid sell-off and also in the rebound.
Global Shares	No Changes	 Portfolio weight 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 over the past year, supported by the very strong rebound in global corporate profits, which continue to beat expectations. During 2021 we are reduced exposures to listed infrastructure shares and also to 'Emerging Markets' shares, which continue to lag global markets. We also reduced carbon footprint in portfolios by switching to fossil-fuel-free funds.
Currency hedging on global shares	No Changes	 0% Hedged 100% Around Neutral	Currency hedging on global shares remains at 50%. The Australian dollar is currently around 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, but will come under downward pressure as the US Fed raises interest rates in advance of the RBA. In the current environment we are remaining neutral on the direction of the AUD, so we are happy to remain neutral (50%) on hedging, meaning 50% of our global share positioned are AUD-hedged).
Property & Infrastructure	No Changes	 Portfolio weight Underweight	In 2020 and 2021 we removed our listed property and infrastructure exposures. 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	 Portfolio weight Under-weight	We are holding very low allocations to Australian fixed-rate debt as we have been wary of rising inflation and bond yields. 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	 Portfolio weight 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 posted a loss in 2021 (their first loss since 1994) 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 have lost most, but not all, of their historical protective qualities against share corrections.
Australian floating rate debt	No Changes	 Portfolio weight 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 inflation (specifically, aggressive rate hikes to slow 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	 Portfolio weight 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 than cash, with minimal volatility, and negligible risk of capital loss.

Soteria Model Portfolio Returns

The following relate to the period to end of December 2021. Returns to end of January available in early-mid February.

As at end: December 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	2.08%	2.91%	17.36%	11.20%	9.15%	January 2017
Soteria Dynamic Index High Growth	CPI + 5.0%	95/5	1.85%	4.20%	19.64%	12.71%	8.81%	October 2018
Soteria Dynamic Active Growth	CPI + 4.5%	80/20	1.82%	2.40%	14.53%	9.49%	7.97%	January 2017
Soteria Dynamic Index Growth	CPI + 4.5%	80/20	1.62%	3.45%	16.12%	10.41%	7.38%	October 2018
Soteria Dynamic Active Balanced	CPI + 4.0%	65/35	1.49%	1.86%	11.44%	8.68%	7.21%	January 2017
Soteria Dynamic Index Balanced	CPI + 4.0%	65/35	1.34%	2.75%	12.93%	9.46%	6.95%	October 2018
Soteria Dynamic Active Moderate	CPI + 3.5%	50/50	1.22%	1.30%	8.41%	7.26%	6.15%	January 2017
Soteria Dynamic Index Moderate	CPI + 3.5%	50/50	1.12%	1.98%	9.31%	8.07%	6.24%	October 2018
Soteria Dynamic Active Conservative	CPI + 3.0%	30/70	0.81%	0.52%	4.28%	5.23%	4.65%	January 2017
Soteria Dynamic Index Conservative	CPI + 3.0%	30/70	0.69%	1.05%	5.02%	5.77%	4.82%	October 2018

For further details please refer to your Advisor.

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

There are no portfolio changes at this review. However, we did conduct our regular re-balancing of all holdings back to their target weights as at the last quarterly review. Portfolios remain neutrally positioned in their overall growth/defensive mix.

Investment Research for funds added to portfolios

This quarter we have added no additional funds or securities to portfolios.

Underlying Fund Returns

to 31st December 2021 (returns for January available in early-mid February)



Group/Investment	APIR Code	Calendar Year Returns				
Australian Shares		2017	2018	2019	2020	2021
Greencap Broadcap Fund	HOW0034AU	0.18%	-0.04%	0.26%	9.42%	17.51%
Fidelity Australian Equities	FID0008AU	11.32%	-3.86%	23.19%	5.11%	22.44%
Ironbark Karara Australian Small Comp	PAT0002AU	19.19%	-3.64%	13.73%	10.19%	12.77%
Allan Gray Australia Equity B	ETL0349AU	18.34%	-7.03%	23.32%	-6.98%	16.04%
Bennelong ex-20 Australian Equities	BFL0004AU	19.14%	-6.80%	25.06%	24.14%	26.82%
VanEck Vectors Australian Equal Wt ETF	MVW	15.54%	-4.52%	24.32%	1.37%	16.23%
Vanguard Australian Shares ETF	VAS	11.81%	-3.17%	23.62%	1.85%	17.66%
Pengana Emerging Companies	PER0270AU	20.87%	-9.82%	24.78%	6.94%	36.94%
Benchmark 1: S&P/ASX 300 TR		11.94%	-3.06%	23.77%	1.73%	17.54%
Benchmark 2: S&P/ASX All Ordinaries TR		12.47%	-3.53%	24.06%	3.64%	17.74%
Benchmark 3: S&P/ASX Small Ordinaries TR AUD		20.02%	-8.67%	21.36%	9.21%	16.90%

Global Shares Hedged		2017	2018	2019	2020	2021
Magellan Infrastructure	MGE0002AU	17.43%	-0.44%	25.48%	-11.68%	15.24%
Vanguard MSCI Intl (Hdg) ETF	VGAD	19.95%	-7.57%	27.02%	10.60%	23.91%
Vanguard Ethcly Cnsc Intl Shrs Idx AUD H	VAN0848AU					
Vanguard Intl Small Companies Index Hgd	VAN0022AU	19.92%	-12.70%	24.94%	8.64%	17.67%
Capital Group New Perspective Hdg (AU)	CIM0008AU	24.38%	-4.57%	29.16%	28.11%	19.11%
Benchmark 1: MSCI ACWI Ex Australia NR (AUD Hedged)		24.54%	-9.76%	25.47%	11.23%	20.31%

Global Shares Unhedged		2017	2018	2019	2020	2021
MFS Global Equity Trust	MIA0001AU	14.90%	0.48%	30.93%	3.41%	24.61%
Magellan Global	MGE0001AU	14.23%	9.82%	28.05%	-0.02%	19.28%
Magellan High Conviction - B	MGE9885AU		3.33%	29.18%	-1.86%	21.10%
iShares MSCI Emerging Markets ETF (AU)	IEM	26.30%	-6.00%	17.76%	6.33%	0.78%
Vanguard MSCI Intl ETF	VGS	13.41%	1.57%	28.11%	5.85%	29.60%
Vanguard Ethcly Cons Intl Shrs ETF	VESG			29.15%	9.91%	29.33%
BetaShares Global Quality Leaders ETF	QLTY			34.52%	13.86%	29.29%
Benchmark 1: MSCI ACWI Ex Australia NR AUD		14.86%	0.71%	26.86%	6.04%	29.58%

Property & Infrastructure		2017	2018	2019	2020	2021
AMP Capital Core Infrastructure A	AMP1179AU	12.53%	3.62%	14.00%	-6.22%	11.49%
AMP Capital W Australian Property	NML0001AU	6.97%	9.25%	7.47%	-1.41%	15.08%
VanEck Vectors Australian Property ETF	MVA	7.27%	6.69%	21.83%	-5.80%	22.22%
Aus Unity Healthcare Property Wholesale	AUS0112AU	21.06%	8.15%	11.10%	11.45%	37.90%
Benchmark 1: S&P/ASX 300 A-REIT TR		6.44%	3.27%	19.57%	-3.96%	27.03%
Benchmark 2: FTSE EPRA Nareit Developed NR AUD		2.17%	4.84%	22.09%	-17.14%	33.83%

Australian Debt		2017	2018	2019	2020	2021
VanEck Australian Sbdntd Dbt ETF	SUBD				2.45%	1.90%
Ardea Real Outcome Fund	HOW0098AU	4.65%	3.29%	8.40%	5.82%	-0.60%
BetaShares Aus Bank Sr Fltng Rt Bd ETF	QPON		1.84%	3.65%	2.48%	-0.23%
Janus Henderson Tactical Income	IOF0145AU	3.43%	2.63%	2.87%	4.49%	0.02%
Perpetual Wholesale Diversified Income	PER0260AU	4.82%	1.34%	4.42%	2.73%	2.28%
PIMCO Australian Bond W	ETL0015AU	3.65%	3.57%	7.40%	4.39%	-3.00%
VanEck Vectors Australian Fltng Rt ETF	FLOT		2.09%	2.71%	1.66%	0.05%
VanEck Vectors Australian Corp Bd+ ETF	PLUS		3.90%	8.59%	5.84%	-2.36%
iShares Core Composite Bond ETF	IAF	3.47%	4.36%	7.09%	4.33%	-3.06%
Benchmark 1: Bloomberg AusBond Composite 0+Y TR AUD		3.66%	4.54%	7.26%	4.48%	-2.87%

Global Debt		2017	2018	2019	2020	2021
Vanguard Intl Fxd Intr (Hdg) ETF	VIF	2.57%	2.44%	6.21%	4.73%	-2.67%
Colchester Global Government Bond I	ETL5525AU	3.32%	2.07%	6.82%	5.60%	-3.36%
Vanguard Intl Credit Secs (Hdg) ETF	VCF	5.23%	-0.24%	9.62%	5.85%	-1.58%
Benchmark 1: BBgBarc Global Aggregate TR Hdg AUD		3.68%	1.65%	7.19%	5.09%	-1.53%

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

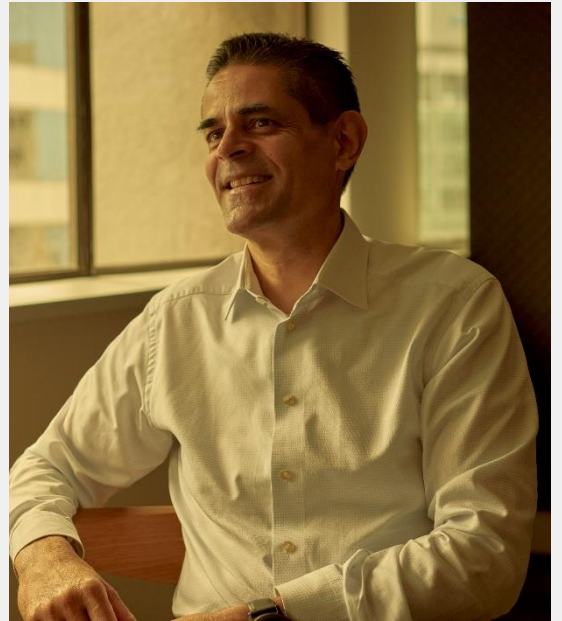
Ashley Owen

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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