Quarterly Investment Report
April 2023

Playing it safe

MACKAY PRIVATE

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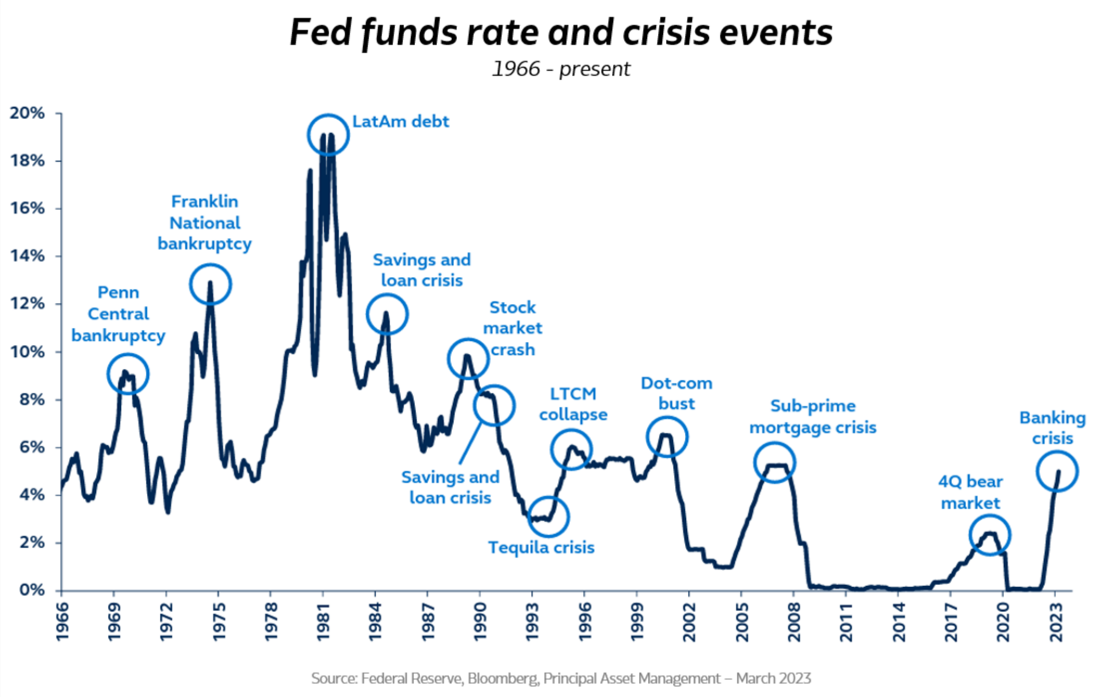
Summary

So far, 2023 has been better-than-expected, with a broad range of assets delivering healthy returns in the face of weak confidence and elevated risk of a recession.

The threat of further turmoil increases with each rate hike.

We've highlighted for some time the lagging impact of monetary policy and that, historically, something breaks whenever there is a radical increase in interest rates.



While the recent banking crisis appears contained, the threat of further turmoil increases with each subsequent rate hike. This itself introduces a new dilemma for central bankers globally; trying to control inflation against fears of financial instability.

Historically, slower lending activity has led to weaker growth.

Given this backdrop, we expect interest rates across developed markets to peak soon and remain at these levels for the remainder of the year; provided there is no severe economic stress.

Understandably, the U.S. banking system is top of mind for investors, notably how recent events may impact future lending activity. The U.S. banking system is the beating heart of the global economy, and historically, reduced lending activity (tighter credit) has led to weaker economic growth and corporate earnings.

Recent events may assist in the fight against inflation.

Recent events may assist central bankers in their fight against inflation. JPMorgan believes conservative lending activity stemming from the banking crisis could have an equivalent impact on the U.S. economy of +1.50% additional rate hikes.

To date, equities have climbed this wall of worry, assisted by lower bond yields and expectations of rate cuts, while looking through earnings' downside risks. The Advisory Board acknowledged the fragility of the equity market performance year-to-date and the downside risk to prices if earnings fall more than expected.

Temporary factors have driven recent equity returns.

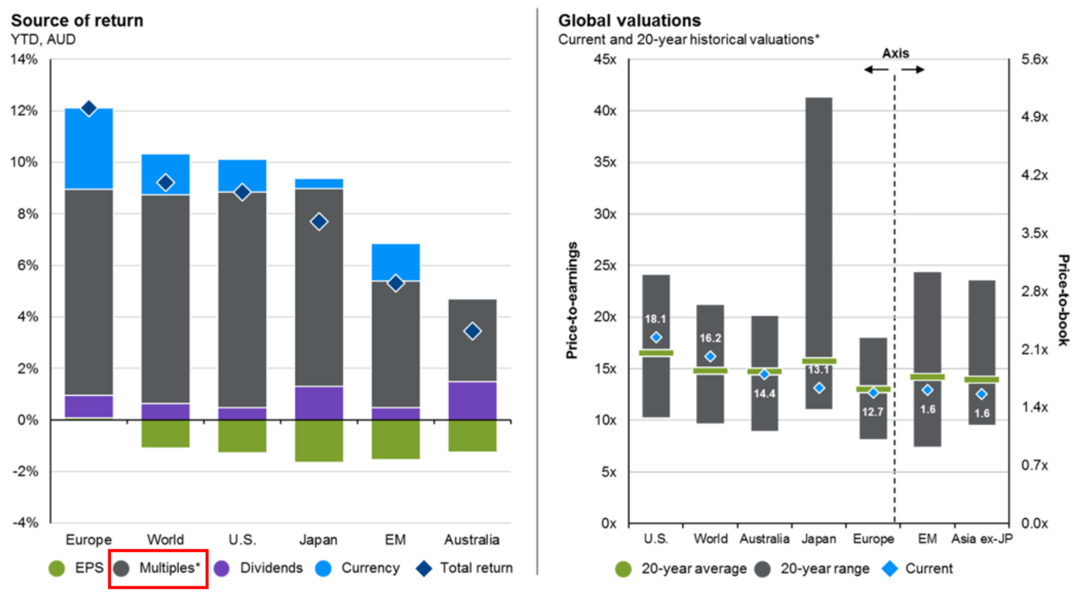
Temporary factors have driven recent equity returns, such as multiple expansion (lower bond yields), not earnings, that fell -1% year-to-date.

The general rule is that earnings growth is needed to deliver sustainable returns. In contrast, returns built on multiple expansion (lower interest rates) are temporary if earnings do not catch up, e.g. Tech investors between 2020 and 2022.

Many tailwinds driving the better-than-expected outcomes for equities may persist.

Source of return and valuations

Equity Indices



Source: JP Morgan Asset Mgmt – March 2023

Alternatively, many tailwinds driving the better-than-expected outcomes for equities may persist, including China's reopening, low unemployment, and swift policy intervention against severe financial instability.

Increasing fixed interest by taking profits across global equities.

How are we positioning for this uncertain period? We have updated our asset class preferences to reflect our modestly conservative views. We have increased fixed interest (**overweight**) allocation by taking profits across global equities (**underweight**) that have outperformed year-to-date and face downward pressure to earnings.

We don't believe it's an appropriate time to take outsized risks. We continue to emphasise a measured approach to asset allocation, balancing both upside and downside outcomes.

Overweight

Neutral

Underweight

Cash

Themes

- The RBA cash rate now sits at 3.6%, +3.5% higher than this time last year.
- Interest rates have increased materially over the past year, and cash savings accounts now offer investors some return on capital.
- Cash offers capital preservation and liquidity in a volatile market.

Strategy

- Current term deposit rates <12 months are attractive in an uncertain environment.
- We are holding some cash for future growth or income opportunities.

Positioning

- **Neutral** – Maintain a good allocation to cash for buying opportunities whilst locking in term deposits for conservative investors.

Fixed Interest

Overweight

Underweight

Neutral

Themes

- The Global Aggregate Bond Index increased +2.4% over the quarter, whilst the local AusBond Composite Bond Index rose +4.6%.
- During March 10-year US and Australian bonds fell ~60bps to 3.56% and 3.30%, respectively.
- This was driven by immediate prospects of a recession in the US, as a result of a financial instability (Bank crisis) and tighter credit conditions across regional banks.
- Financial instability has changed the outlook for future interest rate expectations and is likely end to the hiking cycle. Bond markets are pricing cuts in the US during 2023.
- High yield bonds are venerable to credit spread widening as prices haven't adjusted for the likelihood of a recession and higher defaults.

Strategy

- We upgrade our allocation to Fixed Interest to **overweight** given the economic backdrop and capital preservation benefits.
- Our preference this quarter is to add to long duration bonds which now offer compelling value and diversification benefits.
- At current yield levels, bonds can provide an attractive balance between income generation and cushion against downside economic risks.
- We will continue to maintain a healthy allocation to floating rate and short duration managers, with a focus on quality to mitigate credit risks.

Positioning

- **Overweight** – favour Australian fixed interest over International.

Overweight

Neutral

Underweight

Australian Equities

Themes

- The S&P/ASX 200 Index finished up +3.6% for the quarter, supported by cyclical sectors; materials (+7.2%) and consumer discretionary (+10.7%).
- The reporting season was mixed, with cyclicals delivering better than anticipated results. Almost every sector reported seeing inflationary pressures across their business leading to a slight downgrade in FY23 earnings.
- ASX200 has underperformed global markets during 2023, with a reversal in many themes that drove Australian shares higher in 2022 – for example financials and commodity prices.
- Small caps returned +1.9% over the quarter. Despite underperforming large caps, selective small cap managers with a quality focus have outperformed.

Strategy

- We maintain our neutral position to Australian Equities.
- Valuations remain in line with 20-year averages, in the face of growing concerns about the sustainability of earnings.
- We have not seen a material adjustment to ASX200 earnings expectations over the medium term, despite anecdotal evidence of softer revenue growth and rising cost pressures.
- China's reopening and demand for yield may provide a relative cushion to parts of the market.
- High quality stocks with defensive earnings are expensive, while those with less certain near-term outlooks are being heavily penalised by the market.

Positioning

- **Neutral** – we are actively looking to take profits upon periods of strength and patiently adding to areas of value during market weakness.

Overweight

Neutral

Underweight

Global Equities

Themes

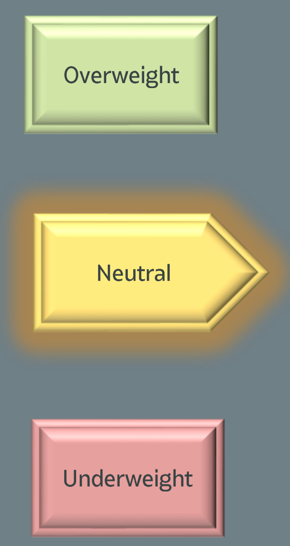
- The MSCI World Index returned +9.08% over the quarter, with Europe outperforming other developed markets.
- The MSCI Emerging Market index increased +5.3% over the quarter, led by China.
- Despite a strong start to the year, risks remain skewed to the downside.
- Company earnings and profit margins have fallen over the last quarter, despite strong market returns. Current consensus earnings growth for the S&P500 is negative -7% over the first half of 2023, with a recovery a recovery in 2024.
- While earnings are likely to deteriorate further in 2023, in the event of a mild recession (our expectation) it should not be catastrophic, particularly across the U.S. and Australia.
- Emerging Markets look cheap and have benefited short-term from a weaker USD and China reopening.

Strategy

- We downgrade our allocation to Global Equities to **underweight** on the back of a strong quarter of performance, led by multiple expansion (lower rates).
- The downgrade reflects our intra-quarter rebalancing that included profit taking across global equities that performed well over the quarter to increase fixed interest.
- The short-term risk and reward for global equities is not compelling.
- Our Advisory Board is cautious over the short-term until we see what impact higher rates will have on company earnings, specifically U.S. We continue to actively rebalancing portfolios around price volatility.

Positioning

- **Underweight** – tactical position given valuations and expected returns over the medium-term.



Property

Themes

- Listed property assets were flat over the quarter, with Australian REITs up +0.5% and Global REITs +0.10%.
- A deterioration in financial conditions during March reversed much of the gains from late 2022.
- Globally, there are heightened risks, as banking stress leads to tighter lending standards and possibly lower commercial property prices.
- Domestically, balance sheets and credit remain strong compared to the GFC and do not represent a systemic risk for investors.
- There is bifurcation within domestic markets. Office and housing continue to face valuation headwinds, whilst industrials remain resilient.
- We continue to believe there are heightened risks to unlisted exposures due to a valuation lag and low transaction levels.

Strategy

- We downgraded our view on Property to neutral, reflecting some short-term profit taking to increase defensive assets within the portfolio (fixed interest).
- We continue to see selective value in listed REIT's (Australia) that are trading at a discount to NTA and provide some earnings growth exposure, including inflation-adjusted rents.
- We are wary of unlisted asset exposures due to the historical valuation lag and have exited all exposures. We have used the proceeds (where possible) to fund listed asset purchases.

Positioning

- **Neutral** – reducing exposure upon price strength.

Overweight

Neutral

Underweight

Alternatives

Themes

- Infrastructure rebounded over the quarter, led by listed assets, up 3.4%.
- Private market strategies delivered positive returns during the quarter of between 0.9%-1.5%.
- Hedge funds continued to deliver positive returns, with our selected exposure achieving a return of 1.9% for the quarter.
- Private equity valuations have not re-rated and are supported by strong investor demand and lower starting multiples, relative to equity markets.
- Surprisingly, we have experienced lower volatility (VIX) in equity markets over the quarter which has muted returns for Hedge Funds.

Strategy

- We upgraded our view on Alternatives to neutral, reflecting short-term opportunities across some new issuances in Private Markets and Infrastructure.
- Recession-year vintages across Private Market strategies typically generate superior returns., therefore, we favour allocating capital to new strategies relative to existing ones.
- Over the short-term we are wary of negative revisions to valuations of existing unlisted assets due to a valuation lag, across both Private Market and Real Asset strategies.
- The managers in portfolios have delivered strong relative returns over 12 months and continue to hold up well in the current environment.
- Our Hedge Fund allocation has proven to be a vital tail risk hedge to the downside risks in the market.

Positioning

- **Neutral** – favour quality managers with proven track records.

Positioning

As of April 2023	Positioning (DAA)		
Asset Class	Underweight	Neutral	Overweight
Cash			
Fixed Interest			
Australian Fixed Interest			
Global Fixed Interest			
Australian Equities			
Global Equities			
Developed Market Equities			
Emerging Market Equities			
Property			
Australian Property			
Global Property			
Alternatives (Inc. Infrastructure)			
Infrastructure			
Other Strategies (Private Markets, Hedge Funds)			

Positioning Definitions

Overweight >= 2.0% above benchmark strategic asset allocation weight

Neutral <= 2.0% versus benchmark strategic asset allocation weight

Underweight >=2.0% below benchmark strategic asset allocation weight

Independent Advisory Board

The Advisory Board believe a robust governance framework is critical in forming a House View and making effective Asset Allocation decisions. The process is governed by an Advisory Board charter and comprises experienced investment professionals with diverse areas of expertise, reflecting an industry best practice in decision-making.

The Advisory board is responsible for setting and reviewing the House View, upholding the fundamental values and investment philosophy of Mackay Private.

The Advisory Board meets quarterly to meet intra-quarter as required. Voting members make all dynamic asset allocation decisions of the Advisory Board. Please visit our webpage, www.mackayprivate.com or contact us directly at info@mackayprivate.com or 1300 721 986.

Important Information