FM Financial Investment Update

2021 – June Quarter

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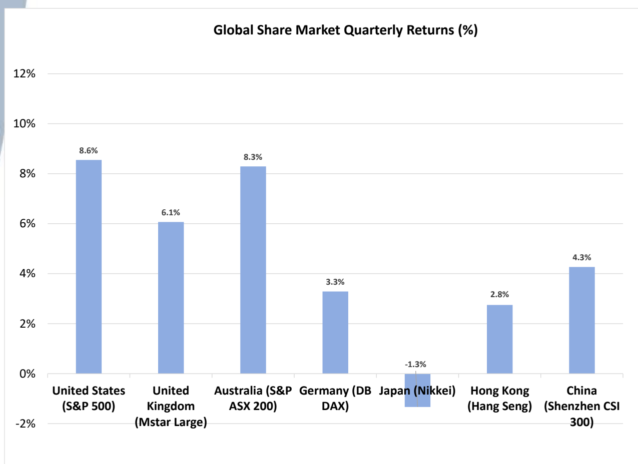
Equity rally continues as bond yields steady

- Economic data and the success of the global vaccine rollout continued to re-enforce a positive outlook for earnings growth, supporting further appreciation on share markets.
- There was sharp disperion across share market sectors and styles over the quarter, with "value" stocks gaining strong momentum at times.
- Despite evidence of higher inflation, longer term bond yields declined over the quarter.

Asset Class Return	3 Months	Annual
Australian Equities	8.3%	27.8%
Global Equities - Unhedged	9.3%	27.5%
Global Equities - Hedged	7.6%	35.7%
Australian Listed Property	10.7%	33.9%
Global Listed Property	9.8%	31.4%
Global Listed Infrastructure	1.8%	17.2%
Australian Fixed Interest	1.5%	-0.8%
Global Fixed Interest	0.9%	-0.3%
Cash	0.0%	0.1%

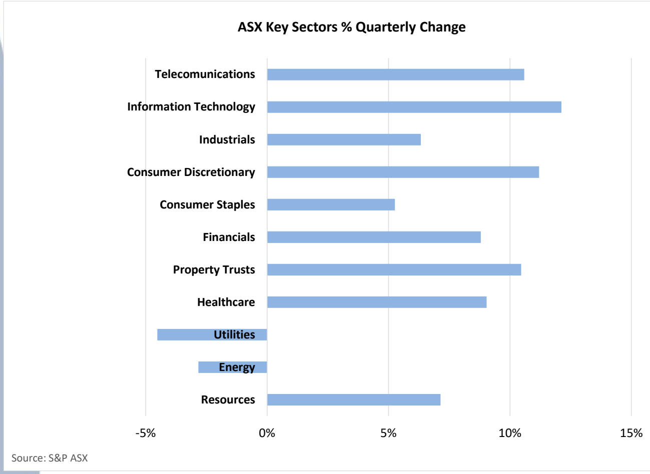
International Equities



The re-opening of economies across Europe and the U.S. has provided solid economic data and maintained positive investor sentiment towards equities. Boosted by confirmation of the U.S. Government's $579 billion new infrastructure spending plan, the U.S. market led global equities higher last quarter, with a gain of 8.6%. The U.K., with a 6.1% increase, was also particularly strong, where a rapid vaccination take-up has accelerated the recovery. In contrast, after a solid March quarter, the Japanese share market produce no growth last quarter with the Nikkei Index down 1.3%, as the economy continues to show less evidence of recovery than elsewhere.
Emerging markets broadly kept pace developed markets over the June quarter, although the Chinese market under performed with a gain of 4.3%. Rising oil prices contributed to gains in Russia and Eastern Europe, whilst higher iron ore prices supported the Brazilian market, which was up 9.3% over the quarter.

Australian Equities

It was a solid quarter for the Australian equity market with the S&P ASX 200 Index gain of 8.3% being ahead of most developed economy markets. Financials, being the largest sector, under pinned much of this increase, with CBA's 16% increase making a major contribution following a positive March quarter trading update. Banks are benefiting from a strong housing market, with new housing finance commitments hitting a record high in May to be 95% above the level recorded one year earlier. Also making a positive contribution to the Australian market last quarter was the resources sector (up 7.1%) as commodity prices continued to escalate. In addition to the ongoing strength in iron ore prices (which are 37% higher over the past 6 months), there has been a strong focus on those commodities that will benefit from higher demand for renewable energy and the electrification of motor vehicles, such as copper.



Indicative of the broader economic recovery, the consumer discretionary sector also performed well over the June quarter, with a gain of 11.2%. In annual terms this is now the best performed sector, rising by 46%. Also signalling investor confidence in the reopening and underlying strength of the economy was a gain of 10.5% in property trusts, with both industrial and office property attracting support, as indicated by respective gains in Goodman and Dexus of 18% and 12%. Although there were periods of underperformance as investors shifted focus to cyclical and "value" stocks, the Information Technology sector once again produced impressive results (up 12.1%), with investors encouraged by the valuation effects of lower longer term bond yields late in the quarter. However, not all sectors delivered positive results. Utilities experienced price decline (down 4.5%), now standing out as the only negatively performing sector in the market over the past year. Being less sensitive to broader economic cycles, utilities have failed to attract investor support in recent times. The energy sector also continued to struggle, despite a 24% jump in the WTI oil price to $US 73.5 cents per barrel over the quarter. It would appear that this recovery in oil prices was largely already factored into share prices, with stocks such as Woodside (down 7.5%) and Santos (down 0.1%) failing to attract support over the quarter.

Fixed Interest & Currencies

Despite the ongoing evidence of economic recovery, and the confirmation in May of the Australian government's ongoing large budget deficit, Australian bond yields have declined from their February peak. During the June quarter, the Australian 10-year bond yield dropped by 0.25% to 1.49%. The equivalent yield in the U.S. remained close to the Australian yield at 1.45%. The loss of the upward momentum in bond yields over the past quarter is likely to reflect a consensus view that inflationary pressures being experienced currently will prove to be "transitory" and not result in a material structural shift away from the low inflationary environment. This is despite a spike in U.S. inflation of 5% in the year to May. There were, however, some indications from members of the US Federal Reserve Bank that interest rate expectations have lifted and there was also some dispersion in views amongst members as to when US monetary policy should be "tapered". However, whilst the revelation of these views did see some short term bond yields rise over the quarter, there was no increase at the longer end of the yield curve.

Suggestions from members of the US central bank of an earlier than forecast lift in interest rates is in contrast to the Australian Reserve Bank, which has maintained a consistent view that cash rates would not be shifted until 2024. The possibility that any rate increases in Australia would lag those of other developed economies put downward pressure on the $A last quarter. This $A depreciation came despite further commodity price rises and exceptionally strong Australian trade accounts. Against the $US, the $A dropped from US 76.0 to US 75.2 cents over the 3 month period and was also 2.7% weaker against the Euro at €0.632.

Outlook and Portfolio Positioning

With global equity markets now more than 20% above their pre COVID-19 crisis peaks, valuations are clearly in the upper ranges of fair value. Expectations for future capital growth should therefore be more modest and more closely tied to further improvements in the outlook for earnings growth. Global economic data remains supportive of company earnings, with the decline in unemployment perhaps the most significant factor in fundamentally lifting the productive capacity of economies around the globe. As such, there remains a reasonable prospect that share markets can continue to track earnings higher over the period ahead, particularly if monetary policy remains supportive. However, it should be acknowledged that as stimulatory fiscal policies are wound back, the scope for ongoing earnings growth may be somewhat more limited.

The possibility that inflation will persist longer and larger than expected remains the largest concern of both equity and bond investors at the moment. Persistence of inflation beyond the transitory spike now being experienced around the globe could see an earlier rise in interest rates than the consensus scenario assumes. Higher interest rates would make existing equity valuations more difficult to justify and could also cut short the favourable economic cycle now prevailing. Increased market volatility in response to new data either supporting or refuting persistent inflation can be expected from here.

Whilst the maintenance of benchmark exposures to growth assets remains the path most likely to achieve real investment return objectives, increasingly investors should be considering biasing portfolios away from assets that have the most excessive valuations and are the most susceptible to an inflationary scenario should it ultimately prevail. Within equities, there are clear valuation discrepancies between sectors and styles and not all future scenarios will be supportive of the current valuation mix. The Information Technology sector, for example, may be more vulnerable to correction with the sector having gained 86% on global markets over the past 2 years. This is in stark contrast to the more defensively positioned utilities sector, which has advanced only 12% over the same time frame. Australian residential property is perhaps another example of an asset class that could come under pressure given the extent of recent valuation increase. Having surprised many over the past 12 months, the next stanza prior to the return of immigration could prove to be far more challenging. With housing supply continuing to increase as a result of heady levels of construction, demand growth will be largely absent in the months ahead, with the market not enjoying the same injections of fiscal stimulus to household incomes, support from returning expatriates and affordability gains from lower interest rates that have been so influential in the post COVID-19 period to date.

Hence, although the macro influence of improved economic activity may well continue to support equity and property markets in the months ahead, there are a number of factors at play that could alter the pattern of returns across and within assets classes. Assets that have done exceptionally well in recent times, and are now expensive as a result, cannot be expected to outperform indefinitely. An active approach to portfolio management that seeks out assets with both defensive earnings and long term growth characteristics may be more important than ever in the months ahead.

Important Information

The following indexes are used to report asset class performance: ASX S&P 200 Index, MSCI World Index ex Australia net AUD TR (composite of 50% hedged and 50% unhedged), FTSE EPRA/NAREIT Developed REITs Index Net TRI AUD Hedged, Bloomberg AusBond Composite 0 Yr Index, Barclays Global Aggregate ($A Hedged), Bloomberg AusBond Bank Bill Index, S&P ASX 300 A-REIT (Sector) TR Index AUD, S&P Global Infrastructure NR Index (AUD Hedged).

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