CAREphilosophy®

CARE Essentials™

Exciting life, boring money and not the other way around

Quarterly Newsletter | June 2021

The news in Australia continued to be positive with unemployment falling back to pre-Covid lows of 4.9% and job vacancy statistics suggesting further improvement lies ahead.

The unprecedented challenges from the coronavirus (COVID-19) continue to hamper economic growth around the world.

For now, global bond markets appear to be comfortable with the "transitory" narrative of recent elevated inflation measures and will be key to watch going forward.

GLOBAL OVERVIEW

At the time of writing, Sydney suffered a Covid-19 Delta variant outbreak which saw a lockdown of over 25% of Australia's population. The variant soon crossed into Victoria seeing Melbourne, the second largest city in Australia also locked down and forcing 50% of the population to remain at home. The testing of Covid strains clearly showed this variant displacing all others at an alarming pace. Fortunately, Delta remains within the reach of existing vaccine regimens, but the risk that a new strain may escape existing vaccine technology is ever present. The program (better described as a race) of vaccinations continues to roll out and plans are increasingly being made for a future where lockdowns will no longer be the strategy of choice. Indeed, Britain has gone down the path of herd immunity and it will be interesting to see the outcome particularly the pressures on the health system. Whilst there will be ramifications to economic growth in the medium term, the Australian share market took the news in its stride, barely flinching - unlike the selloff we saw a year or so ago. The Australian share market increased 2.3% over the month to be 27.8% higher over the year. Australian small companies increased 3.1% over the month to be 33.2% higher over the year.

Although the economic news is dated considering the latest lockdowns, the news in Australia continued to be positive with unemployment falling back to pre-Covid lows of 4.9% and job vacancy statistics suggesting further improvement lies ahead. Again, that was before the latest outbreak so it will be interesting to see whether more small businesses have taken a fatal blow and their owners, currently on life support from the government, join the jobseeker market. New lending for housing increase solidly over the quarter however, the trends over recent months show an acceleration in lending to investors and a flattening out in lending to first home buyers. Investor lending is now very close to its previous peak in early 2015 probably driven by the very poor term deposit rates currently on offer. These trends raise the risk of the reintroduction of restricted lending policy (called macro -prudential policy) by the Australian Prudential Regulatory Authority (APRA) to cool the market. Previous macro prudential policy has been aimed at keeping a lid on lending to investors, lending on an interest only basis and lending at a high loan to valuation ratio. Investor lending

Emmanuel Calligeris

Chairman of the CARE Investment Committee

The RBA announced its decision to extend bond purchases (money printing) from early September until mid-November at a reduced rate of $4 billion per week.

In terms of other central bank policy, The US entral bank, the Federal Reserve, contin-ues to print money at an alarming rate.

came into focus when investor credit growth was running at 10% per annum. While we are currently well short of that figure, the reaction function of APRA may change.

The NAB business survey registered a significant hit from the beginning of Sydney's lock-down in late June and the tail end of restrictions from Melbourne's May/June experience. However, confidence and conditions nationally remain above average, and key detail from the survey (namely strength in employment and capital expenditure intentions) is constructive for the outlook. Australia's state economies have rebounded strongly out of previous lockdowns; the pre–conditions for another robust recovery are clearly present.

The RBA announced its decision to extend bond purchases (money printing) from early September until mid-November at a reduced rate of $4 billion per week. This was both a taper as well as a shift to take a more flexible approach to money printing. In his press conference of 6 July RBA Governor Lowe stated,

"the reviews of our bond purchases take into account: the effectiveness of the bond purchases to date; the decisions of other central banks; and, most importantly, progress towards our goals for inflation and employment. We will use this same framework in our future reviews."

In terms of other central bank policy, The US entral bank, the Federal Reserve, continues to print money at an alarming rate. In more normal times, we would be worried that all this money printing will lead to inflation. However, these are not normal times. Although the Federal Reserve raised its headline inflation by 1% to 3.4%, the central bank continued to reassert that inflation pressures are ***"transitory"*** despite the biggest rise in consumer prices in 13 years. Inflation increased to 5% on a year-over-year basis in May. Excluding food and energy, the core inflation rate increased 3.8% year over year, the highest pace since 1992. The Federal Reserve's assertion that US inflation numbers are transitory seems to have been accepted by financial markets as indicated by the move lower in long term (3 to 30 year) interest rates. The move lower in rates highlighted a clear change in the market's view of the Federal Reserve reaction function. The market believes that the US central bank is now less likely to let the US economy run hot, less likely to tolerate inflation running above target for too long and more likely to increase short-term interest rate, earlier. Inflationary fears have been significantly downgraded as a result.

In China, economic growth seems to have peaked however remains resilient at 7.9% over the year. Inflation jumped to 5.3% year on year on rising prices for producers including a higher iron ore price. Growth was supported by the catch-up of industrial companies spending more money on capital investment (machinery, computers) whilst real estate investment cooled. Retail sales grew 12.1% over the year thanks to strong online sales. The latest COVID-19 wave and the resultant partial lockdowns in Guangdong (11% of China's GDP) will have affected restaurant and offline sales, especially auto sales since the data was released. Industrial production growth held up at 8.3% over the year on resilient exports, despite the rising cost pressures, the upbeat exports supported manufacturing. Labour market conditions further improved, with the surveyed unemployment rate fully returning to the pre-COVID level at 5.0% in June vs 5.3% in March.

The Peoples Bank of China (the Central Bank) cut the amount of money it requires banks to hold with it. This effectively allows banks to lend out more money. Authorities' initial hint of such a cut surprised investors as it signalled concerns of slower growth. The cut is expected to release about 1 trillion yuan into the economy. The more money in the economy means the cheaper the price of money which usually means companies and people are prepared to increase their borrowings to invest and spend more.

In Europe, the rift between Central Bank members that want stronger growth and those that think stronger growth will lead to higher inflation, seems to be back on the widening path with some members arguing in favour of a small reduction of money printing. While members 'widely agreed' with the view of higher inflation being mainly transitory, there also seemed to have been concerns about a less sluggish pass-through from producer to consumer prices than in the past. Some members even argued that ***"there could be upside risks to inflation not only over the shorter term but also over the medium term".*** The point for reduced money printing was made on the back of more favourable financing conditions as well as an improved economic outlook. We believe that those fearing higher long-term inflation are jumping at shadows. Growth and inflation are likely to remain low as we come through the Covid affected data.

The Australian Share Market

recorded an increase of 27.8%.

International Share Markets

ended the quarter 9% higher in Australian dollar terms to be 26% higher over the year.

The unprecedented challenges from the coronavirus (COVID-19) continue to hamper economic growth around the world. The Delta strain seems to be even more infectious than earlier strains however markets seem less phased than they did in the first and second quarters of 2020. Supply side disruptions remain particularly the supply of microchips which is in turn disrupting many industries including the auto industry. The Australian share market recorded an increase of 27.8% as mentioned above. This was captured in the Vanguard Australian Share (VAS) exchange traded fund. Within VAS, the banks did a lot of the heavy lifting whilst resource companies including BHP, Rio and Fortescue Metals performed well thanks to the high iron ore price. Telstra shares rose 7% after the company announced the sale of a 49% stake in its Tower portfolio for $2.8b to a consortium of infrastructure investors. The price was materially higher than analyst expected. Sydney Airport received an opportunistic takeover bid. Sydney Airport's shares, which were trading at close to $9 before COVID-19 hit, tumbled after Australia's borders closed and have not fully recovered, The airport's shares increased 34% following news of the $22 billion offer. Companies whose share price did not perform well include A2 Milk, AGL and construction group Cimic whose share price declined following a disappointing profit report.

International share markets ended the quarter 9% higher in Australian dollar terms to be 26% higher over the year. The US share market in particular had a buoyant year, with both the S&P 500 (the index of the 500 largest companies) and the technology heavy Nasdaq 100 reaching a new all-time high. Global property trusts, represented by DJRE in the CARE Essentials high growth portfolio, increased by 10.7% over the quarter.

The CARE Investment Committee took the opportunity to rebalance the portfolios over the quarter as price fluctuations afforded the opportunity. Within the CARE Essentials High Growth portfolio, hedged international shares were sold as too was QUAL (the Enhanced - World ex Australia Quality ETF). The proceeds were invested into global emerging market shares (VGE) and GOLD. Remaining disciplined to rebalancing is important and a key benefit of the CARE Investment Philosophy.

The QUAL investment performed well, beating the performance of the broader international share market by 3%. The ETF screens for companies that have a high return on shareholder money, profit stability and low financial leverage. Positive contributors included investments in Alphabet, Microsoft and Facebook. Alphabet increased after the parent of Google reported that rising spending on digital advertisements boosted first-quarter sales to USD 55.3 billion, a higher-than-expected rise of 34% from a year earlier. Microsoft's share price increased as rising demand for computers, gaming consoles, and digital services delivered over the cloud boosted the software company's first quarter sales by a higher-than-expected 19%. Microsoft also agreed to buy speech recognition firm Nuance Communications for US$19.7 billion, to expand the services it can offer business customers. The Facebook share price increased after the company reported a 48% increase in first-quarter sales which was well above expectations. Furthermore, a US judge unexpectedly dismissed two complaints against the company from the

US regulator because the Federal Trade Commission failed to prove the company was a monopoly.

The enhanced Australian Shares component gains exposure through AUMF the Blackrock investment that filters companies by quality, value, size and momentum. The return for the quarter ending June was 10.31% against the broader S&P/ASX 200 index of 8.48%. Over the year the investment returned 26.08%. The rebound in performance over the quarter was aided by Mineral Resources, an iron ore and lithium mining company. The company's share price increased after the recent announcement that it agreed to pay $200 million up front for a 40% stake in a large package of undeveloped iron ore tenements in the West Pilbara. Other stocks to perform well were retailer JB HiFi, ARB Corporation – the maker of four-wheel drive equipment, and Australian Pharmaceuticals Industries (API) the owner of Priceline Pharmacies. Wesfarmers made a takeover bid for API in a bid to extend into a part of the retail market in which it currently does not operate. Dragging on performance was fruit and vegetables company Costa Group whose share price fell following warnings about labour shortages among fruit and vegetable pickers, due to Covid. This was a handbrake on profits and triggered a share price fall. The other drag on performance was the underweight to Banks. Although the investment holds Commonwealth Bank, Westpac and NAB, the portfolio's exposure is less than the S&P/ASX 200 Index.

Share and property markets around the world have provided investors excellent gains over the last year. It is important we understand that such large gains have stemmed from the large sell-off we saw as the pandemic first struck panic into investors. Such large gains are unlikely to be repeated in the near term. Having said that, the investment outlook remains bright. The vaccination rollout to date has been slow in Australia and further lockdowns are likely to ensure interest rates remain low for some time. In the US, the sensitivity of share markets to daily comments by the central bank is a salient reminder of the significant impact ultra-loose monetary policy has had on global markets for more than a decade. For now, global bond markets appear to be comfortable with the "transitory" narrative of recent elevated inflation measures and will be key to watch going forward.

As the pandemic months drop out of the comparisons and the supply chain issues are sorted, inflation will eventually fall back towards its target of 2% on average. Government debt around the world is huge. Bond yields remain low in this context and now likely to consolidate around current levels until more data on the progress of inflation and the durability of the economic outlook becomes available in the face of Covid variants.

RETURNS

ESSENTIALS PORTFOLIO RETURNS TO THE 30th June 2021

	1 Month	3 Months	6 Months	1 year
Essentials Conservative	1.23	3.37	2.72	7.52
Essentials Moderate	1.83	4.92	5.85	13.26
Essentials Balanced	2.28	6.08	8.19	17.57
Essentials Growth	2.73	7.24	10.54	21.88
Essentials High Growth	3.33	8.79	13.66	27.63

* Returns are based on model portfolios assuming benchmark allocation. The numbers are before tax, adviser fees or platform fees but are net of the CARE Investment Management fees.

* The CARE Essentials returns are calculated assuming below allocation to the Essentials High Growth portfolio and the Essentials Defensive Portfolio:

	Essentials High Growth	Essentials Defensive
Essentials Conservative	30%	70%
Essentials Moderate	50%	50%
Essentials Balanced	65%	35%
Essentials Growth	80%	20%
Essentials High Growth	100%	0%

Simply Sophisticated

The CARE Investment Committee

Emmanuel Calligeris
BEc MBus (Finance)

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

Rob McGregor
SIA (Aff) ADFP

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

Grahame Evans
GAICD DipSM MBA

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

Dr. Mark Brimble
BCom(Hons) PhD CPA FFin

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

CAREphilosophy®

Easton Wealth Australia Pty Ltd

ABN 89 104 065 250 | AFSL 264 125

Level 15, 115 Pitt Street, Sydney NSW 2000

+61 02 8074 8599

info@eastonwealth.com.au

Easton Wealth Australia Pty Ltd is the investment manager of CAREphilosophy®. The information contained in this report has been provided as general advice only. The contents have been prepared without taking account of your personal objectives, financial situation or needs. You should, before you make any decision regarding any information, strategies or products mentioned in this report, consult your own financial advisor to consider whether that is appropriate having regard to your own objectives, financial situation and needs. Investment markets past performance are not necessarily indicative of future performance. Whilst Easton Wealth Australia Pty Ltd is of the view the contents of this report are based on information which is believed to be reliable, its accuracy and completeness are not guaranteed and no warranty of accuracy or reliability is given or implied and no responsibility for any loss or damage arising in any way for any representation, act or omission is accepted by Easton Wealth Australia Pty Ltd and its affiliated entities or any officer, agent or employee of Easton Wealth Australia Pty Ltd and its affiliated entities.