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KAURI ASSET MANAGEMENT

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How markets are responding to a rapidly-changing macro environment, is inflation here to stay?

The unpredictable nature of the market means investors should remain alert, but also take stock of the long-term picture.

Monthly Portfolio Reports

Our portfolio managers take you through the main contributors and cover any changes across both the Australian and US markets.

MICHAEL SMITH
Head of Research and Senior Investment Advisor

How markets are responding to a rapidly-changing macro environment

The unpredictable nature of the market means investors should remain alert, but also take stock of the long-term picture

The start to 2022 has raised a number of challenges in a short time.From soaring inflation to war breaking out, trade tension and sanctions, lockdowns in China, and the world's most-watched central bank finally pushing ahead with the first of what is predicted to be a series of rate hikes this year.

Although the last couple of years should have prepared us to expect the unexpected, these events are no less concerning.

They have also culminated in a challenging start to the year for markets across the world. The S&P 500 at one stage dipped into correction territory, while the Nasdaq technically entered a bear market.

Although these indexes have since pared some of their year-to-date losses, they are not alone in demonstrating the challenge that investors currently face across a number of fronts.

However, despite these prevailing headwinds, there are also investment stories perhaps being overlooked amid some of the catalysts sparking the action.

Commodities are in full swing

Over the last 12 or so months, commodities have effectively been the best-performing asset class, streets ahead of any other asset during this time.

In 2021, commodities returned 27.1%, however, in the first quarter of this year, those returns were already on their way to being eclipsed thanks to a return of 25.6%.

The data shouldn't particularly come as a surprise. Iron ore prices have been on a tear amid China's insatiable appetite for the steel-making ingredient.

Uranium and lithium prices have soared as investors look at the next-generation of renewable investments. The war in Ukraine has sparked a significant rally in the likes of gold, food, oil and gas, however, the latter two were already entering 2022 full of momentum amid supply constraints elsewhere in the world.

Meanwhile, a number of base metals have also been enjoying a near-unprecedented rise. Look no further than the short squeeze that took nickel prices above US$100,000 per tonne before the London Metal Exchange was forced to intervene in order to bring efficiency back to the market.

It's a sharp turnaround for an asset class that, for the most part, has underperformed for the best part of the last decade. Commodities have ranked last or second-last among all asset classes on eight out of ten occasions between 2011 and 2020.

Growth may have taken a hit, but that doesn't spell the end of an era

The data on commodities emphasises the need to have an adaptable approach to investing. In essence, it pays to look at what is unfolding at this time.

Growth names have been one of the best-performing asset classes since 2019, delivering returns of 34.1%, 34.2% and 21.4% in the three years respectively.

But this segment has taken a hit at the start of 2022 amid red-hot inflation numbers across the globe and rising Treasury yields.

The war has also added another complexity for central banks to consider, with unknown ramifications for global economic growth, but a need for policy to try to tame escalating consumer prices.

Nonetheless, there is also the long-term game to consider. And the long-term data suggests growth stocks are likely to have their moment in the sun again, which is why now could well be a very compelling time to be acquiring or adding to positions in growth assets.

After all, the growth asset class has been the best or second-best performing asset class in five of the last eight years, more than any other category.

That includes during periods where interest rates were sitting higher than they are now, and higher than what they are expected to reach. Take 2017 for example, rate hikes occurred several times, but growth stocks returned 28.5%, the second-best performing asset class.

And while growth assets have tumbled by 9.6% during the first three months of the year, their worst result in any year since at least 2009, it is only their third negative return in that period - and there is time yet for this instance to be turned around given how early we are in the year.

Can the US and Asia bounce back?

In terms of regional performance, we're seeing a flip to the script so far in early 2022, with US markets and Asia (ex-Japan) struggling to trade in positive territory.

In fact, it is the UK market that delivered the highest returns through the first quarter of the year, albeit at just 0.5%. On the other hand, the S&P 500 shed 4.6%, and the MSCI Asia (ex-Japan) declined 8%.

The US, largely driven by growth names, has been dealing with a shift in sentiment both towards tech, as well as rising inflation dampening consumer confidence. That is despite otherwise strong growth in the labour market.

Meanwhile, Asia has been weighed down by China in particular, which is dealing with lockdowns across its biggest cities, which has in turn hit manufacturing. Tighter regulations have also played their role in driving a rotation out of some high-growth tech names listed in Hong Kong.

However, we see these issues as transitory in nature. We would expect US consumer sentiment to return once rising interest rates begin to quash inflation.

Furthermore, the unparalleled success of the US market's biggest tech stories is something we believe has been consistently on show over the years, during the ups and downs of the rate cycle, and all sorts of market conditions.

History also supports a rebound for US markets. The S&P 500 has delivered the best-performing returns of any regional stock market in three of the last four calendar years, and in 2020, when it ranked third, it still delivered a healthy double-digit return of 18.4%.

In fact, the S&P 500 has ranked first or second for performance on four more occasions since 2010, and the only negative return in any calendar year since that time was 2018, yet it still topped all regions.

The story is a little more unresolved for the likes of Asia, where despite a growth focus, the region has actually underperformed on eight occasions since 2010, and then led all others on four separate instances.

But we expect growth to return to the fore in Asia, again led by China, with policy support and investment critical to restoring growth. The regulatory changes being rolled out now are in many respects future-proofing China's biggest companies and the economy at large.

Taking stock of the situation

Throughout history, war and geopolitical events have often had a temporary impact on the stock market.

While 2022 has raised a number of challenges, we see this as another instance where the market may be making a short-term adjustment in anticipation of building a platform for a return to some of the tried and trusted themes of past years.

For now, that means diversification to commodities is helpful, but for the long-term, there is good reason to believe that US growth may yet lead the way.

Mike Smith
Managing Partner

MICHAEL SMITH
Head of Research and Senior Investment Advisor

George Wong
Senior Financial Advisor

Performance:

Index	*March Performance*	*2022 Performance*
Dow Jones	2.3%	-4.6%
NASDAQ	3.4%	-9.1%
S&P 500	3.6%	-5.0%
Global Growth Portfolio	**-0.6%**	**-14.0%**

Top 10 Holdings:

Code	*Company Name*	*Weighting %*
COST	**Costco**	7.9%
BRKB	**Birkshire**	6.5%
MSFT	**Microsoft**	6.0%
GOOGL	**Google**	5.6%
TGT	**Target**	4.3%
V	**Visa**	4.2%
PFE	**Pfizer**	4.0%
PG	**P & G**	3.9%
ISRG	**Intuit**	3.6%
CME	**CME Group**	3.2%

International

International Growth Portfolio

While the underlying performance of our core holdings showed promising signs last month, NAV for the Global Growth Portfolio fell by 0.6% as foreign exchange headwinds persisted.

Throughout the month, the USD/AUD continued to slide, this time dropping from 1.3770 to 1.3363. A strong performance in the Aussie dollar has been the driving force, with the currency taking confidence from a booming commodities market as the likes of iron ore continue to outperform.

Stripping out currency headwinds, the Portfolio returned 2.6% on our stock positions, which was slightly ahead of the Dow Jones, which rose by 2.3% throughout March. The S&P 500 and Nasdaq fared slightly better, returning 3.6% and 3.4% respectively.

Our underperformance on that front can be attributed to the fact we entered the month with excess cash and bided our time before entering new opportunities, so these have not been afforded enough time as yet to play out.

Some of the stocks we have added to the Portfolio provide exposure to pressing themes at this time. For starters, Advanced Micro Devices (AMD), ASML Holding (ASML) and Nvidia (NVDA) all tap into the semiconductor shortage that continues to play out across the world.

Defence names like Lockheed Martin (LMT), Northrop Grumman (NOC) and Raytheon Technologies (RTX) are stocks that we believe will see fresh demand in the wake of the war in Ukraine, so we increased our exposure to this sector.

Another consequence of the war is the threat to food security, which has resulted in global food prices spiking to all-time highs. Mosaic (MOS), a potash and phosphate mining company, is leveraged to this theme by virtue of the fact its key commodities are used to manufacture fertilisers for crops and food. Our entry in this stock appears to have been well-timed, with the stock rising nearly 20% following our purchase.

Elsewhere, Berkshire Hathaway (BRK.B) was an integral performer in the Portfolio last month, as were Costco (COST) and Pfizer (PFE). Berkshire's performance has seen it hit a series of fresh all-time highs, and we like Warren Buffett's first big acquisition in over five years, Alleghany, which we see offering strong synergies in insurance, railroads and also as an inflation play.

Following last month's result, unrealised gains for the Portfolio stand at roughly 12% of NAV. With the market finding some confidence once again, we don't see as many fresh risks moving forward, albeit volatility may persist.

George Wong
Senior Financial Advisor

MICHAEL SMITH
Head of Research and
Senior Investment Advisor

Performance:

Index	March Performance	2022 Performance
ASX 200	6.4%	0.7%
ALLORDS	6.4%	0.1%
Conservative Portfolio	2.5%	-1.0%

Hub 24 - Conservative

Conservative Portfolio

We are pleased to see the Conservative Portfolio bounce back strongly last month and more than offset the small loss from February.

NAV for the Portfolio climbed by 2.5% during March, and while this wasn't quite up to the mark of the ASX 200, which leapt 6.4%, there were a number of encouraging signs.

Furthermore, the Conservative Portfolio is designed to target sustainable income and shield from capital losses, so it follows that we don't have the risk exposure or growth holdings here from sectors like tech that would be required to return a monthly result in excess of 6%.

Across the board, all but a handful of results delivered positive returns for the Portfolio last month. The real strength was in the banking and mining sectors, although a host of others contributed as well.

Commonwealth Bank (CBA) and Macquarie Group (MQG) both had a bumper month, and that followed the Federal Reserve's decision to lift interest rates in the US.

With expectations the Reserve Bank of Australia will follow suit, we believe the banks can begin to look at restoring net interest margins following a difficult period. The banks are typically one of the beneficiaries of a rising interest rate environment, and with reliable income for the Portfolio, CBA and Macquarie remain core positions for us moving forward.

In terms of mining stocks, BHP (BHP), Rio Tinto (RIO) and Newcrest Mining (NCM) all performed very well, up 10.9%, 6.4% and 4.2% respectively. The commodities sector has seen prices boom since the war started in Ukraine. Gold has been the obvious name amid uncertainty, while iron ore prices are being fuelled by speculation the Chinese government will kick-start its policy support to prevent the world's second-largest economy from stalling.

Income also played a prominent role in our results last month, with as much as one-fifth of our returns generated from dividends and/or distributions.

After holding onto some excess cash in February, we have since deployed some funds towards increasing our hybrid exposure, which we believe should also help secure further sustainable income in what may still be a volatile trading environment in the near-term.

George Wong
Senior Financial Advisor

Samuel Waldron
Financial Analyst

Performance:

Index	March Performance	2022 Performance
ASX 200	6.4%	0.7%
ALLORDS	6.4%	0.1%
Balanced Portfolio	3.0%	-5.4%

Hub 24 - Balanced

Balanced Portfolio

NAV for the Balanced Portfolio grew by 3% in March, which represented a robust recovery from the month prior. With that said, the Portfolio trailed the ASX 200, which rose by 6.4% on the back of risk-on sentiment returning mid-way through the month.

Furthermore, the ASX actually managed to outperform most other stock markets in March, including the US indexes, which we have large exposure to. This ultimately played a role in terms of our underperformance.

Gains were spread relatively evenly across the holdings in the Portfolio, with the breadth of our stocks meaning no particular name stood tall above the rest.

With that said, Commonwealth Bank (CBA), Macquarie Group (MQG), BHP (BHP) and Fortescue Metals Group (FMG) all recorded the highest share price increases last month, each offering double-digit returns solely through capital growth.

As mentioned in the summary for our Conservative Portfolio, the banks are leveraged to the rising rate cycle. We believe the start of a new round of interest rate hikes offers a sound backdrop for the banks to restore margins and in turn generate some growth after a lacklustre couple or so years.

On the other hand, iron ore prices have passed US$160 per tonne once again, despite a government crack-down in China intended to take the heat out of the iron ore market. In our view, the reality is that China will sooner or later need to stimulate its economy to maintain growth, especially in light of the current lockdowns and the country's focus on a covid-zero policy.

As part of some modest changes we made to the Portfolio last month we increased our exposure to hybrids in order to provide some more visibility over our income stream, also while adding an element of protection. To achieve this, we trimmed our position in defensive stocks like Transubran (TCL), Goodman Group (GMG) and Woolworths (WOW).

One of the areas we made a new investment in is the BetaShares Global Agriculture ETF (FOOD). With global food prices at record highs amid the threat to food security driven by the current war in Ukraine and other supply disruptions across the world, we believe exposure to the agriculture supply chain is an area that offers potential upside at this time.

With the Reserve Bank of Australia likely to begin preparing investors for a rate hike in the coming months, we see the Portfolio well-positioned for this environment.

George Wong
Senior Financial Advisor

Samuel Waldron
Financial Analyst

Performance:

Index	March Performance	2022 Performance
ASX 200	6.4%	0.7%
ALLORDS	6.4%	0.1%
Growth Portfolio	3.4%	-5.8%

Hub 24 - Growth

Growth Portfolio

Turning around the performance from February, NAV for the Hub24 Growth Portfolio increased by 3.4% last month. That meant the Portfolio also outperformed both the Conservative and Balanced Portfolios, however, it wasn't enough to beat the benchmark ASX index, which surged more than 6%.

The underperformance compared with the ASX came about following disappointing results for a trio of our core holdings, which also happen to be leveraged to international markets.

The T.Rowe Price Global Equity Fund fell by 3.8% last month, having the biggest drag on our Portfolio given our weight towards this holding. Also weighing on the Portfolio was the Fidelity Global Emerging Markets Fund (FEMX), down by 6.1%, and the BetaShares Asia Tech Tigers ETF (ASIA), which slumped 6.9%.

China's plans to lock down millions across the nation to try stamp out the Coronavirus has hit sentiment in a number of Chinese companies, and the Hong Kong market at one stage dropped to its lowest point in six years before a late-month rally. Along with regulatory risk as well, the investment has not performed to our expectations to date, but we do see long-term upside as China reprioritises economic growth.

In contrast with the above international funds, the VanEck MSCI International Quality ETF (QUAL) and Hyperion Global Fund (HYGG) both had a solid month, buoyed by a turnaround in growth assets like Apple. It was a similar story for the BetaShares Nasdaq 100 ETF (NDQ), which highlights the importance that just a few key positions can make.

BHP (BHP) also had an exceptional month, up 10.9% and along with Commonwealth Bank (CBA), driving a significant portion of NAV growth across the Portfolio. While both these names are leveraged to key trends at this time, namely rising iron ore prices and expectations of rising interest rates, they are quality blue-chip names that offer a robust mix of income and capital growth.

We have also replicated a decision we made in our Balanced Portfolio to take a position in the BetaShares Global Agriculture ETF (FOOD), which offers exposure to global agriculture firms at a time when food prices are at record highs. With sanctions hitting exports, a multitude of supply chain disruptions across the world, and high inflation, we believe the case for investing in food is strong right now.

We have held off from rotating back into tech as there is still some vulnerability in play, but we will continue to look for opportunities as growth comes back into favour.

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