

17/01/2022

DECEMBER QUARTER FUND REVIEW



Lower ahead but not transitory

In 2020 the global economy came to a juddering halt. In 2021 it got moving again, only to become stuck in one of history's biggest supply chain jams creating inflation pressures in the process. As fast as the word came into our everyday lexicon it was gone again. "Transitory" is no longer the word to describe inflation according to the US Federal Reserve. The US central bank became more concerned about inflation's persistence over the quarter and quickly pivoted the outlook for policy to reflect that concern. Having said that, the Fed still believe inflation will be lower later this year.

The December quarter was all about growing inflation risk, persistent supply shortages, diverging global interest rate policy, emerging new virus variants (that some had trouble pronouncing) and strengthening Chinese growth headwinds. The combination of which made for volatile financial markets.

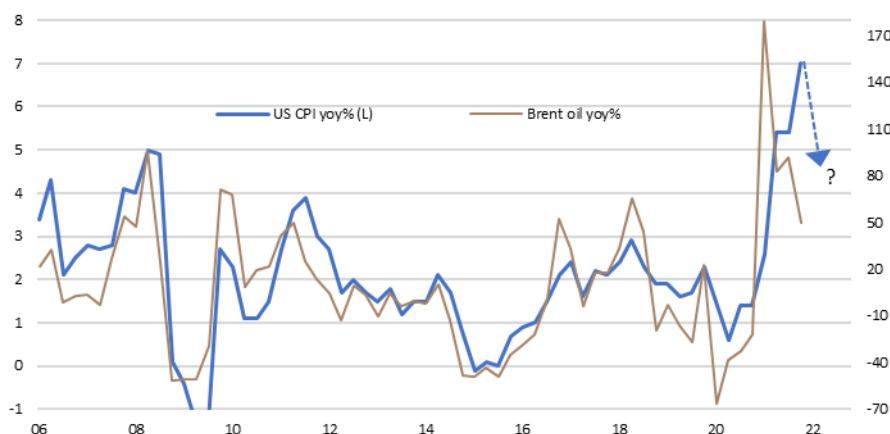
1. Inflation – the waning boost from oil prices

Oil prices appear to have peaked, at least on an annual percentage change basis and it is the change in price that matters most for inflation. This will have implications for upcoming readings on the US CPI given the close correlation between the two.

Inflation is closely linked to the change in oil prices. The chart below shows the annual change in oil prices (Brent oil) and US inflation rates over the last 15 years. The 180% increase year-on-year in oil prices drives the 7% inflation rate we currently see in the United States.

But remember that inflation is a change in price. So in order to see a similar inflation rate one year from now, oil price growth would have to return back to around 150-180%, which would see Brent sitting at around US\$190/bbl from US\$84/bbl today – the highest they have ever been. This may be a stretch given growth in both the US and China is slowing down.

Chart 1: US CPI and Brent Oil



Source: Bloomberg

2. The Powell Pivot

US Federal Reserve Chair Jay Powell became more concerned about inflation risk and signalled the possibility of the Fed moving toward the end of its bond purchase program faster, opening the way for an earlier start to the rate hike cycle in 2022.

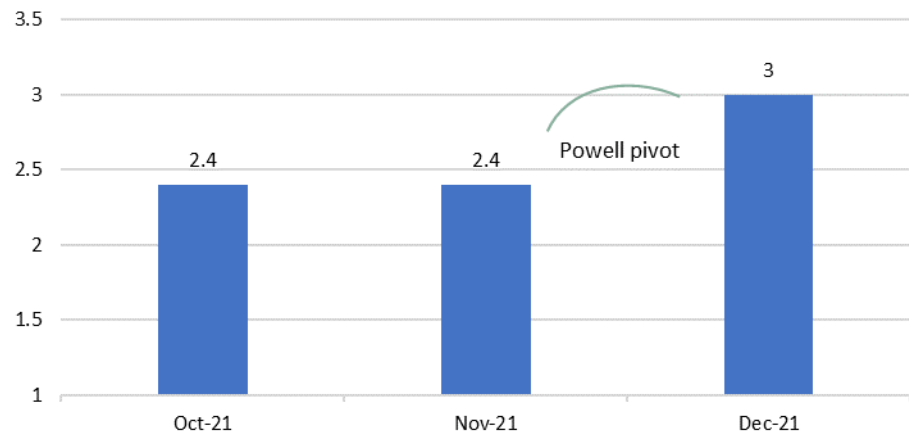
Powell also said it was time to drop the word transitory when referring to inflation suggesting he is concerned that inflation has some persistency to it. Despite this, the Fed's own economists still expect inflation to be significantly lower next year and we are already seeing signs the supply-chain pressures peaking of their own accord.

The tilt to being more concerned about inflation saw the market price in more rate hikes in the near term and slower growth and lower inflation in the medium to longer term.

Powell now seems of the view that policy has a role in bringing down the inflation that we are currently experiencing – that is a change. Previously the key to bringing down inflation was time – hence the word transitory – it implies a time element. By dropping the word transitory, he is implicitly dropping the time element and adopting a more proactive stance.

The risk is that Powell's Fed fights a battle they don't need to fight or indeed can't fight, hurting growth in the process. Raising interest rates won't bring back labour into the US workforce.

Chart 2: Market pricing – the number of US rate hikes priced in for 2022

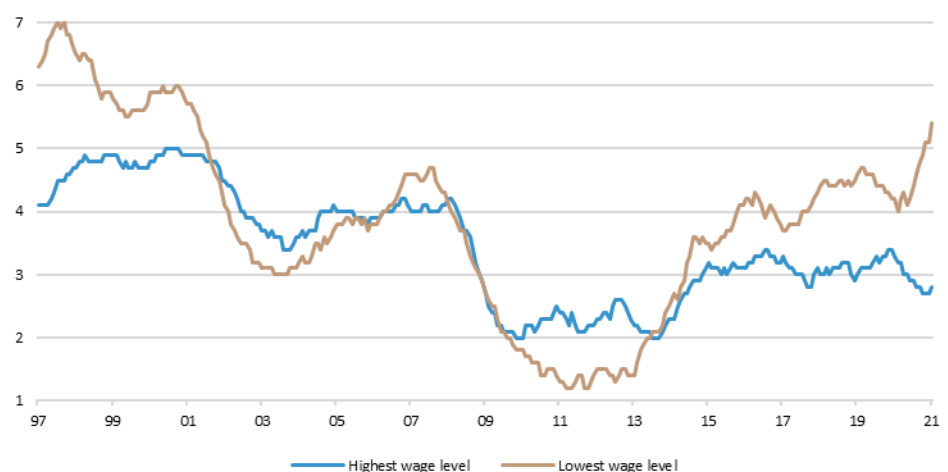


Source: Bloomberg

3. Labour supply issues linger longer

The labour market, particularly in the US, is still adjusting to the challenges brought about by covid. Around 1.1 million people in the US reported that they were prevented from looking for work due to the pandemic. Most of these people are in the leisure and hospitality and food services industries. Employment in leisure and hospitality added 2.6 million jobs in 2021, but is down by 1.2 million vs pre-pandemic. Employment in food services and drinking places is down by 653,000 vs pre-pandemic. These industries face the greatest labour supply shortages and is where the greatest pressure on wages resides. In general, low wage groups in the US are experiencing wage growth of 5.1% (the highest since May 2002). In contrast, high wage groups are seeing growth of 2.7% (the lowest since Mar 2015).

Chart 3: Atlanta Fed Wage Growth Tracker (yoy%)



Source: Bloomberg

Australian Shares	3m	1 Yr p.a.	3 Yr p.a.	5 Yr p.a.	10 Yr p.a.
Legg Mason Martin Currie Equity Income	-1.00%	14.41%	9.99%	5.56%	9.99%
Legg Mason Martin Currie Equity Income - Ethical	-0.42%	17.07%	11.20%		
Bennelong Concentrated Australian Equity Fund	0.04%	27.29%	23.85%	17.68%	18.32%
Selector Australian Equities	2.87%	24.53%	21.11%		
Pendal Australian Share SMA	1.30%	16.64%	14.77%	10.52%	
Alphinity Sustainable Share	3.42%	20.60%	18.44%	13.53%	13.02%
WaveStone Australian Share	1.96%	20.64%	14.54%	11.53%	11.65%
Pendal Focus Australian Share Fund*	1.05%	16.19%	15.74%	11.54%	12.16%
Selector High Conviction Equity A	3.05%	23.56%	20.25%	17.57%	19.13%
iShares Core S&P/ASX 200 ETF	2.05%	17.11%	13.51%	9.62%	10.52%
S&P/ASX 200 Accumulation Index	2.09%	17.23%	13.62%	9.76%	10.80%
Ophir Opportunities Fund	2.56%	29.53%	30.42%	22.36%	
QVG Opportunities Fund	3.19%	33.31%	25.73%		
Spheria Australian Smaller Companies	2.74%	25.91%	19.38%	14.02%	12.15%
Spheria Australian Microcap	10.97%	46.22%	27.36%	17.28%	
Fairview Equity Partners Emerging Co	5.08%	27.16%	26.15%	17.38%	13.47%
Flinders Emerging Companies Fund	1.09%	16.74%	19.93%	12.95%	
SPDR® S&P/ASX Small Ordinaries ETF	0.97%	15.41%	15.10%	10.57%	7.56%
BetaShares Australian Sustnby Ldrs ETF	3.58%	17.99%	14.60%		
S&P/ASX Small Ordinaries Accumulation Index	2.03%	16.90%	15.71%	11.17%	7.98%

* Performance as at November 2021



Key points:

- The Australian equity market completed a clean sweep of quarterly gains in the final three months of 2021, with equities edging higher despite a pick up in volatility, again predominantly driven by macro factors.
- While Victoria and NSW came out of lengthy lockdowns and domestic vaccination rates rose above many other countries, persistent inflationary concerns bringing forward the tightening of monetary policy and the emergence of the omicron COVID strain provided a somewhat challenging environment for the market.
- Earnings revisions were also somewhat variable; four successive months of downgrades were halted by upgrades in November, before dropping again in December.
- Sector performance across the quarter also revealed no discernible trend in key drivers of the market's performance, although strong gains in mid-tier and smaller mining companies stood out, particularly in the gold sector. Among the sectors that lagged included energy, as oil retreated from a cyclical high, and financials, following a soft reporting period for the major banks. Most of our large cap managers are underweight financials, so this was a tailwind for their performance.
- On aggregate, our large cap Australian equity funds produced very strong returns in 2021, particularly the growth-focused strategies of Bennelong and Selector. There was, however, few standouts in the December quarter, with modest outperformance from Alphinity and Selector leading the way.

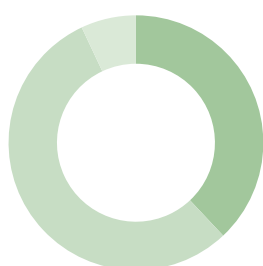


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- Of our large cap SMA strategies, Pendal lagged the index slightly for the quarter, primarily driven by weaker performance across stocks held in the more cyclical sectors of resources and financials.
 - Our small cap managers also rounded out an excellent year of significant outperformance. QVG, Fairview and Ophir all managed to outperform the benchmark Small Ordinaries Accumulation Index by 10% or more in 2021, adding to their solid long-term track records. These results were achieved despite a positive year for the resources sector, which most small cap managers tend to be underweight.
 - While outperformance was not as significant in the December, the majority of our small cap managers still reported returns ahead of benchmark. The standout was Fairview, which generated 3% outperformance – a solid result given the more diversified and balanced approach taken by the manager.



International Shares	3m	1 Yr p.a.	3 Yr p.a.	5 Yr p.a.	10 Yr p.a.
MFS Concentrated Global Equity Trust (Wholesale)	5.62%	26.99%	20.79%	15.85%	18.50%
MFS Global Equity Trust	5.10%	24.61%	19.05%	14.27%	17.07%
WCM Quality Global Growth	5.93%	23.76%	29.94%	23.30%	21.40%
Franklin Concen Glb Eq ex-Aus Model (SMA)*	-0.75%	18.03%	31.39%	25.62%	
WCM International Small Cap Gr	-1.36%	21.21%			
Impax Sustainable Leaders Fund A	7.63%	28.93%	23.10%		
Pengana WHEB Sustainable Impact	4.59%	20.93%	19.72%	10.50%	8.82%
Stewart Investors Worldwide Sus-Class A	4.83%	24.65%	18.04%	15.25%	
Franklin Global Growth I	5.28%	21.94%	29.44%	21.34%	19.95%
Artisan Global Discovery	1.77%	19.30%			
Loftus Peak Global Disruption	9.77%	21.20%	32.04%	24.68%	18.77%
Munro Climate Change Leaders**					
MSCI AC World ex Aus (\$A)	6.07%	25.99%	19.23%	14.41%	15.89%
MFS Fully Hedged Global Equity Trust	6.00%	20.87%	18.88%	13.42%	14.98%
ClearBridge RARE Infrastructure Value – Unhedged	7.46%	18.64%	12.76%	9.84%	11.78%
ClearBridge RARE Infrastructure Value Fund – Hedged	8.59%	15.00%	12.76%	8.91%	10.01%
ClearBridge RARE Infrastructure Income – Hedged	7.76%	15.38%			
ClearBridge RARE Infrastructure Income – Unhedged	7.01%				
MSCI AC World ex Aus	6.76%	18.71%	20.52%	14.51%	11.98%
RWC Global Emerging Markets Fund	-2.17%	0.48%			
Fidelity Asia	4.10%	14.66%	19.28%	17.38%	17.27%
MSCI Asia-Pac Ex Japan (\$A)	-1.36%	-3.06%	11.83%	10.71%	8.51%
UBS Emerging Markets Equity Fund	-3.33%	-3.54%	9.55%		
MSCI Emerging Markets (\$A)	-1.95%	3.44%	9.76%	9.79%	9.18%
Quay Global Real Estate Fund	9.75%	37.82%	15.53%	12.40%	
FTSE EPRA Nareit Developed Index (\$A)	9.66%	35.02%	11.65%	8.73%	13.40%

* Performance as at November 2021
 ** The maturity of this fund is less than 3-months



Key points:

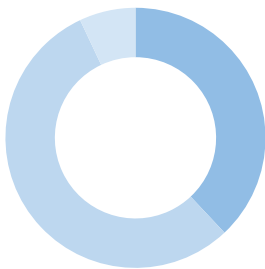
- Global equities were up 7.5% in the December quarter after recording a small decline in the September quarter.
- For the fourth consecutive quarter emerging markets underperformed developed markets with the former falling by 1.7%. The quarter once again saw some heavy selling of Chinese equities, down 5.6% as regulatory risk and a deflating housing market weighed. The weakness spread into other Asian markets with Hong Kong down 4.8%, South Korea down 3.0% and Japan down 2.0%. Europe performed well with the French CAC index up 9.7% and the German DAX up 4.1% while the US S&P500 finished up a solid 10.6% helped by healthy gains in technology stocks. The NASDAQ rose by 8.3%.
- Over the year, the US S&P500 rose by 26.9% beating the 16.3% return in 2020. European markets were up between 20-30% while Asian markets were more mixed with Chinese equities down by 23.3% while Taiwan was up 23.7%.
- The best performing funds over the quarter were our thematic sustainable and tech disruption funds. Loftus Peak Global Disruption rose by 9.8% helped by healthy gains in Qualcomm. The position is one the team have held for some time and which has increased in weight as confidence in the stock rose.
- Our sustainable funds, Impax, Stewart and Pengana, all did well. The 7.6% gain in Impax was helped by gains in MediaTek, the world's 4th largest global fabless

semiconductor company. Mediatek is rapidly closing the gap with industry leaders in the chip design space. The stock outperformed due to the launch of a new product targeting the high-end mobile phone market.

- The other funds that did well over the quarter were those that tend to provide a hedge against inflation. This includes our ClearBridge infrastructure funds and our allocation to Quay Global Real Estate.
- Underperforming over the quarter were our small cap funds – WCM International Small Cap and Artisan Global Discovery. WCM International was weighed down by Zur Rose, a Swiss healthcare company, after Germany's Ministry of Health announced a delay in the introduction of mandatory e-prescriptions, which had been planned for Jan. 1.
- Also underperforming over the quarter were our emerging markets funds. RWC was weighed down by its holding in Meituan, China's largest food delivery platform. Tencent divested out of a number of Chinese tech companies including Meituan. The move by Tencent comes on the back of Chinese regulators crackdown on anti-competitive behaviour among some of China's larger companies. Fidelity Asia has reduced its holdings in Alibaba and Tencent and does not hold Meituan.
- The Australian dollar rose slightly against the USD, providing a small outperformance of our hedged funds against their unhedged equivalent. This was the case for MFS Global Equities and the ClearBridge RARE Infrastructure funds.



Fixed Income	3m	1 Yr p.a.	3 Yr p.a.	5 Yr p.a.	10 Yr p.a.
Legg Mason Western Asset Aus Bd A	-1.46%	-2.93%	3.08%	3.56%	4.67%
Realm High Income - Wholesale	0.16%	2.75%	4.73%	3.95%	
Realm Short Term Income Ordinary	0.24%	1.98%	2.51%		
Perpetual Credit Income	0.02%	2.63%	3.50%	3.49%	4.47%
Alexander Credit Income Fund	0.85%	4.63%	3.77%		
<i>Bloomberg AusBond Bank Bill Index</i>	0.01%	0.03%	0.63%	1.11%	1.94%
<i>Bloomberg AusBond Composite Index</i>	-1.46%	-2.87%	2.87%	3.36%	4.15%
Bentham Global Income Fund	0.65%	4.62%	4.52%	4.47%	6.88%
PIMCO Global Bond Fund – Wholesale Class	-0.28%	-1.37%	4.11%	3.61%	5.37%
PIMCO ESG Global Bond Fund - Wholesale	-0.27%	-1.79%	3.97%		
PIMCO Global Credit W	-0.25%	-0.67%	4.15%	3.54%	5.00%
Perpetual Ethical SRI Credit	0.00%	2.49%	2.90%		
Ardea Real Outcome Fund	-0.19%	-0.60%	4.47%	4.27%	
Robeco SDG Credit Income (AUD Hdg) A	-0.95%	0.59%			
<i>Barclays Global Aggregate \$A (Hdg)</i>	0.03%	-1.53%	3.52%	3.17%	4.64%



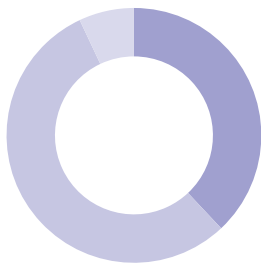
Key points:

- Government bond yields were higher over the quarter leaving the high duration funds such as Western Asset Management Australian Bond Fund and the PIMCO Global Bond Fund underperforming.
- The two pure credit funds (where the majority of the risk comes from credit and not duration) did relatively well in the quarter. The Perpetual Credit Income Fund returned 0.02% while the Bentham Global Income Fund returned 0.65% after fees.
- The Ardea Real Outcome Fund declined by 0.19% over the quarter. This fund is designed to take advantage of short-term dislocations in the bond market. At its core, the Fund has an allocation to inflation-linked bonds the value of which declined due to a rise in real yields over the quarter. We have been disappointed with the performance of this fund over the past several years and as a result has now been removed from our approved list of funds.
- Our best performing funds over the quarter were the funds that sit in our “liquidity” bucket - Realm Short-Term Income, Realm High Income Fund and Alexander Credit Income Fund. These funds are designed to provide investors with a high level of liquidity while also being low in volatility.



Alternatives	3m	1 Yr p.a.	3 Yr p.a.	5 Yr p.a.	10 Yr p.a.
Partners Group Global Value Fund*	3.24%	23.33%	16.33%	13.83%	
Munro Global Growth Fund	2.94%	11.68%	20.81%	17.62%	
Hamilton Lane Global Private Asst (AUD)*	4.84%	22.42%			
Hamilton Lane Global Private Asst (Unhedged)*	6.54%				
Platinum Global Fund (Long Only)	0.21%	14.79%	11.63%	10.77%	13.56%
Antipodes Global Fund - Class P	0.90%	12.18%	8.51%	7.96%	14.86%
Aquasia Enhanced Credit Fund*	0.73%	4.69%	4.78%	5.19%	6.69%
Charter Hall Direct Office Fund	5.29%	15.44%	12.27%	13.23%	
Barwon Healthcare Property Fund	1.20%	19.71%	12.38%	10.21%	
Merricks Capital Agriculture Credit Fund - Founders Class	1.91%				
Merricks Capital Partners	1.85%	8.14%	9.58%	10.48%	
Realm Strategic Income Enduring	1.50%	5.86%			
Alium Alpha Ordinary*	6.77%	18.31%	17.61%	20.92%	
Spire Oaktree Opps XI (AUD) Frst Cls*	3.41%	7.52%			
MSCI AC World ex Aus	6.76%	18.71%	20.52%	14.51%	11.98%

* Performance as at November 2021



Key points:

- The fourth quarter proved to be volatile for hedge funds with a range of macro factors impacting markets namely: the emergence of the new COVID variant putting pressure on the outlook for the economy, supply chain challenges and the US pivoted more hawkishly and flagged an early end to tapering and more aggressive rate hike cycle in 2022.
- Equity long short manager Munro Global Growth finished the quarter up 2.9%. Positive contributions came from the High Performance Compute and Innovative Health investment themes. The Fund's High Performance Compute investments stand to benefit from the accelerated computing demand, driven by data centre growth to help power artificial intelligence and gaming. Innovative Health names stand to benefit from increased COVID testing and biopharma manufacturing of vaccines and biologics drugs.
- Private equity finished off a record breaking year with another big quarter, deal flow and exit activity significantly exceeded previous records as a combination of ample investor liquidity and many rearranged deals previously postponed due to the pandemic all meant that 2021 was a very good year for private equity investors. For the year dealmaking surpassed \$1.2tn which was more than 50% above the previous record whilst the number of private equity led exits almost doubled compared to the level seen in 2020.
- Both of our private equity fund managers had strong three month returns to the end of November 2021 with Partners Group Global Value Fund finishing up 3.2% and Hamilton Lane Global Private Assets Hedged gaining 4.8% for the period. Partners Group benefited from selling a South American food franchise investment, Pacific Bells, at an uplift in valuation and also had positive revaluations to direct equity positions in the portfolio. Hamilton Lane gained from revaluations to many portfolio companies including AIT Worldwide Logistics on increased sales and improved operating profits.
- In the private debt space Merricks Partners Fund added 1.9% over the three months ending November 2021 with loans fully repaid in the office property and agriculture industries adding to returns. The team continue to see good risk adjusted opportunities in agriculture where they have added 8 new loan facilities

recently and are also deploying capital in commercial real estate subcategories of land subdivision, residential and office in particular.

- In direct property, the Barwon Healthcare Property Fund added 1.2% over the quarter with twelve month rolling returns 19.8%. The income return and the capital return were 5.87% and 13.91% respectively (net of fees and expenses, pre-tax). The healthcare sector has continued to perform considerably better than other areas of the economy. As an essential service, healthcare operators have been a beneficiary of government support and funding and on balance have experienced limited disruptions to operations.
- The Charter Hall Direct Office Fund had an above benchmark twelve month return of 15.7% on the back of positive revaluations for all office properties within the portfolio as of June 2021. The fund's focus on A-grade buildings in prime CBD locations on the eastern seaboard, with long weighted average lease expiry (WALE) and strong tenant profile have seen returns remain resilient over recent years.



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