

#### Asset Allocation themes<sup>1</sup>

| Asset class               | Change | New AA |
|---------------------------|--------|--------|
| Australian Equities       | —      | 10.0%  |
| International Equities    | 1.8    | 34.7%  |
| Property & Infrastructure | —      | 0.8%   |
| Australian Bonds          | 2.0    | 25.9%  |
| International Bonds       | —      | 7.7%   |
| Alternatives/Other        | —      | 6.7%   |
| Cash                      | -3.7   | 14.2%  |

#### Growth vs Defensive splits<sup>1</sup>

| Assets    | Change | New Split |
|-----------|--------|-----------|
| Growth    | 1.7    | 48.9%     |
| Defensive | -1.7   | 51.1%     |

<sup>1</sup> May not sum to 100.0% due to rounding.  
Morningstar Investment Management considers Alternatives/Other to be 50% Growth / 50% Defensive assets.

#### About Morningstar Investment Management Australia

Morningstar Investment Management Australia is a global leader in asset allocation and multi-asset portfolio construction.

Morningstar's long-term, valuation-driven approach is underpinned by an emphasis on preserving capital and undertaking fundamental analysis of global asset classes and securities. We invest with the client in mind, delivering holistic and cost-effective investment solutions, helping them to meet their investment goals.

#### At a glance ....

- Conflict between Russia and Ukraine, and ongoing uncertainty around the impact of inflation (and the potential for rising interest rates), have led to falls across key share and bond markets across the first quarter of 2022. Pleasingly, however, the portfolio continues to perform well under these challenging circumstances.
- With sharemarkets now generally offering better value, we have increased our weighting to broad global equities with further, and more targeted, allocations to European shares.
- We've also made a number of changes to the Australian equities' component of the portfolio. All in all, the portfolio's weighting to growth assets has increased, as has our allocation to Australian bonds, all of which has been funded from cash.

A volatile start to 2022 has continued throughout the quarter, as investors try and understand the potential implications of rising inflation and an escalation in hostilities between Russia and Ukraine. This is no easy feat! For example, one might typically expect interest rates to rise sharply in response to soaring inflation but, on the other hand, envisage them softening as a consequence of geopolitical conflict (with bonds typically doing well in times of uncertainty). In terms of sharemarkets, investors are usually able to tolerate moderate inflation, particularly when it is accompanied by growth in corporate profitability (less so, with persistently higher inflation, or a lack of growth), with sharemarkets understandably coming under pressure when the macroeconomic or geopolitical environment appears more challenged.

So where are we now? Interestingly, we have seen losses across broad share and bond markets over the course of 2022. To put some numbers around this, broad global sharemarkets are down around 6% in 2022, with the rising Australian dollar further impacting returns for unhedged investors, while domestic and global bonds are down in excess of 4%, over this same period. This defies the theoretical principles of diversification, i.e., in normal markets we would look for bonds to buffer the portfolio from sharemarket losses and vice versa. In part, this reflects expectations around interest rates moving higher although we also note that many key share and bonds markets previously appeared overvalued, on our analysis, making it more difficult for the typical relationships between assets to hold in this uncertain environment. Pleasingly, however, the portfolio has held up well under these circumstances.

As with COVID-19, we cannot predict what the ultimate humanitarian and financial cost of the escalating Russia/Ukraine situation will be. Inflation remains similarly difficult to forecast, although it seems reasonable to assume that it will settle at a level that many would not have considered possible 18 months ago. However, we can recognise much better value in share and bond markets courtesy of the recent sell off. With this in mind, we have increased our allocation to growth assets (funded from cash), via a higher weighting to global shares in the portfolio,

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while also making a number of changes to the portfolio's Australian sharemarket investments. Lastly, we have increased our investment in Australian bonds, again funded from cash.

**Portfolio action**

| Security   | Security/<br>APIR Code | Current<br>Weighting | New<br>Weighting | Increase /<br>Decrease <sup>2</sup> |
|--|------------------------|----------------------|------------------|-------------------------------------|
| <b>Australian Equities</b>                             |                        | <b>10.0%</b>         | <b>10.0%</b>     | <b>0.0%</b>                         |
| CSL Limited  | CSL-AU                 | 0.0%                 | 0.9%             | 0.9%                                |
| Resmed Inc.  | RMD-AU                 | 0.0%                 | 0.8%             | 0.8%                                |
| The a2 Milk Company Limited                            | A2M-AU                 | 0.5%                 | 0.0%             | -0.5%                               |
| Westpac Banking Corporation Limited                    | WBC-AU                 | 1.7%                 | 1.3%             | -0.5%                               |
| Woodside Petroleum Limited                             | WPL-AU                 | 1.9%                 | 1.3%             | -0.6%                               |
| <b>International Equities</b>                          |                        | <b>33.0%</b>         | <b>34.7%</b>     | <b>1.8%</b>                         |
| Vanguard FTSE Europe Shares ETF                        | VEQ-AU                 | 0.9%                 | 1.6%             | 0.8%                                |
| iShares Core MSCI World (Ex Australia) ESG Leaders ETF | IWLD-AU                | 0.0%                 | 1.0%             | 1.0%                                |
| <b>Australian Bonds</b>                                |                        | <b>23.9%</b>         | <b>25.9%</b>     | <b>2.0%</b>                         |
| Vanguard Australian Fixed Interest ETF                 | VAF-AU                 | 2.0%                 | 4.0%             | 2.0%                                |
| <b>Cash</b>  |                        | <b>18.0%</b>         | <b>14.2%</b>     | <b>-3.7%</b>                        |
| iShares Core Cash ETF                                  | BILL-AU                | 11.3%                | 7.6%             | -3.7%                               |

<sup>2</sup> May not sum due to rounding.

**Rationale**

We have added **CSL** and **Resmed** to the portfolio. Narrow moat rated, CSL is Australia's third-largest company (by market capitalisation) and is a leader in the global biotechnology industry. They develop, manufacture and distribute a range of high-quality medicines, that treat people with rare and serious diseases, and influenza vaccines, which help prevent and control the spread of influenza. Shares in CSL have fallen over the course of 2022, extending a difficult final period of 2021, as investors digested the sizeable acquisition (and subsequent capital raising) of Swiss pharmaceutical company, Vifor Pharma. While not necessarily cheap, we view this acquisition as logical, with Vifor's focus on renal disease and iron deficiency expected to complement CSL's existing interests. As such, the recent share price weakness has provided us with a rare opportunity to buy the company for less than we believe it to be worth, and we have moved accordingly.

Narrow moat rated, Resmed, is a global leader in sleep technology, sleep medicine and non-invasive ventilation products. They, too, have had a weak start to the year, delivering slower earnings growth than expected, given the impact of the global chip shortage on their ability to supply product to their market. Nonetheless, the long-term growth profile for the company appeals, underpinned by favourable demographic and healthcare trends. In this regard, the sleep apnea market remains significantly underpenetrated, with Resmed well positioned to

capitalise on expected future demand for cloud-connected respiratory devices, in our view. At current levels, Resmed appears reasonably priced, and we have made an investment for the portfolio.

Elsewhere, we have exited our investment in **a2 Milk** (producer of dairy products and infant formula). We accept that this trade has not gone to plan. Restrictions on the movement of global citizens, aimed at containing the spread of COVID-19, have disrupted the lucrative Chinese distribution channel. To be fair, a2's brand is strong and much of the original investment case assumed relatively modest sales growth, but even so, earnings uncertainty has increased, and we no longer feel that we are being appropriately compensated for this range of outcomes.

While we appreciate the frustration and disappointment that this investment may have caused, it's important to note that we have not deviated, at any point, from our robust investment process that seeks to identify undervalued assets that we think will deliver longer term returns to client portfolios. That said, and despite having what we believed to be a sufficient margin of safety to invest in this company, there may be occurrences like this, however rare, where an investment thesis does not play out as expected – and we must act accordingly. This is especially the case when superior opportunities exist elsewhere in the investment universe, as they do now. For additional context, it's worth highlighting that a2 Milk makes up a relatively small component of the portfolio (around 0.5%) and, while the performance of this investment has been unsatisfactory, the ultimate impact to the portfolio's returns has been relatively minor.

More broadly, the Australian sharemarket has outperformed global peers of late. Key behind this has been surging commodity prices (notably oil & gas, nickel, iron ore and wheat) which have rallied as a result of rising inflation and/or in response to escalating Russia/Ukraine uncertainty (with Russia and/or Ukraine accounting for a meaningful amount of global supply in these commodities). This has flowed through into extraordinary returns for some individual stocks. **Woodside** (Australia's largest oil and gas producer), for example, is up by more than 50% in 2022 alone, leading us to move to lock in some profits at this level. Elsewhere, **Westpac** (Australia's second biggest bank) has also delivered positive returns and we similarly have trimmed our investment. That said, both companies remain significant investments in the portfolio.

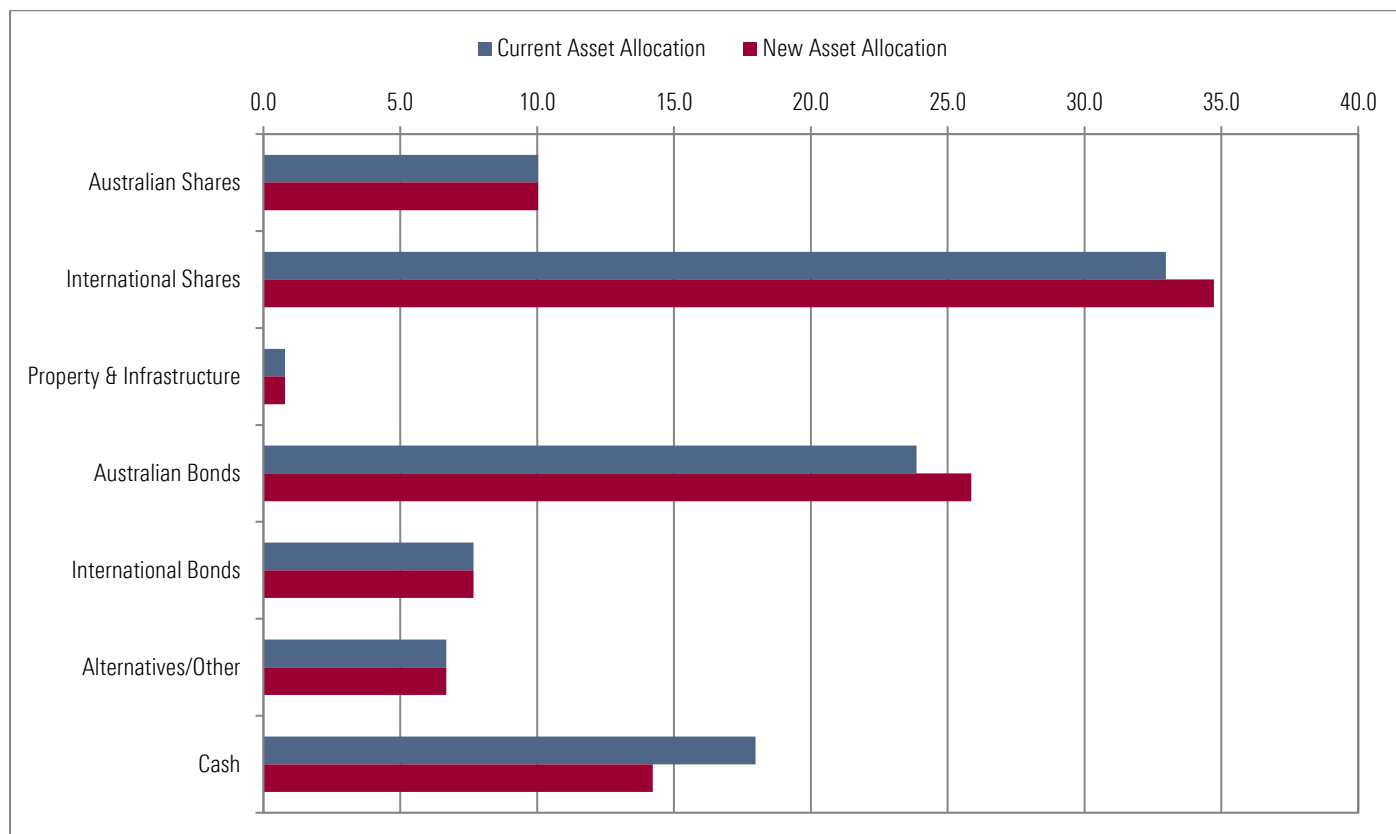
In terms of global shares, the commencement of combat between Russia and Ukraine saw European shares tumble. This is an understandable if predictable investor response – humans don't like to invest when challenged by fear and uncertainty – and, while we cannot predict how this geopolitical event will play out, we can recognise (and take advantage of) the opportunity to buy quality European businesses (via the **Vanguard FTSE Europe Shares ETF**) at a better price than was previously available. In time, this weakness has extended to global sharemarkets, more generally, and we have subsequently added an investment in the **iShares Core MSCI World (Ex Australia) ESG Leaders ETF** to the portfolio. To clarify, this is not an ESG-based decision – it just so happens that this particular ETF, which replicates the global market capitalisation of companies, is an extremely cost effective (at an MER of 0.09%) way of increasing our unhedged global equity allocation.

Lastly, Australian bond yields have risen sharply of late (the 10-year Australian government bond yield is sitting around 2.7%), driven higher by inflation concerns and expectations that central banks, globally, will look to unwind the stimulus programs that have been in place, in some cases, for many years. With this improvement in value, we are much more confident in the ability of longer-dated bonds to deliver income and diversification benefits to the portfolio and

have increased our allocation to this asset class (by adding to our investment in the **Vanguard Australian Fixed Interest ETF**).

Portfolio cash levels fall as a result of these trades.

## Current versus New Asset Allocation



## Our investment principles



We put investors first



We're independent-minded



We invest for the long term



We're valuation-driven investors



We take a fundamental approach



We strive to minimise costs



We build portfolios holistically

## Portfolio Post Changes

| Security   | Security/APIR Code | GICS Industry Group                            | New Weighting <sup>3</sup> |
|--|--------------------|--|----------------------------|
| <b>Australian Equities</b>                               |                    |  | <b>10.0%</b>               |
| Brambles Limited   | BXB-AU             | Industrials                                    | 1.8%                       |
| Medibank Private Limited                                 | MPL-AU             | Financials                                     | 1.4%                       |
| Westpac Banking Corporation Limited                      | WBC-AU             | Financials                                     | 1.3%                       |
| Woodside Petroleum Limited                               | WPL-AU             | Energy   | 1.3%                       |
| Newcrest Mining Limited                                  | NCM-AU             | Materials                                      | 1.0%                       |
| Insurance Australia Group Limited                        | IAG-AU             | Financials                                     | 0.9%                       |
| CSL Limited  | CSL-AU             | Pharmaceuticals, Biotechnology & Life Sciences | 0.9%                       |
| Commonwealth Bank of Australia Limited                   | CBA-AU             | Financials                                     | 0.8%                       |
| Resmed Inc.  | RMD-AU             | Health Care Equipment & Services               | 0.8%                       |
| <b>International Equities</b>                            |                    |  | <b>34.7%</b>               |
| Morningstar International Shares Active ETF              | MSTR-AU            |  | 7.1%                       |
| Morningstar International Shares Fund                    | INT0017AU          |  | 5.8%                       |
| BetaShares FTSE 100 ETF                                  | F100-AU            |  | 5.3%                       |
| iShares MSCI Japan ETF                                   | IJP-AU             |  | 3.4%                       |
| BetaShares Global Energy Companies ETF (AUD Hedged)      | FUEL-AU            |  | 3.1%                       |
| iShares MSCI South Korea ETF                             | IKO-AU             |  | 1.9%                       |
| Vanguard FTSE Europe Shares ETF                          | VEQ-AU             |  | 1.6%                       |
| iShares China Large-Cap ETF                              | IZZ-AU             |  | 1.6%                       |
| iShares Europe ETF                                       | IEU-AU             |  | 1.4%                       |
| Vanguard FTSE Emerging Markets Shares ETF                | VGE-AU             |  | 1.3%                       |
| iShares MSCI Emerging Markets ETF                        | IEM-AU             |  | 1.1%                       |
| iShares Core MSCI World (Ex Australia) ESG Leaders ETF   | IWLD-AU            |  | 1.0%                       |
| <b>Property &amp; Infrastructure</b>                     |                    |  | <b>0.8%</b>                |
| GPT Group  | GPT-AU             |  | 0.8%                       |
| <b>Australian Bonds</b>                                  |                    |  | <b>25.9%</b>               |
| iShares Core Composite Bond ETF                          | IAF-AU             |  | 18.0%                      |
| Vanguard Australian Fixed Interest ETF                   | VAF-AU             |  | 4.0%                       |
| BetaShares Australian Bank Senior Floating Rate Bond ETF | QPON-AU            |  | 3.8%                       |
| <b>International Bonds</b>                               |                    |  | <b>7.7%</b>                |
| Morningstar International Bonds Fund                     | INT0082AU          |  | 7.7%                       |
| <i>BNY Mellon Global Aggregate Bonds</i>                 |                    |  |                            |
| <i>Colchester Global Sovereign Bonds</i>                 |                    |  |                            |
| <i>Ashmore Emerging Market Bonds</i>                     |                    |  |                            |
| <b>Alternatives/Other</b>                                |                    |  | <b>6.7%</b>                |
| Morningstar Multi Asset Real Return Fund                 | INT0011AU          |  | 6.7%                       |
| <b>Cash</b>  |                    |  | <b>14.2%</b>               |
| iShares Core Cash ETF                                    | BILL-AU            |  | 7.6%                       |
| BetaShares Australian High Interest Cash ETF             | AAA-AU             |  | 3.8%                       |
| Platform Cash  | CASH_AUD           |  | 2.9%                       |
| <b>Total</b>   |                    |  | <b>100.0%</b>              |

<sup>3</sup> May not sum to 100.0% due to rounding.

# Glossary

## Credit spreads

This relates to the difference in yield between two bonds that are identical in all respects (e.g. maturity, fixed/floating payments) except for creditworthiness. Generally, this refers to the premium that a corporate bond investor expects to receive over the 'risk-free' benchmark (e.g. a treasury bond, which is considered 'risk free'), as he/she needs to be compensated for taking on additional risk. Widening credit spreads generally indicate growing concerns about the ability of 'non-government borrowers' to service their debt. On the other hand, tightening credit spreads generally indicate the opposite – improving creditworthiness.

## Valuation driven asset allocation

Our asset allocation process focuses on identifying 'undervalued', 'under-owned' quality assets that we believe will offer the greatest potential for strong returns over the longer term. Importantly, this process includes not only an assessment of return expectations for each asset class, but also a strong focus on capital preservation, with the aim to avoid losing money that can't be made back during an investor's investment timeframe. If the reward isn't worth the risk, we will avoid that asset class. Once we have identified the preferred asset classes through this disciplined approach, we apply portfolio construction principles to ensure that the resulting portfolio is adequately diversified.

## Intrinsic value

This relates to what we perceive as the actual or true value of a company or an asset based on all aspects of our analysis (in terms of both tangible and intangible factors). We consider an asset to be mispriced (that is, trading at a premium or discount) if the intrinsic value does not align with the current price in the market.

## Morningstar® Economic Moat Rating

The idea of an economic moat refers to how likely a company is to keep competitors at bay for an extended period. One of the keys to finding superior long-term investments is buying companies that will be able to stay one step ahead of their competitors, and it's this characteristic – think of it as the strength and sustainability of a firm's competitive advantage, or a company being like a castle – a moat is better than no moat, and a wide moat is even better.

The Underlying Sources of Economic Moats:

- Network effect, i.e. the more people use a product or service, the more valuable it becomes
- Intangible assets, e.g. brands, patents, or regulatory licenses
- Cost advantage, e.g. from economies of scale or access to a unique asset
- Switching costs, i.e. it would be costly for customers to stop using the product or service
- Efficient scale, i.e. a limited market effectively served by one or a small handful of companies.

## Yield curve

A line on a graph that plots interest rates (y-axis) of bonds (of equal credit quality) against different maturity dates (x-axis). The yield curve is considered a 'lead indicator' because it conveys investor expectations of future economic growth and inflation. There are three main types of curves:

- Normal: lower yields for shorter term bonds – investors generally expect normal economic conditions and require higher yields to compensate for time.
- Flat: shorter and longer-term yields are very close (e.g. there is little benefit in holding the longer-term bonds) – generally, this indicates that investors are uncertain of the economic environment and are willing to tie up their money for longer periods with little additional compensation.
- Inverted: higher yields for shorter term bonds – investors generally expect poor economic growth (e.g. recession) and lower inflation (and thus lower interest rates). Essentially, investors are willing to tie up their capital for the longer term as they expect shorter term yields to fall significantly in the near term.