Quarterly Asset Allocation Update

May **2021**

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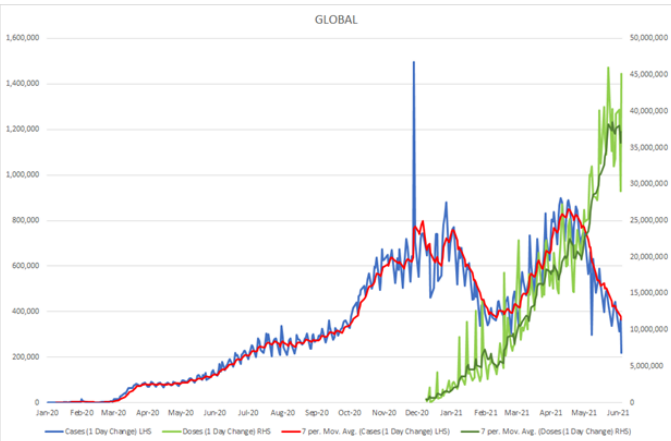
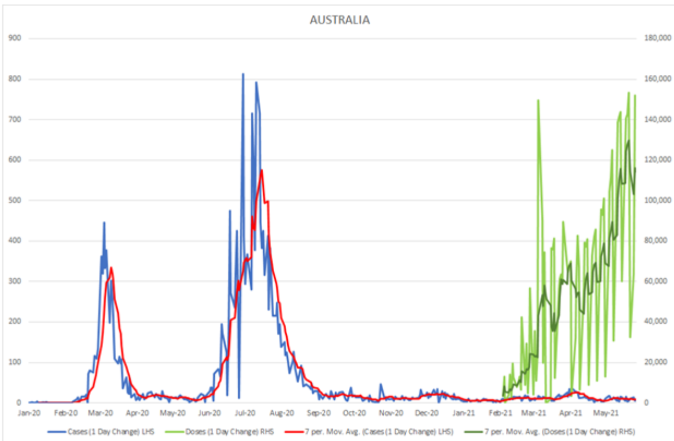
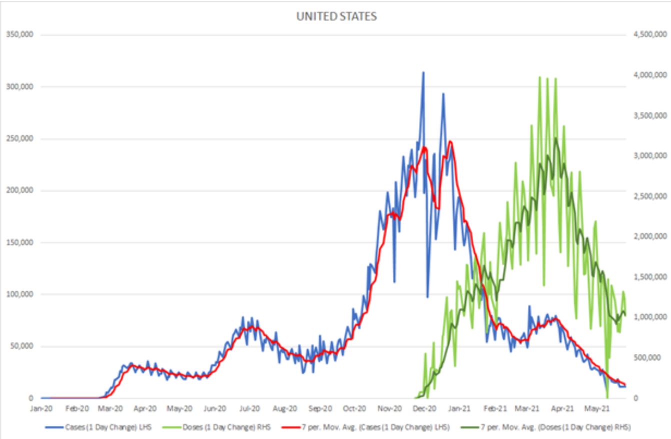
As a part of our regular deliberations, the Asset Allocation and Investment Committee has been monitoring the world's progress in protecting its population from Covid-19 with these charts, which show trends in the rate of cases and doses. As with the economic recovery and the rebound in financial markets, there has been varying progress in different countries and some important divergences look set to persist.

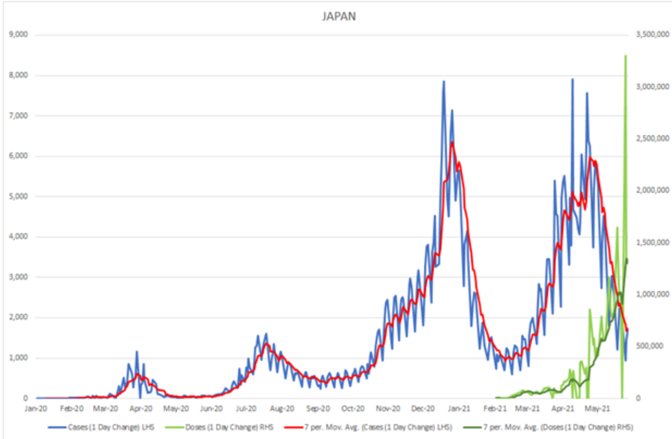
The first set of these charts show the global numbers alongside those for Australia, with the blue line representing the number of new daily cases and the red line showing a 7-day average. Similarly, the light green shows the number of daily vaccine doses given, with the 7-day average in dark green. The trends are clearly encouraging, as less people are contracting the virus than the recent peak, and more people are receiving the vaccine. The Australian data is consistent with some other countries in our region who also chose a more stringent stance in terms of lockdowns and social distancing requirements, but have also been slower so far with their rates of vaccine distribution.



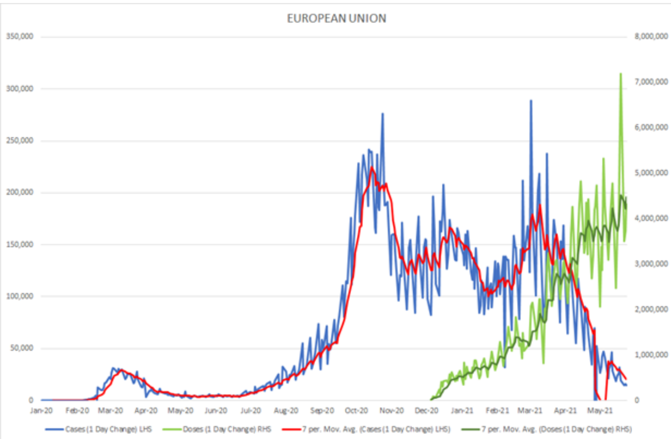


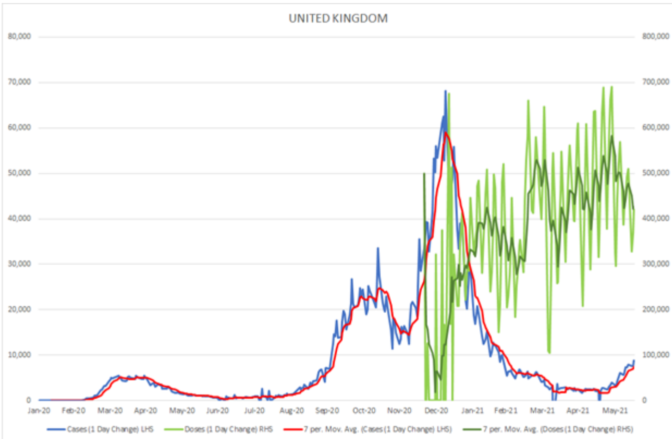
The most interesting conclusion from the United States data is that they are now seemingly at the point where those who were most willing to be vaccinated have already been vaccinated. Whilst it is encouraging to see that the case count continues to trend lower, there is a real likelihood that herd immunity is never achieved in a significant portion of the country. As with many issues in America, it should not surprise that the divide between states with high vaccination rates and low is split on a partisan political basis.





Japan has felt an economic impact from their recent spike in cases, and this has flowed through to a modest downturn in their equity market from mid-March through early May, though much of this has now been recovered. They of course also face the upcoming risk of hosting an Olympic Games, a risk that will now come without much of the anticipated economic benefits given international travel restrictions.





Both data series are trending in their respective positive directions for the European Union. Though they certainly were laggards through much of 2020 in terms of dealing with outbreaks, pleasingly they are now accelerating their vaccine distribution. The United Kingdom has just delayed a relaxation of restrictions, in the context of the uptick in cases seen bottom right above. However, they will be held in good stead by a relatively high vaccination rate, and current expectations are that this delay will not have a big impact on the momentum in their re-opening and economic recovery.

To finish this discussion, we share some encouraging numbers sourced from an article titled *Herd Immunity Is Closer Than You Think*.[1] "The arithmetic is simple … China now accounts for 17-20 million of the 33-36 million doses being administered worldwide every day. With China included, the [global vaccine] countdown reaches zero in just over 200 days; without China, the time increases to 370 days. That is an important difference, but it amounts to reaching the finish line in July 2022, rather than in January.

Let's look at the numbers. The world's population is 7.9 billion, an estimated 5.85 billion of whom are adults (74%). If the goal is an immunization rate of 80%, 4.7 billion will need shots, which on a two-dose vaccine regimen means 9.4 billion doses. As of June 11, 2021, … more than 2.3 billion doses have already been administered worldwide, leaving just over seven billion doses. Divide that by a mid-range daily figure (34 million) and you get roughly 211 days – January 2022."

This optimism should be tempered with reasonable concerns about virus variants and the ongoing challenges in vaccine distribution, and the investment committee will continue to monitor the trends depicted above so that we can interpret likely impacts on financial markets and your portfolio investments. That said, we believe there is good reason for holding an optimistic outlook on the sustained recovery from the virus, and last year's economic recession and the associated bear markets.

Kind regards
Asset Allocation and Investment Committee

Ten Year Forecast Returns

	Australian Equities	Inter Eq - Dev Mkts	Inter Eq – Emerg Mkts	Listed Property	HY Income Securities	Income Securities
Current Yield	4.4%	1.7%	1.9%	4.1%	5.5%	2.7%
+ Currency Impact		0.7%	-2.4%			
+ EPS Growth (10 Yrs)	3.8%	3.1%	4.8%	1.4%*		
+ Valuation Effect	-1.7%	-2.2%	0.7%	0.5%	-1.5%	
Index Return (Pre-Tax)	6.4%	3.2%	5.0%	6.0%	4.0%	2.7%

* Forecast Distribution Growth

Please note that the active asset allocation targets mentioned below apply to both the Exchange Traded Fund portfolios managed by Implemented Portfolios and the portfolios that own direct shares which are managed by Joseph Palmer & Sons. However, commentary below about individual investments is in relation to the ETF portfolios only.

Australian Equities

Australian Equities	No. 1	No. 2	No. 3	No. 4	No. 5
Neutral	10.0%	15.0%	20.0%	27.0%	40.0%
Target*	10.2%	15.3%	20.4%	27.4%	40.4%

At our meeting in April the Asset Allocation and Investment Committee agreed that it was prudent to slowly reduce the long-held overweight in Australian Equities, and we continue to make the intended incremental progress towards that target. Pleasingly, as the Target numbers show above, the effect of continued market strength is that the explicit Neutral target is already floating higher. That provides a welcome opportunity to complete the monthly tranches of selling at ever higher prices and we believe validates the decision to be patient in completing this adjustment. Using the No.3 program as our example, so far portfolios have reduced their Australian Equities allocation from 28% to approximately 25%, and we expect to continue moving to Neutral at a pace of about 1% per month.

The most recent reductions have been targeted in the two ETFs that provide exposure to the medium and smaller sized companies listed on the ASX. Recent performance has been relatively strong in those two sectors and as result of today's higher prices we have lower expected returns. Specifically, the long-term annual expected returns are 3.9% for the MidCap ETF and 4.2% for Small Companies, compared to the 6.4% shown above for Australian Equities overall. This implementation decision is also supported by higher forecasts for the largest companies that comprise the ASX50 ETF at 6.9%, and for the Financials sector where the long-term expected annual returns are 6.6%.

International Equities

International Equities	No. 1	No. 2	No. 3	No. 4	No. 5
Neutral	5.0%	10.0%	15.0%	23.0%	35.0%
Target*	5.6%	10.9%	16.0%	23.9%	34.9%

We are also on a consistent path in making subtle adjustments to the composition of the International Equities asset class and continue to reduce the exposure to the Asia-Pacific (ex-Japan) region. Key country exposures within that ETF have done exceptionally well in recent times, notably Taiwan and Korea where the benchmark indices have added 31% and 19% p.a. since the start of 2019, in Australian dollar terms. As a result, they have made a strong contribution to the 15% p.a. total return on the Asia-Pacific ETF, again over the same 2½ year time frame and in our local currency.

The funds made available from reducing the exposure to Asia-Pac were initially used to increase the existing holdings in Japan and Europe, and more recently to add an exposure to the United Kingdom. As mentioned above, there were certainly issues in dealing with the coronavirus in both regions, and that meant that the prices available in their equity markets looked more attractive in our long-term forecasts. We are pleased to see that that value has already started to be recognised with data showing strong investor demand for European and UK equities in particular, and this in turn being reflected in encouraging recent performance for both of the relevant ETF investments in your portfolio.

Japan remains the largest single country exposure in this asset class, and to reiterate, the trends in the cases and doses charts has been somewhat reflective of the recent equity market performance, with the added overlay of a strong Yen versus the A$ providing a headwind to your portfolio returns. Over the same period used above, since the start of 2019, the annualised A$ returns from the Japan ETF have been better than expected at 10.6% p.a.

The table above again shows the impact of allowing the target weights to float higher, compared with the Neutral stance set by the Asset Allocation and Investment Committee. For now, we remain comfortable allowing this to continue as these markets show some momentum, but in time we expect that it will become prudent to trim that floating weight adjustment back to target.

Listed Property

Listed Property	No. 1	No. 2	No. 3	No. 4	No. 5
Neutral	5.0%	5.0%	10.0%	10.0%	10.0%
Target*	6.0%	5.9%	11.8%	11.6%	11.5%

Whilst it must be acknowledged that reasonable uncertainty persists in this asset class, and in relation to the Office sub-sector particularly, the market seems to have come to terms with that and recent performance has been quickly catching up to the other Australian Equities indices. In fact, with the benefit of hindsight we can observe that a short-term bottom occurred around the time of our last Quarterly note in late February. The total return from the ETF in this asset class since then has been an impressive 16.5% (not annualised).

At the risk of being repetitive, that performance has again pushed the Target weight shown above higher than the 10% overweight stance that the committee explicitly adopted and has also reduced our current forecasts. We have opted again in this case to allow some of that momentum to continue to boost your portfolio performance, though expect it will be prudent to start to trim that exposure in the near future.

High Yield Income Securities

HY Income Secs	No. 1	No. 2	No. 3	No. 4	No. 5
Neutral	10.0%	15.0%	15.0%	15.0%	10.0%
Target*	0.0%	0.0%	0.0%	0.0%	0.0%

We remain 100% underweight here as the forecast return is not sufficient to compensate for the risks.

Income Securities & Cash

Income Securities	No. 1	No. 2	No. 3	No. 4	No. 5
Neutral	40.0%	40.0%	30.0%	20.0%	0.0%
Target*	55.2%	54.6%	42.4%	33.1%	9.3%

Cash	No. 1	No. 2	No. 3	No. 4	No. 5
Neutral	30.0%	15.0%	10.0%	5.0%	5.0%
Target*	23.0%	13.2%	9.5%	3.9%	3.9%

As we reduce the Australian Equities overweight to neutral, the effect will be to release funds that, all else being equal, will increase the exposure to these defensive asset classes in your portfolio. The targets above represent the endpoint of that reduction in Australian Equities, and we will manage this transition between asset classes over time, and as market opportunities present themselves.

Attention from the investment world continues to be focused on the updates to inflation data, but very strong recent CPI numbers in the US have not been accompanied by the expected rise in bond yields. The committee continues to actively consider important further adjustments in this asset class and expects that activity will be evident over the next couple of months. We will of course keep you updated on any subsequent decisions through the more frequent written commentaries.

** The Target weights outlined above reflect both the active asset allocation stance as determined by the committee and also the impact of market price changes as portfolios use a floating weight regime for securities within an asset class, and asset classes within each of the respective Investment Programs.*

Asset Class Tipping Points

The tables show that Australian Equities is now back in the Fair Value range as at the end of May, and that is consistent with our decision to be moving back from our long-held Overweight to Neutral. At time of writing (mid-June), the local share market is regularly hitting new all-time highs, and that is providing a welcome environment in which to complete the required modest amounts of selling. The committee at our most recently meeting agreed to maintain the initially agreed pace towards that target, which will see portfolios back at Neutral in a total of approximately 6 months.

Asset Class Tipping Points - May 2021

Australian Equities

All Ords	10 Year Forecast	Valuation	31-May
10,700	1.5%	Overpriced	
10,400	1.9%	Fully Priced	
10,100	2.3%	Fully Priced	
9,800	2.7%	Fully Priced	
9,500	3.1%	Fully Priced	
9,200	3.5%	Fully Priced	
8,900	3.9%	Fully Priced	
8,600	4.4%	Fair Value	
8,300	4.9%	Fair Value	
8,000	5.4%	Fair Value	
7,700	5.9%	Fair Value	
7,400	6.5%	Fair Value	Aust 6.4% Fin'l 6.6%
7,100	7.0%	Cheap	
6,800	7.7%	Cheap	
6,500	8.3%	Cheap	
6,200	9.1%	Cheap	
5,900	9.8%	Cheap	

Income	4.4%	p.a.
Earnings	3.8%	p.a.
Valuation	-1.7%	p.a.
Forecast	**6.4%**	**p.a.**

International Equities - Developed

World ExAust	10 Year Forecast	Valuation	31-May
3,500	1.7%	Overpriced	
3,400	2.0%	Fully Priced	
3,300	2.4%	Fully Priced	
3,200	2.7%	Fully Priced	
3,100	3.1%	Fully Priced	Dev 3.2%
3,000	3.4%	Fully Priced	
2,900	3.8%	Fully Priced	
2,800	4.2%	Fully Priced	
2,700	4.7%	Fair Value	
2,600	5.1%	Fair Value	
2,500	5.6%	Fair Value	
2,400	6.1%	Fair Value	
2,300	6.6%	Fair Value	
2,200	7.1%	Cheap	EU/UK 6.8% Japan 7.3%
2,100	7.7%	Cheap	
2,000	8.3%	Cheap	
1,900	9.0%	Cheap	

Income*	2.4%	p.a.
Earnings	3.1%	p.a.
Valuation	-2.2%	p.a.
Forecast	**3.2%**	**p.a.**

International Equities - Emerging

Emerging Markets	10 Year Forecast	Valuation	31-May
1,850	1.6%	Overpriced	
1,800	1.9%	Fully Priced	
1,750	2.2%	Fully Priced	
1,700	2.6%	Fully Priced	
1,650	2.9%	Fully Priced	
1,600	3.2%	Fully Priced	
1,550	3.6%	Fully Priced	
1,500	4.0%	Fully Priced	
1,450	4.4%	Fair Value	
1,400	4.8%	Fair Value	
1,350	5.3%	Fair Value	EM 5.0%
1,300	5.7%	Fair Value	Asia-P 5.5%
1,250	6.2%	Fair Value	
1,200	6.7%	Fair Value	
1,150	7.2%	Cheap	
1,100	7.8%	Cheap	
1,050	8.4%	Cheap	

Income*	-0.5%	p.a.
Earnings	4.8%	p.a.
Valuation	0.7%	p.a.
Forecast	**5.0%**	**p.a.**

Listed Property

ASX200 Property	10 Year Forecast	Valuation	31-May
2,050	1.7%	Overpriced	
2,000	2.1%	Fully Priced	
1,950	2.4%	Fully Priced	
1,900	2.7%	Fully Priced	
1,850	3.1%	Fully Priced	
1,800	3.4%	Fully Priced	
1,750	3.8%	Fully Priced	
1,700	4.2%	Fully Priced	
1,650	4.6%	Fair Value	
1,600	5.0%	Fair Value	
1,550	5.5%	Fair Value	
1,500	5.9%	Fair Value	A-REITs 6.0%
1,450	6.4%	Fair Value	
1,400	6.9%	Cheap	
1,350	7.5%	Cheap	
1,300	8.0%	Cheap	
1,250	8.6%	Cheap	

Income	4.1%	p.a.
Dist Grwth	1.4%	p.a.
Valuation	0.5%	p.a.
Forecast	**6.0%**	**p.a.**

** Income for International Equities includes dividends and forecast currency impact.*

Sources/Notes:

1. B Emmott, "Herd Immunity Is Closer Than You Think" – Project Syndicate. 14-Jun-21.

NOTE: It is important to note that each portfolio is managed to its own mandate, which can mean that activity mentioned above is not reflected in your own portfolio. This may be because it is more beneficial to your portfolios after tax performance to complete the trading at a different time or may be due to individual customisation that you have requested. This flexibility is an integral part of the investment process. If you would like to discuss the tailoring of your portfolio please contact your Adviser.