Bond and Equity market volatility rose in November, as risk assets sold off in the last week of the month. Volatility spiked following a change in rhetoric on inflation from the US Federal Reserve and the emergence of the new Omicron Covid-19 variant led to uncertainty around the efficacy of existing vaccines.

Policy Watch: Central banks now largely acknowledge that inflation is likely to persist for longer than first thought. The US Federal Reserve began tapering its bond purchases but pushed back on the idea that rates would start to increase in the middle of next year. Business leaders are voicing more concern about price rises and a more persistent lift in input and operating costs.

Vaccine Update: Markets are waiting for additional data on the efficacy of existing vaccines against the Omicron variant. It will be weeks before large studies can be done and several more weeks to months for modifications to vaccines can be made if required. However, early signs are that that virus is less harmful. However, with a large portion of the developing world still to be vaccinated, investors need to be watchful for future variants.

Inflation Watch: Inflation growth in the US came in as expected but at historically high levels. Underlying data suggests that price increases are more widespread than previously appreciated, with rising labour and other input costs from disrupted supply chains causing inflation in a wide range of goods and services.

Risk Budget: US equity markets fell away in the last week of the month. Bond and Equity market volatility rose sharply. These bouts of volatility to date have been short lived and have quickly subsided.

Call to Action: We maintain our risk weighting after making a change in November. We had previously flagged that the run into the end of the year was likely to be more volatile, but equity markets would likely grind higher. We expect this to remain the case into Christmas and remain watchful for opportunities to emerge.

Sayers Portfolio Management 2021:

In November 2020 Sayers Capital Solutions Group moved all portfolios above their neutral risk weight (i.e. increased allocations to risk assets such as equities).

This overweight remains in place, however in June and again in November of 2021 each of the portfolios has had the level of risk exposure reduced to manage risk and take profits.

Outlook 2022:

- Vaccine rollout continues across the globe and should be effective against emerging strains of Covid-19.
- The world economic growth rate should moderate but remain above trend – providing a solid backdrop for corporate earnings. Despite rising input costs, margins are expected to expand slightly.
- Supply chain issues should moderate but price levels likely to remain elevated providing impetus for tighter policy settings. Emergency fiscal measures will naturally roll off during 2022.
- There is still room for pro-cyclical trades to perform well in near term but prepare for risky asset returns to flatten out as cycle matures.
- Much hinges on the path of long bond yields and their impact on the valuation of equities and other assets.
- We believe that the current equity rally has some room to run further in 2022, however we maintain that volatility will remain elevated and there will be opportunities to actively manage our positions.

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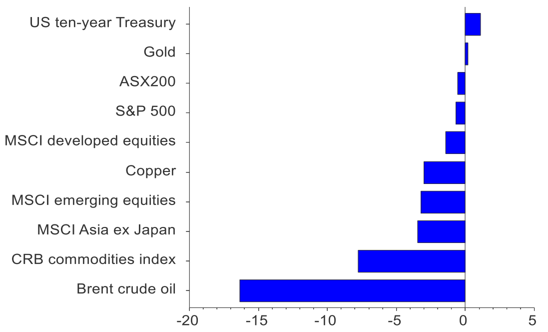
November Review

A volatile end to the month saw major equities markets lose ground for November. The emergence of the Omicron Covid-19 variant saw investors move out of risk assets fearing a rise in cases, hospitalisations and deaths should vaccines prove less effective. This coincided with a pivot in language from the US Federal Reserve Chair Powell, telling Congress that inflation was less transitory than first thought. The S&P500 retraced -.7%, while the ASX200 lost a slightly less (-.5%). Emerging Markets were hit hard with the MSCI EM Index (USD) losing over 4% as capital sought safer markets. Oil and commodities also sold off.

Chart 1: September Asset Class Performance
Percentage Change (total return in local currency)

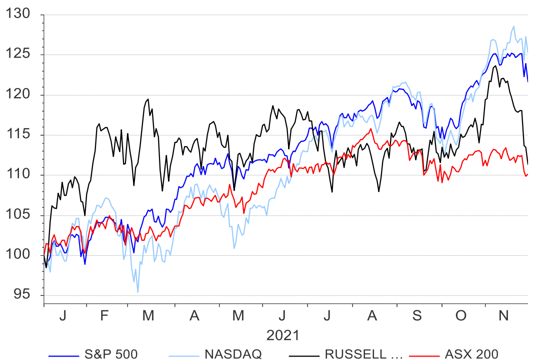


Source: Refinitiv Datastream/Fathom (Note: Past Performance is not a reliable indicator of future performance)

The US Energy Sector (-5.09) suffered on the back of a large move lower in oil prices throughout the month, as investors thought a resurgence in covid could hamper the recovery in travel. Financials (-5.7%) were shunned by investors as bond curves flattened. IT (4.35%) bucked the trend as a rotation back to big tech names, away from reopening plays, occurred. Small Caps had a tough month with the Rusell 2000 (-4.3%) as the index is heavily weighted towards energy and reopening themed stocks.

European markets gave up more than their US counterparts with the UK and European indices losing over 2%. Bond yields and safe haven currencies rallied as investors shunned risk assets.

Chart 2: US and Australian Equity Markets YTD Relative Performance (100 = 1 Jan 2021)

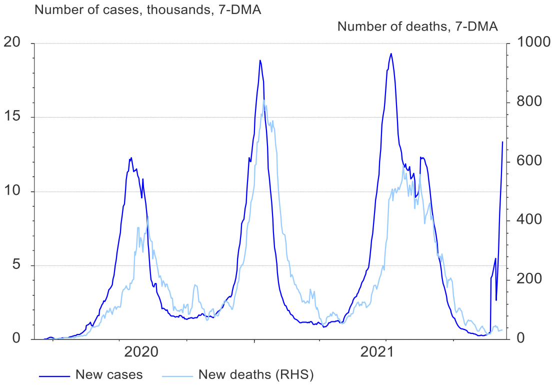


Source: Refinitiv Datastream/Fathom (Note: Past Performance is not a reliable indicator of future performance)

The ASX200 finished down 0.5%, with financials losing 6.9% and energy 8.3%. Materials (6.3%) rebounded on a recovery in iron ore prices. While the ASX200 is 14.1% higher year-to-date, most of this came in the early stages of the calendar year as the index has traded broadly sideways over the past five months.

Markets were focused on the emergence of the Omicron variant, first reported in South Africa. Given the significant mutations of this strain, compared to the more dominant Delta strain, the scientific community and investors were uncertain whether existing vaccines would maintain their efficacy. Initial data suggested that the new strain spread more quickly than previous strains. Daily case numbers and the reproductive rate in South Africa are again nearing their pandemic highs. However, so far hospitalisations are acting like prior waves, with vaccines providing very protection against severe impact. There are though some concerns around elevated cases for children. It will be several weeks before more broad studies are done, and months before for vaccine manufacturers amend existing MRNa vaccines should it be necessary.

Chart 3: South Africa Covid-19 Cases & Deaths



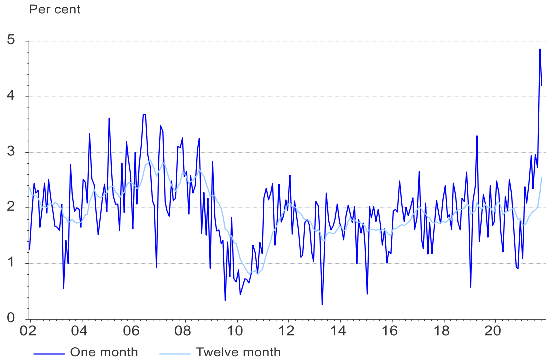
Source: Refinitiv Datastream/Fathom (Note: Past Performance is not a reliable indicator of future performance)

So far, the economic implications of Omicron have been downplayed by central bankers and it appears there is a general reluctance for the reintroduction of lockdowns. November did see infections rising across Europe and restrictions were reintroduced and vaccination mandates. Germany, which has a higher vaccination rate than the US, is a focus for investors with the country also experiencing a record high in covid cases. The government has imposed strict restrictions on the unvaccinated. Austria has imposed vaccination mandates and Slovakia and the Czech Republic have imposed restrictions on people who are unvaccinated while in Belgium, employees will be made to work from home for four days a week until mid-December.

Inflation remains a focus for markets. The US Federal Reserve's preferred inflation measure – the Personal Consumption Expenditure Deflator (PCE) came in as expected at 4.1% yoy while the separately released Dallas Fed Trimmed Mean PCE lifted to its highest level since 2008. Both numbers suggested that inflationary impacts were broadening in the economy. These data points have led to a hawkish tilt by the US Fed Chair Powell, who commented in his US Senate testimony that it was time to "retire the word [transitory]".

The broadening of inflation pressures is important and has been one factor driving more FOMC officials to consider whether to accelerate the taper profile and whether to lift rates multiple times in 2022.

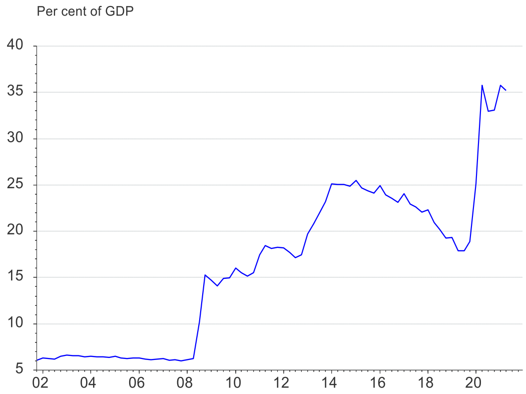
Chart 4: Dallas Fed Trimmed Mean PCE



Source: Refinitiv Datastream/Fathom (Note: Past Performance is not a reliable indicator of future performance)

Despite the increase in prices, US consumers continue spending with growth of 1.6% in October. Headline retail sales rose 1.7% m/m against 1.4% expected, alongside a modest revision to prior data. The core measure of retail was even stronger relative to consensus at 1.6% m/m against 0.9% expected. This contrasts with the final University of Michigan Consumer Sentiment numbers which had the 5-10yr inflation expectation revised higher to 3.0% (from 2.9%) and consumer sentiment at 67.4 (consensus 66.9) still not recovering from its sharp fall in August and at its lowest level since November 2011.

Chart 3: Federal Reserve Balance Sheet



Source: Refinitiv Datastream/Fathom (Note: Past Performance is not a reliable indicator of future performance)

As widely expected, the US Federal Reserve announced it will start tapering its asset purchases at a pace of $15bn per month through to June 2022. From there reinvestment will occur, but the balance sheet will stop expanding. Given the Fed's recent pivot away from its initial view that inflation would subside quickly, the market is now thinking the taper may be accelerated and completed by as early as March 2022, potentially paving the way for a lift off in cash rates later in the year. The Fed repeated its

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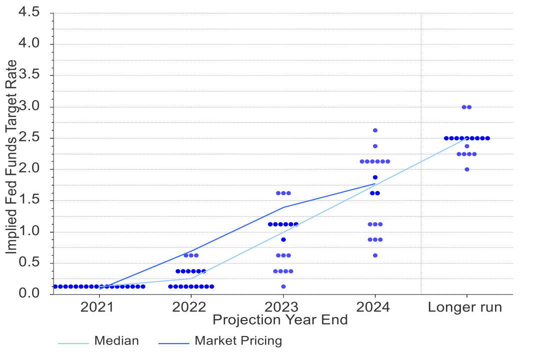
view that there is no direct line between tapering and rate lift and said it can be patient on rates, because the economy is not yet at maximum employment.

Chart 4: FOMC Dot Plot & Market Pricing



Source: Refinitiv Datastream/Fathom (Note: Past Performance is not a reliable indicator of future performance)

Elsewhere, the Bank of England surprised by not increasing rates. Markets had fully priced a 15bp hike for the November meeting, given the clear messaging of its members that action was needed to combat rising inflation.

Chart 5: US and AU 10 Yr Bond Yields

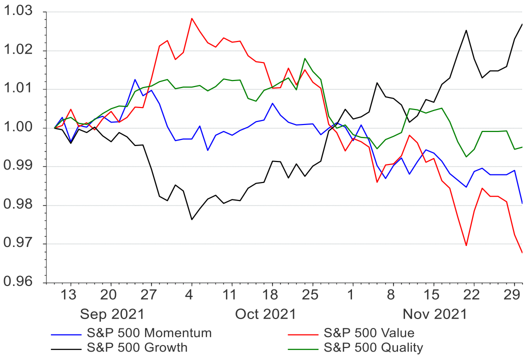
Source: Refinitiv Datastream/Fathom (Note: Past Performance is not a reliable indicator of future performance)

The Reserve Bank of Australia (RBA) released its Statement of Monetary Policy, which confirmed that the RBA's central scenario was for rates to remain on hold until 2024, with a plausible upside of moving in 2023. Market pricing continues to question the RBA's timing, with approximately 90bps worth of hikes priced by February 2023.

Bond markets continued their recent flattening trend with short-end rates attempting to price in the short-term path in cash rates. Longer dated bonds rallied on the back of risk-off sentiment towards the end of the month.

Growth was a standout performer in November with a brief rotation to reopening and value stocks derailed by the Omicron variant.

Chart 5: S&P500 Equity Factor Relative Performance (3 months)

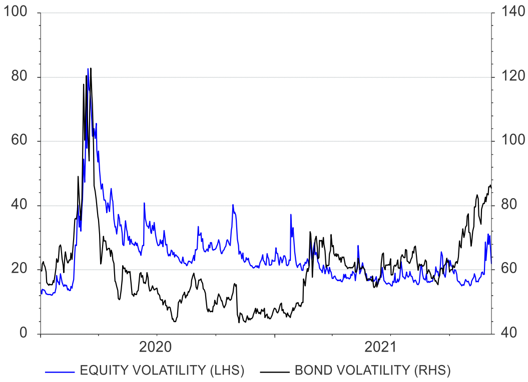


Source: Refinitiv Datastream/Fathom (Note: Past Performance is not a reliable indicator of future performance)

Risk

Equity volatility following rising bond volatility higher during the month. With both the Fed's comments on inflation being less transitory than first thought and the emergence of omicron causing concerns for investors.

Chart 6: US equity & bond Volatility (MOVE)



Source: Refinitiv Datastream/Fathom (Note: Past Performance is not a reliable indicator of future performance)

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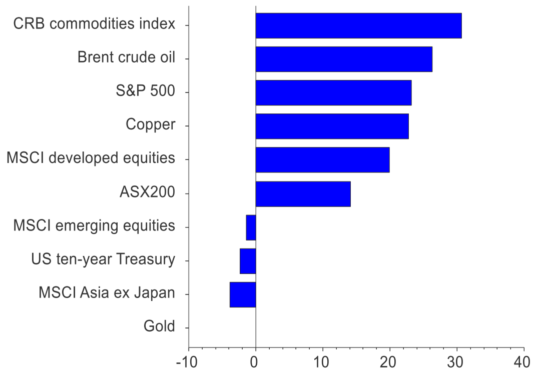
Portfolio Positioning in 2021

Chart 7: Asset Returns YTD (End of Nov)



Source: Refinitiv Datastream/Fathom (Note: Past Performance is not a reliable indicator of future performance)

The Sayers Flagship Multi-Asset Discretionary Portfolios were established in July 2020. Since this time, the portfolios have been actively managed to a risk budget and investment goal.

In November 2020 Sayers Capital Solutions Group moved all portfolios above their neutral risk weight (i.e. increased allocations to risk assets such as equities). The results have been pleasingly strong performance across all three portfolios.

This overweight remains in place, however in June and again in November of 2021 each of the portfolios has had this exposure reduced to manage risk and take profits. Rather than solely allocating to cash or fixed income, risk was reallocated to non-correlated strategies (alternative assets) and some short duration corporate bond strategies. For example, in the June rebalance we had a positive view of the US dollar, and all three portfolios had their allocation to P/E Global FX Alpha Fund increased. The Fund has added over 20% since that time, outperforming the S&P500 in both USD and AUD terms.

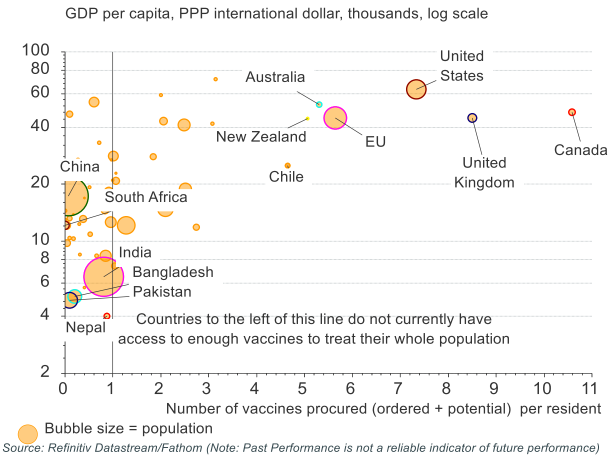
In each of the portfolios, those with active manager selection (DP5, 10 & 15) has added value versus the benchmark portfolios that use the same asset allocation but use passive benchmarks and ETFs (IP5, 10 & 15).

2022 Outlook

Investors are looking through new strains of the virus and assuming that vaccines will be broadly effective against new strains (or new vaccines will adjust much like the annual flu shot). Time will tell how heroic this assumption is – but we continue to believe that this is the most likely scenario to base your investment strategy.

While developed markets remain well advanced in vaccine roll outs and have secured supplies for booster shots and vaccines for children, the supplies to the developing world have been slow. 2022 will be a catch up for many of those economies, providing they can get sufficient access. We fully expect 2022 to be another year with large divergences between growth rates across countries – even in the developed world.

Chart 8: Vaccines ordered vs GDP per capita



Source: Refinitiv Datastream/Fathom (Note: Past Performance is not a reliable indicator of future performance)

How countries deal with outbreaks of existing or new strains will continue to be a point of volatility for markets. While it is unlikely that the US or Australia will experience major disruptive lock downs, other countries, particularly in Europe where there have been higher levels of vaccination hesitancy may see more broad-based lockdowns.

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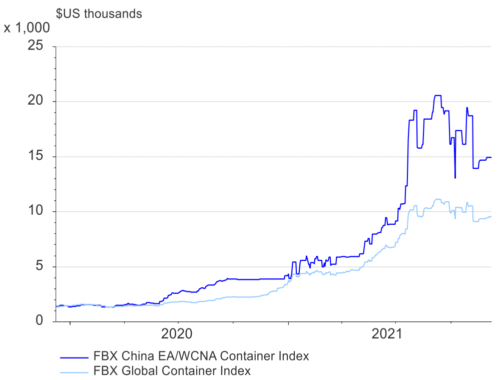
Chart 9: Container Shipping Costs ($US thousands)

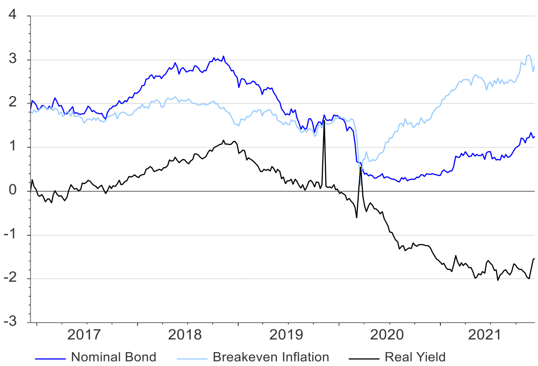


Source: Refinitiv Datastream/Fathom (Note: Past Performance is not a reliable indicator of future performance)

Supply chain disruptions are likely to ease as global shipping and manufacturing return to more normal patterns. However, income inequality over the past two years has been exacerbated by the rapid increase in real asset values and it is likely we will see a more concerted effort for organised labour to push for higher wages in 2022.

Governments and central banks have continued to stimulate economies in 2021. Both monetary and fiscal policy is set to be wound back through the course of 2022. While this stimulus will be removed, we believe that pent up consumer demand and overall inventory rebuilding should provide a solid unpinning to growth in 2022. Furthermore, while government spending may indeed be reduced, the timing of budget repair via increased taxes or running budget surpluses seems to have been pushed out well into the future, while interest rates remain low versus historical levels.

Chart 10: 5 Year Bond Yields



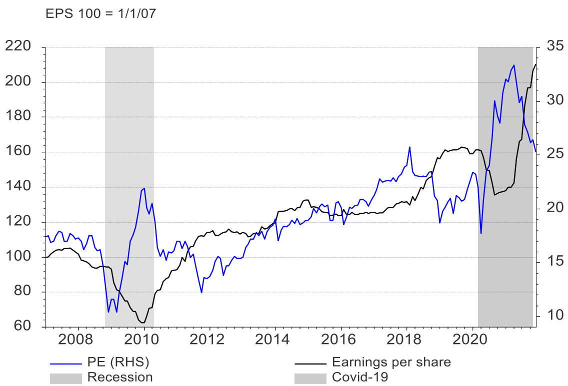
Source: Refinitiv Datastream/Fathom (Note: Past Performance is not a reliable indicator of future performance)

Our base case and how we plan to approach the management of portfolios is that the S&P500 rally has further to run. We believe that a background of strong economic growth and vaccines remaining effective against covid will provide for earnings to increase 8-10% from current levels to ~$230. Maintaining this level of earnings growth beyond 2022 will be more challenging.

Despite increasing costs companies have been able to defend and expand profit margins. We expect profit margins can rise further in 2022 before giving some of that expansion back in 2023 due to corporate tax reform and tighter financial conditions.

In our view, growth in earnings will offset pressure on multiples to the extent that S&P 500 P/E multiple stays roughly flat at 22 times earnings. This leads us to believe that the S&P500 index will climb to 5050-5100 in 2022. A gain of around 10% including dividends. The path, however we do not believe is likely to be linear with inflation, central bank policy action and covid all ongoing factors driving equity and bond market volatility.

Chart 11: S&P500 EPS, P/E



Source: Refinitiv Datastream/Fathom (Note: Past Performance is not a reliable indicator of future performance)

After two years of near-zero interest rates, the Fed will likely begin hiking in July. 10-year Treasury yields will rise to 2% by the end of next year but be offset by a declining Equity Risk Premium as policy uncertainty declines and consumer confidence rises. Strong corporate and household demand for equities will help support valuation.

We believe that offshore developed market equities will produce greater earnings growth than Australian equities and continue to position our portfolios appropriately.

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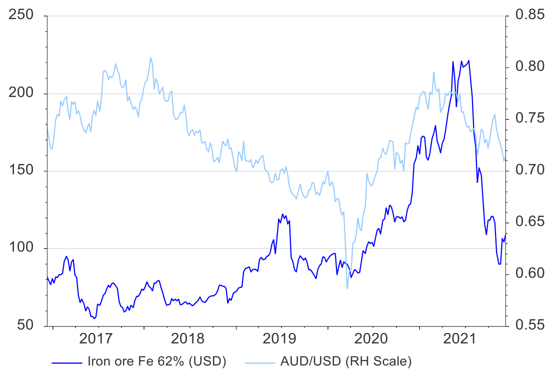
Emerging markets may remain challenging for some time, however we believe that longer term trends support an allocation to these markets. Alternative and non-correlated assets will continue to be useful as a tool to smooth out volatility.

We believe that bond yields need to rise further before Fixed Income becomes more attractive versus other asset classes.

Chart 12: AUD & Iron Ore Price



Source: Refinitiv Datastream/Fathom (Note: Past Performance is not a reliable indicator of future performance)

Next year, FX investors and risk managers should focus on differentiation based on the central bank policy outlook, exposure to commodity prices and tourism, as well as carry. We expect the AUD to continue to come under pressure as commodity prices and interest rate differentials act as strong headwinds.

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