

Drummond Dynamic Portfolio

Quarterly Investment Review – Q4 2022

We believe we are in an era of increased volatility and uncertainty regarding future asset class returns. The Drummond Dynamic Portfolio (DDP) has been created to provide exposure to a diversified set of global investments, with the aim of protecting capital in bad periods and growing wealth in good periods. This is our core, dynamically managed multi-asset investment portfolio.

Market Overview

Equity markets rose in the fourth quarter despite falls in the technology sector as inflation optimism and China's walk back of its zero Covid policy boosted sentiment

Global equity markets rebounded in the final quarter of 2022. The MSCI ACWI index rose 7.5% in the quarter, reducing its full year loss to -15.6%. Technology continued to weigh, with the Nasdaq falling -0.8%. Europe was strong, with the Euro Stoxx rising 12.7% as warm weather reduced the risks of further gas price spikes while emerging markets benefitted from China's walk back of its zero Covid policy. The Australian ASX200 index rose 9.4%, buoyed by China sentiment lifting resources and the bank's strong earnings. Central banks remained broadly hawkish, with interest rates continuing to rise and Japan's surprising move to slightly tighten its monetary stance though changes to its yield curve control policy.

Bond markets outside of Japan were broadly flat over the quarter despite exhibiting large trading ranges as inflation and recession forecasts ebbed and flowed. Corporate debt performed strongly with both high yield and investment grade credit spreads rallying ~5% over the quarter as deeper recession fears eased.

Commodities were positive over the quarter with broader commodities (S&P GSCI Commodity Index) rising 3.4% as the demand outlook improved driven by China's zero Covid policy shift. Oil was surprisingly lacklustre however, rising only 0.4%. Peaking inflation expectations saw the USD fall helping gold to rally 8.5% while positive risk sentiment boosted the AUD by 4.2%.

Portfolio Performance & Review

Over the quarter, the Dynamic Portfolio returned 2.4%*. This was behind the FE AMI Mixed-Asset peer index that returned 3.2% over the period. As is shown in the table below, the portfolio continues to perform well when compared to the institutional peer group.

DRUMMOND DYNAMIC PORTFOLIO PERFORMANCE HISTORY					
	3 month	6 month	1 year	3 year p.a.	Inception p.a.
Dynamic Portfolio*	2.4%	2.0%	-5.5%	3.6%	4.2%
Peers**	3.2%	2.7%	-4.8%	1.9%	3.3%
Outperformance	-0.9%	-0.7%	-0.6%	1.7%	1.0%

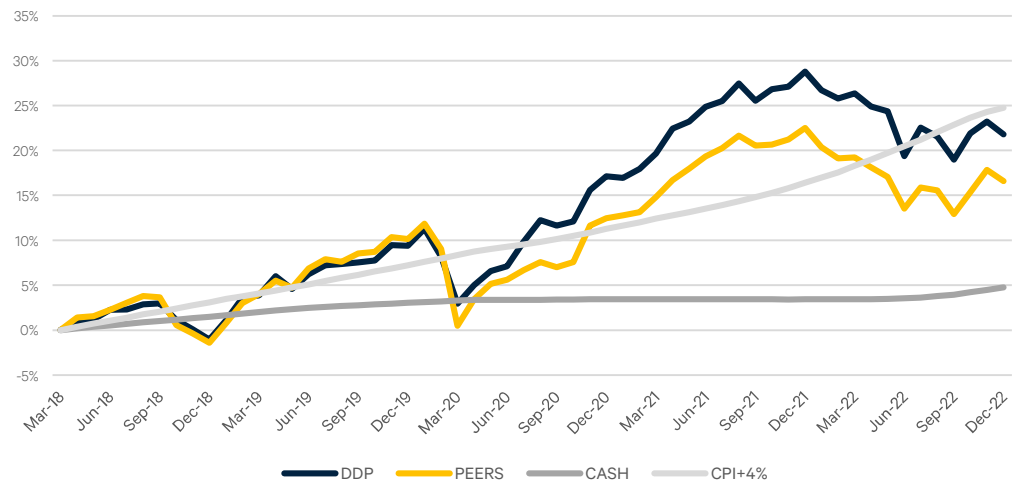
Source: Drummond Capital Partners, *BT Panorama, Refinitiv; **FE AMI Mixed Asset – Flexible Sector

The portfolio performed below peers over the fourth quarter. The larger exposure to global equities over Australian equities during the period was a relative detractor given the latter's outperformance, as was being underweight equities overall in a strong quarter including having no emerging market exposure as it bounced back. The portfolio's large cash exposure also detracted in a quarter where credit outperformed. The portfolio's neutral style exposure also didn't aid relative performance where value styles outperformed given the bounce back in China sentiment helping materials and reduced economic concerns also helped the more value orientated sectors. The portfolio continues to be well diversified by asset class and manager.

The changes made to the portfolio during the quarter saw overall equity exposure reduced as markets rallied into the end of the year across both Australian and international equities. Changes were also made within international equities in October to increase the amount of currency hedging as sentiment towards China improved. Combined, these changes took overall growth asset exposure from 42.3% at the beginning of the quarter to 41.6% at quarter's end.

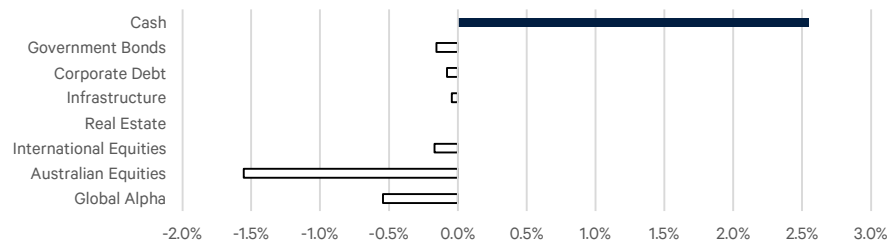
The portfolio performed below peers over the quarter as positive risk sentiment returned.

DRUMMOND DYNAMIC PORTFOLIO RETURN vs. PEERS**



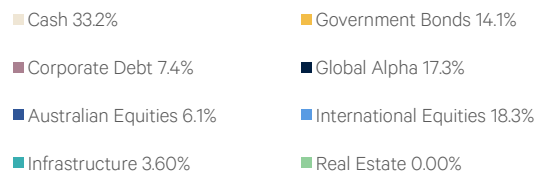
PORTFOLIO ASSET ALLOCATION CHANGES – Q4 2022

Allocations to growth assets were reduced in the quarter in favour of cash



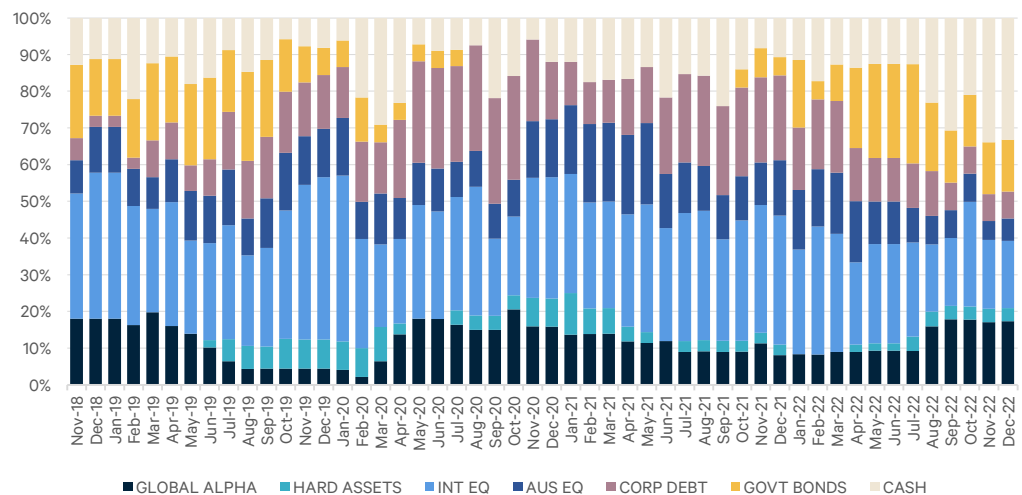
PORTFOLIO ASSET ALLOCATION – Q4 2022

The portfolio is underweight growth assets, and overweight cash



PORTFOLIO ASSET ALLOCATION HISTORY

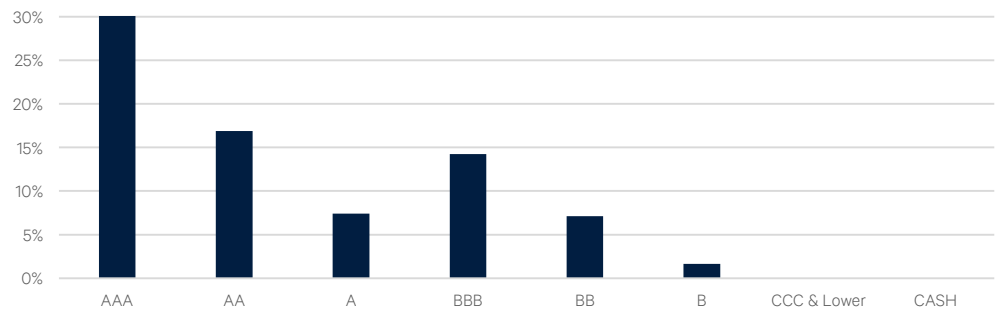
International equities and cash are the biggest asset class exposures



Corporate Debt

Credit markets were stronger in the fourth quarter as inflation pressures moderated and jobs data remained robust, alleviating economic hard landing concerns and expectations of a weak credit cycle. US high yield credit spreads rallied from 5.4% to 4.8% over the quarter. Investment grade credit spreads also tightened, moving from 2% to 1.7%. We maintained a reduced exposure to credit given our expectation that a recession and ensuing credit cycle remains possible.

PORTFOLIO LOOK THROUGH CREDIT GRADE EXPOSURE (CORPORATE DEBT & GOVERNMENT BONDS)



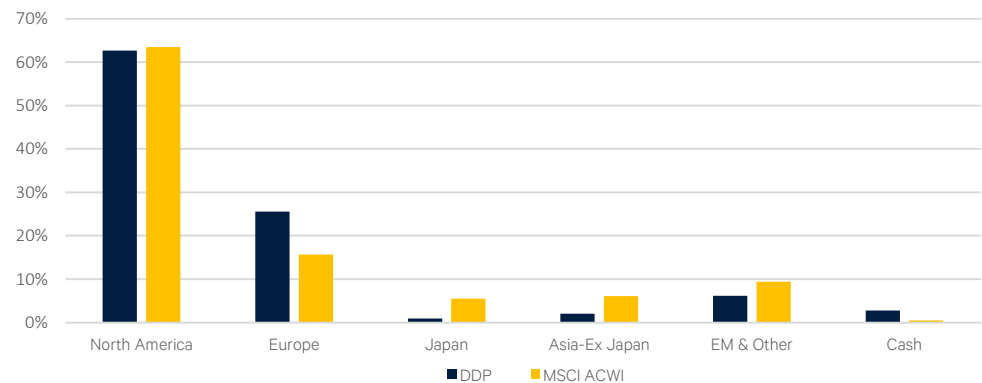
Source: Drummond Capital Partners, manager reports

Government Bonds

Government bond prices remained volatile over the quarter. Australian 10yr bond yields traded in a range between 4.15% at the highs and 3.3% at the lows, finishing the quarter 0.1% higher at 4.05%. It was a similar story in US government bonds with a volatile range but finishing relatively unchanged for the quarter at 3.8%. We maintained our exposure to government bonds during the quarter given we think there is value in government bonds with inflation having peaked and economic growth slowing.

International Equities

PORTFOLIO LOOK THROUGH COUNTRY EXPOSURE vs. BENCHMARK



Source: Drummond Capital Partners, manager reports

World equities (MSCI ACWI) rallied 7.5% in local terms over the fourth quarter, taking the 12 month return to -15.6%. Despite profit taking in December on more hawkish commentary from Fed Chairman Jerome Powell, markets traded higher off the lows in September on the view that core inflation had peaked and China's moves to begin to wind back its zero Covid policy would help to bolster global growth. Asian equities were particularly strong after underperforming for a considerable period on economic recovery hopes post walking back on zero Covid policies. The Hang Seng finished up 15% after being down 15% at one point during the quarter. As hopes grew for a soft economic landing and peak inflation, value orientated sectors continued to outperform growth as tech bellwethers came under continued pressure and Tesla halved in value. Given the less bad outlook for China we reduced our offshore currency exposure early in the quarter and used the strong rally through to December to reduce equity exposure marginally in favour of cash.

Australian Equities

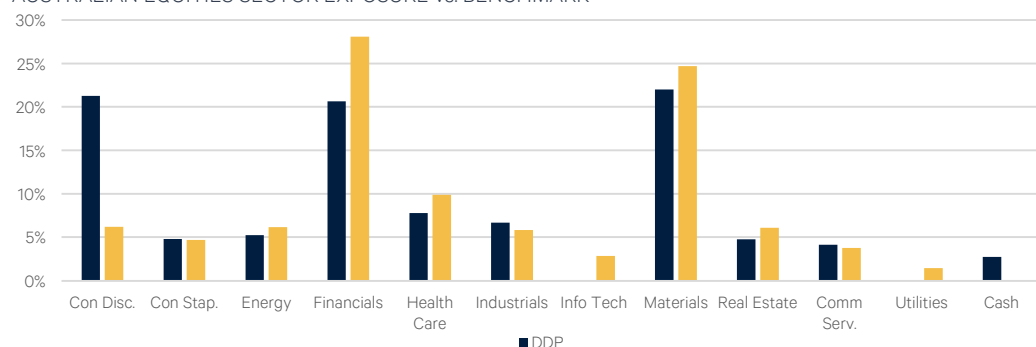
We maintained a reduced overall credit exposure given the possibility of a recession in 2023

Government bonds prices were volatile over the quarter

Global equity markets recovered in the fourth quarter as inflation looked to peak and China walked back its zero Covid policy

Australian shares had another strong relative quarter benefitting from resources and financials strength

AUSTRALIAN EQUITIES SECTOR EXPOSURE vs. BENCHMARK



Source: Drummond Capital Partners, ASX

Australian shares were strong over the quarter, outperforming global equities as the two dominant sectors of the index, resources and financials, were both strong. All sectors were positive with the utilities sector benefitting from the Origin Energy bid, and real estate recovering after significant weakness over the year. Health care and consumer staples lagged. Overall exposure to Australian shares was decreased marginally over the quarter, taking advantage of the strong rally.

Hard Assets (Infrastructure / Real Estate / Commodities)

Both real estate and infrastructure were positive over the quarter though the lower beta nature of the sectors was evident as they fell well short of the gains in equity markets. Commodity markets were positive on China's re-opening hopes and a weaker USD. Exposure to the asset class overall was maintained over the quarter.

Global Alpha

Global alpha managers had a tougher quarter, struggling to produce positive returns in the risk on environment. We continue to believe that non-directional global alpha funds are well placed to produce positive results for the portfolio in an environment where economic conditions and asset class prices should remain volatile.

Outlook

2022 was a difficult year. Indeed, for investors in multi-asset portfolios, one of the most difficult on record. We were active at the beginning of the year to reduce portfolio risk by removing small caps and reducing equity exposure and continued to remain active through the year as we navigated both the bond and equity sell off simultaneously. We are satisfied that we outperformed peers over the year and at the same time disappointed that we weren't able to put more ground between us and peers. We feel this was mainly a result of the Australian equity markets outperformance and the drag that mega cap technology underperformance weighed on all global equity managers that were not pure value in their style. Our move into government bonds as they recorded one of their worst selloffs in history was also in hindsight marginally early, but we continue to feel this is ultimately the right call given the changing macro environment.

Perhaps surprisingly, we feel 2023 again has a rather asymmetric downside profile to it much like 2022. Despite all the negativity of 2022, much of what has occurred in equity markets has been about a valuation adjustment rather than an earnings adjustment as multiples fell due to rising interest rates but earnings barely moved.

Inflation peaking helps reduce larger drawdown scenarios for equities and bonds, but for equity investors at least, now comes time to deal with the potential oncoming recession and the threat of a second negative year of returns. While the recession is much anticipated, expectations remain for a mild recession with a small increase in the unemployment rate given strong household and corporate balance sheets. The problem we see is that equity markets have basically priced in this soft-landing scenario already, allowing little room for error.

Despite a weak 2022, 2023 continues to pose downside risks

We do not think we are too far away from the point at which economic weakness becomes more evident in data. Many global PMIs as well as the US ISM continue to show slowing global growth. In a normal environment, the lags between monetary tightening and economic growth suggest 2022's rate hikes will begin to be meaningfully felt from the middle of this year suggesting a recession begins middle to late 2023 with interest rates to be cut late 2023 or early 2024.

A peak in CPI, China's re-opening and a much warmer European winter (averting a spike in gas prices and a deeper recession) have so far allowed markets to look through the economic valley. We expect the market's attention will soon turn towards how high the unemployment rate could rise and how far corporate earnings estimates should be cut. Growing expectations for an orderly retreat in inflation towards the Fed's 2% target could also be misplaced.

We believe owning bonds will benefit portfolios this year as the potential for a recession gets closer while the increase in yields in 2022 means the carry earned from bonds is much better than has been the case over the past decade. We continue to run the portfolios with low equity and credit risk, awaiting more certainty on the timing and impact of a recession and valuations that better reflect these risks.

Regards,

The Drummond Capital Partners team

*Inception date is 31/3/2018. Source: BT Panorama. The returns shown are net of fund manager fees and do not incorporate any other fees including Advisory Fees, Admin Fees or Portfolio Manager Fees. They are calculated from the model portfolio within BT Panorama and as such may vary over time and vary by individual client.

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