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MORROWS PRIVATE WEALTH ANNUAL MARKET UPDATE AUGUST 2024

Your financial future,
tailored your way

MPW Annual Market Update – August 2024

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The purpose of this presentation is to provide you general advice and insight into MPW's current market outlook and investment philosophy.

Where our presentation provides general advice, we must explain that this advice has been prepared at this time without taking into account your individual personal needs, objectives, or financial situation, and the personal information we hold about you has not specifically been considered in forming our views.

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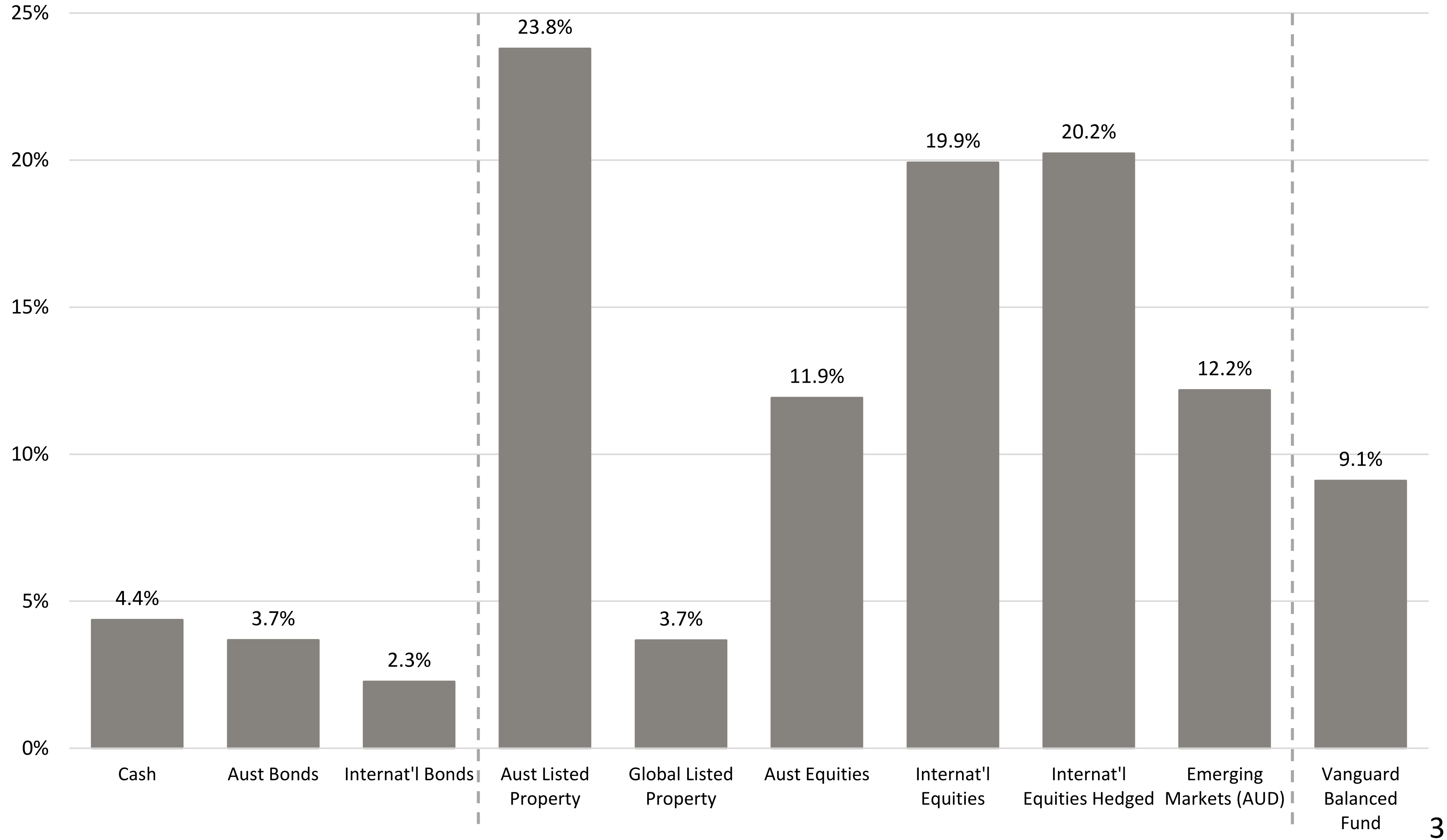
Asset Class Returns 12 Months to 30th June 2024



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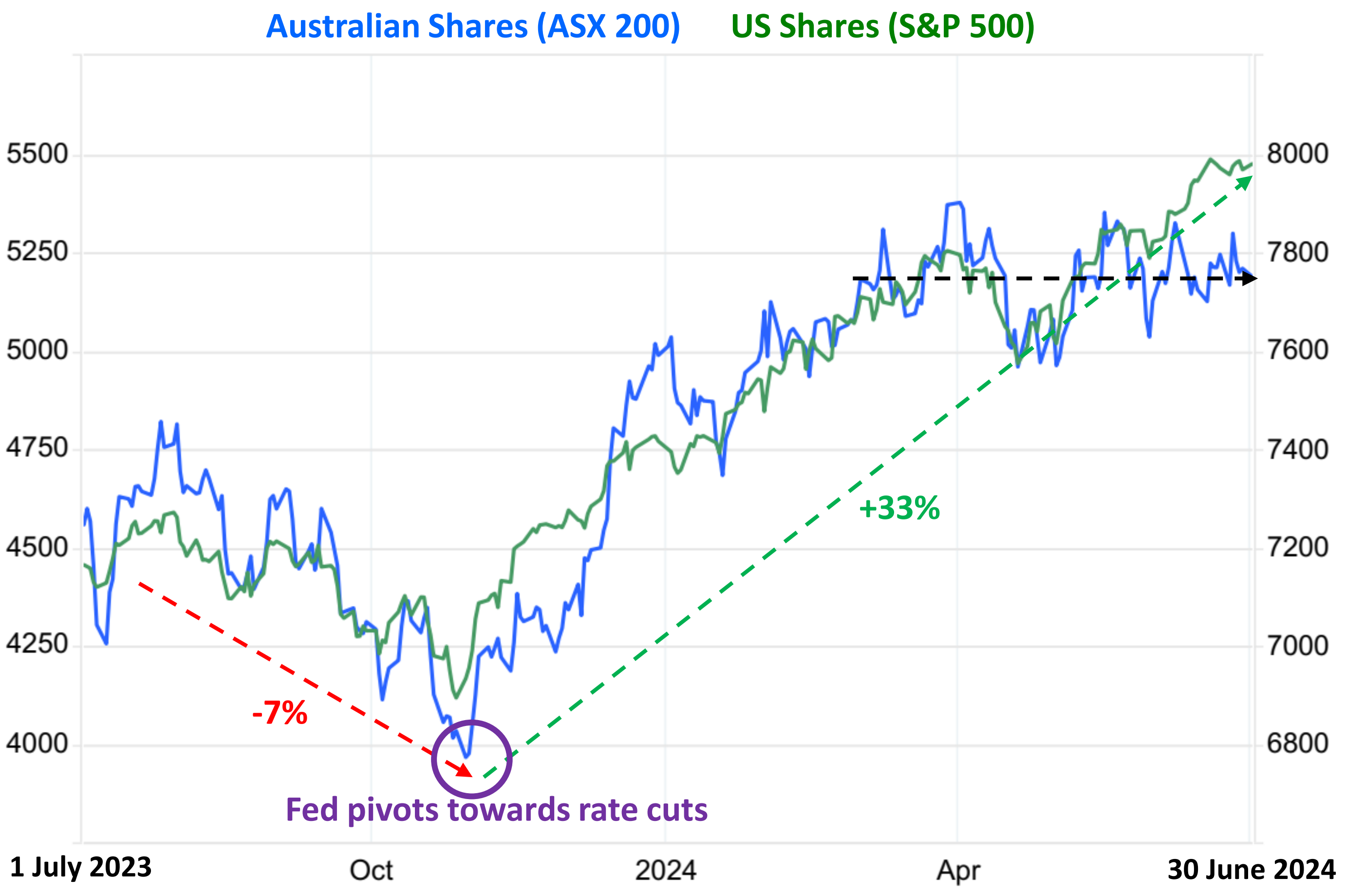
A Quick Snapshot Of The 2024 FY

Despite many uncertainties and headwinds last financial year, the global economy and markets were solid. Why?

- Unemployment remained very low;
- Inflation continued to fall;
- Corporate earnings were growing;
- Consumers were spending; and
- Investor sentiment priced in US rate cuts.

The chart opposite shows the US share market in green rallying 33% from the October lows and whilst the Australian share market in blue also rallied strongly it was flat from March onwards.

Can this market rally continue into 2025?



source: tradingeconomics.com

MPW Outlook: Will Rate Cuts Avoid A Recession?

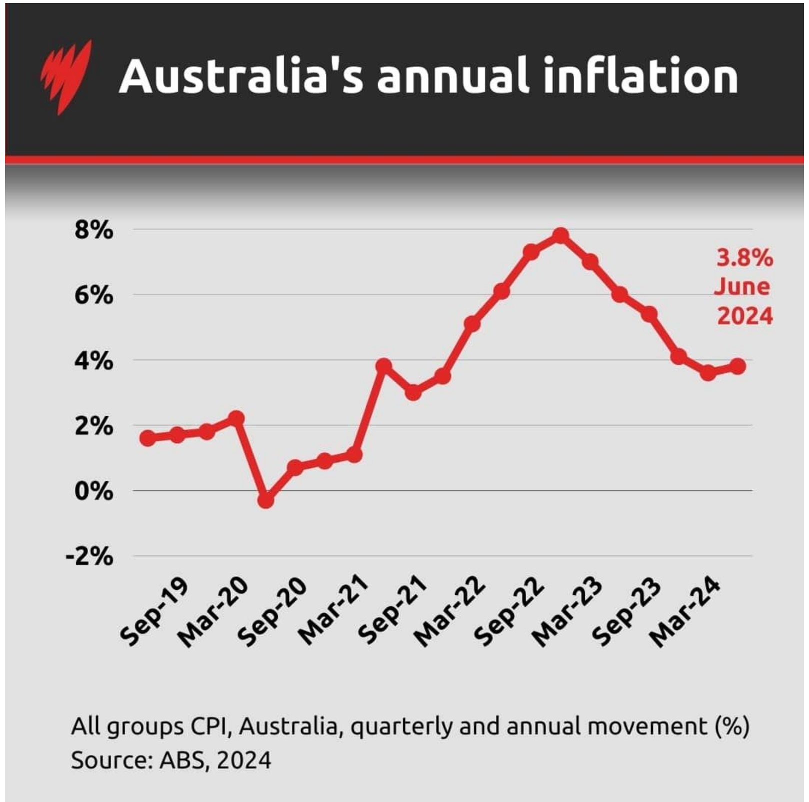
1. Hard Landing: Global Recession MPW Probability = Medium	2. Soft Landing: Mid-Cycle Slowdown MPW Probability = Medium	3. Strong Growth: New Bull Market MPW Probability = Low
• Inflation remains sticky	• Inflation moderates towards targets	• Inflation continues to fall
• Central banks hold rates steady	• Central banks slowly cut rates	• Central banks are accommodative
• Unemployment rises 1-2%	• Unemployment rises marginally	• Employment growth remains strong
• Savings rates evaporate	• Savings rates are neutral	• Savings rates remain elevated
• Consumer spending slows sharply	• Consumers continue to spend	• Consumer confidence picks up
• Economic data deteriorates	• Economic data stabilises	• Economic data strengthens
• Corporate earnings fall further	• Higher revenues offset higher costs	• Companies improve productivity
• Geopolitical risks intensify (wars)	• No further sanctions or conflict	• Geopolitical risks and conflict abates
• Oil price spike magnifies the above	• Supply issues don't spike oil prices	• Oil prices stabilise at lower levels
Markets are <u>not</u> priced for this, expect further decline from here (~-20% plus)	**Markets <u>are</u> priced for this, value can be selectively found at current levels**	**Markets are <u>not</u> priced for this, risky assets will perform very strongly**

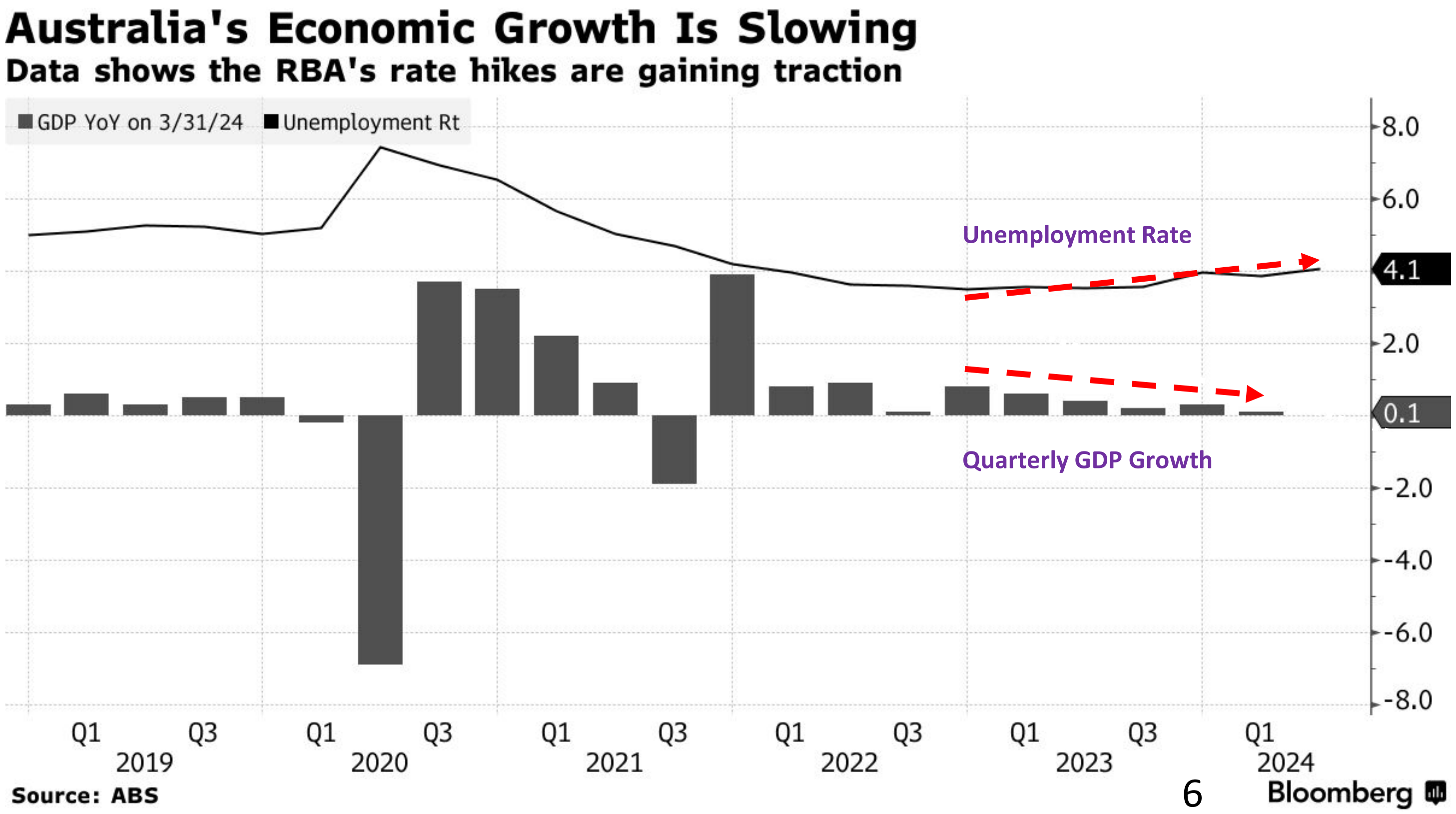
Australian Inflation Risk vs Recession Risk

Inflation has fallen but there is a risk it remains 'sticky' and takes time to fall within the RBA's 2-3% target band.

Annualised GDP Growth has stalled at 1.1% with the quarterly trend below looking recessionary.

Unemployment remains historically low but has risen from 3.5% to 4.1%, so this trend is problematic.



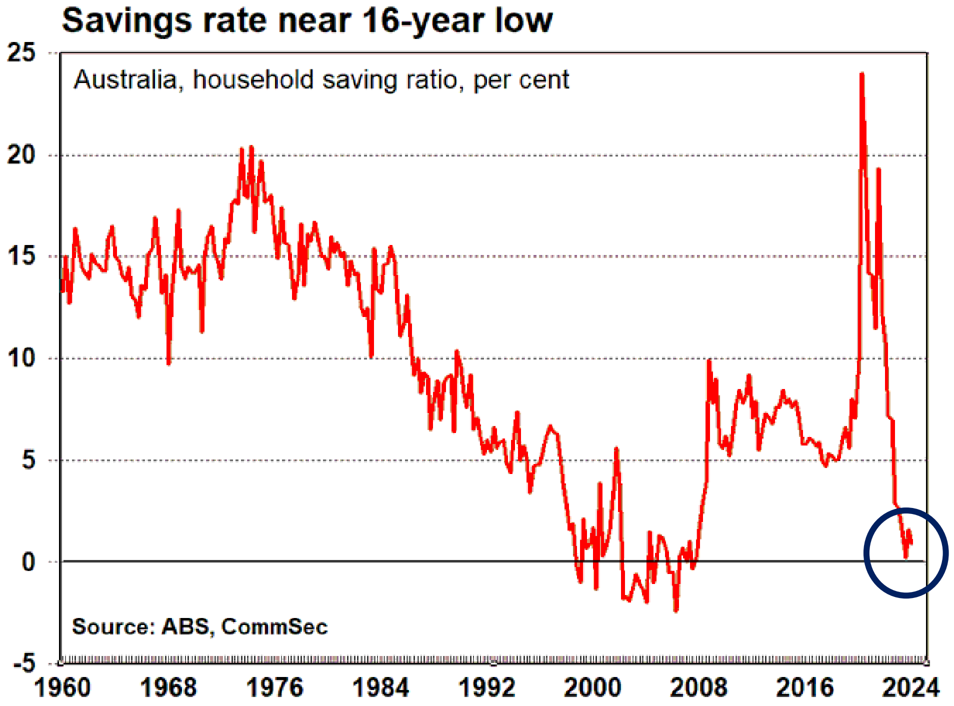


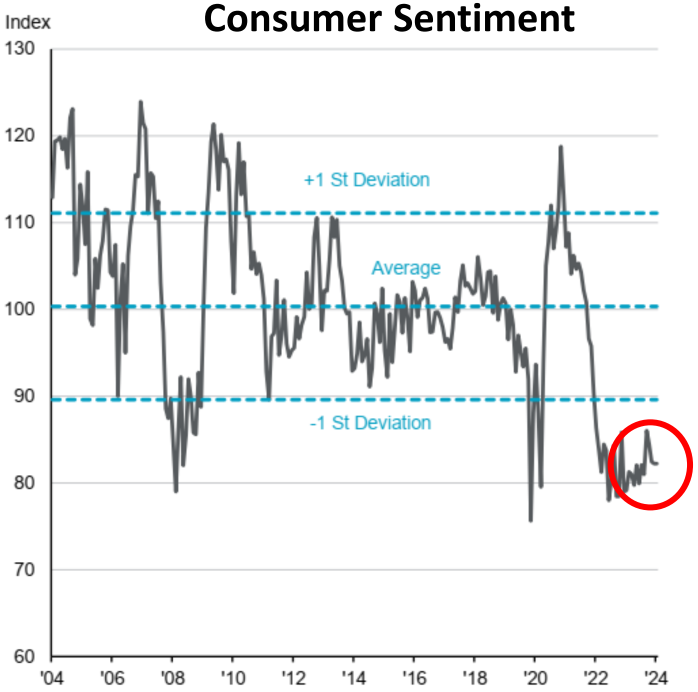
Can Australian Consumers Weather The Storm?

Household savings have depleted as higher rates and costs weigh on consumers.

Consumer Sentiment has fallen to levels historically seen in recessions.

Interest rates could be on hold for longer in Australia.





How Australia compares on inflation and interest rates

Region	Inflation	Rates
Australia	3.8%	4.35%
US	3.0%	5.50%
UK	2.0%	5.25%
Canada	2.7%	4.50%
Eurozone	3.5%	3.75%

Source: ABS & SBS Finance

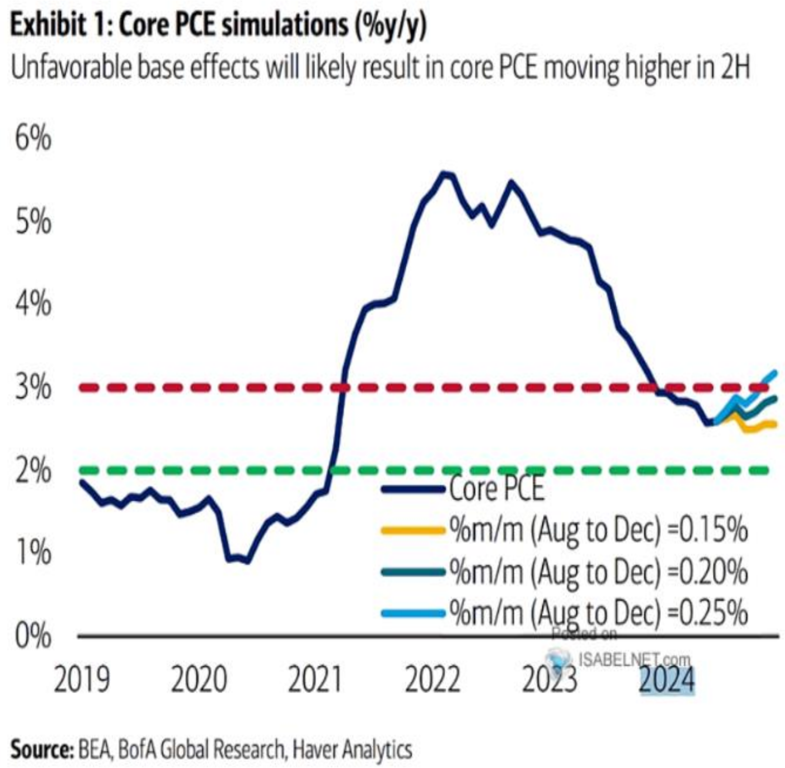
Source: Australian Bureau of Statistics, BEA, FactSet, Reserve Bank of Australia, J.P. Morgan Asset Management.

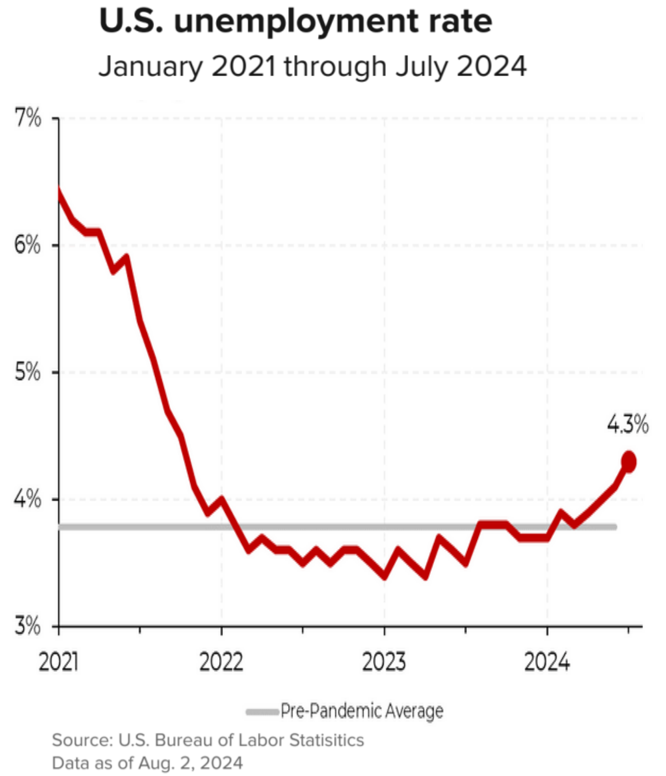
US Inflation Risk vs Recession Risk

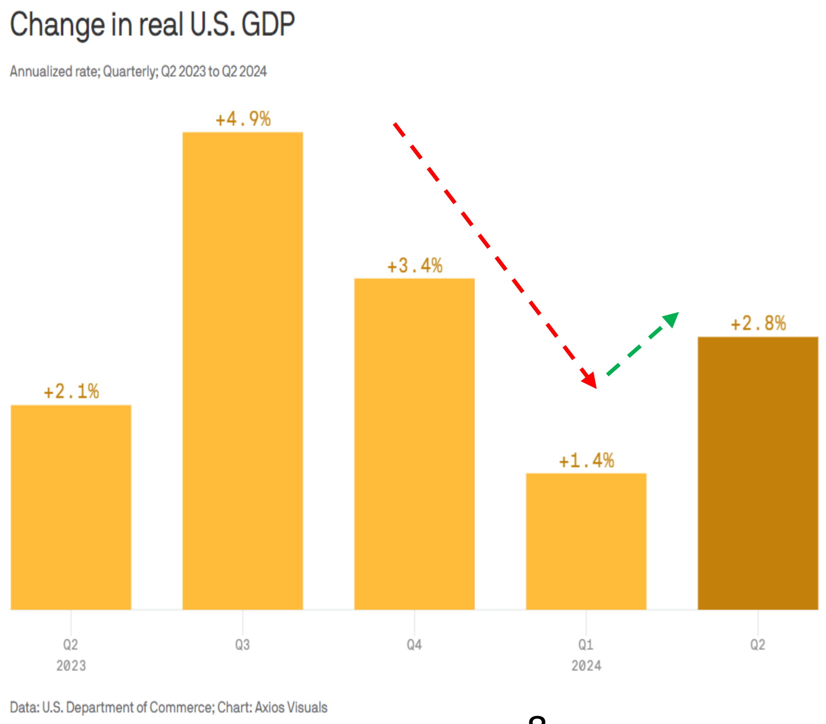
US inflation is falling but there is a risk it remains 'sticky' and even increases in coming months.

US unemployment remains historically low, but the trend is rising which increases recession risk.

Annualised **US GDP Growth** rose more than expected in June 2024 to reverse what was looking like a recessionary trend.





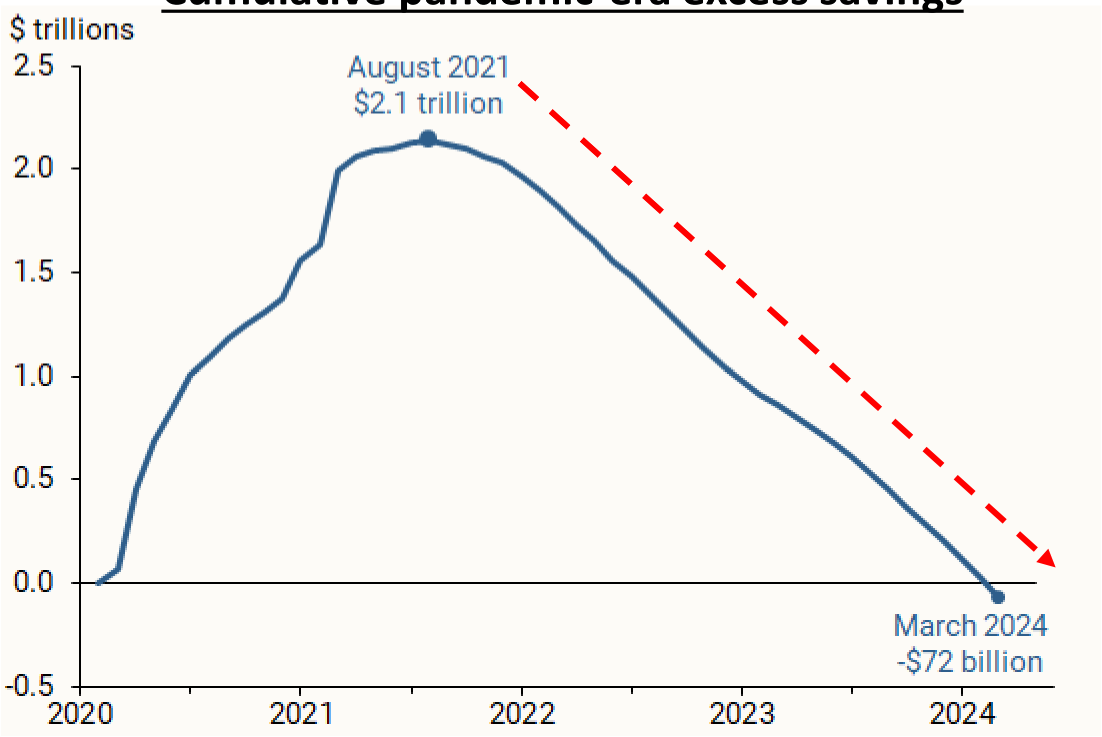


Can US Consumer Spending Hold Up?

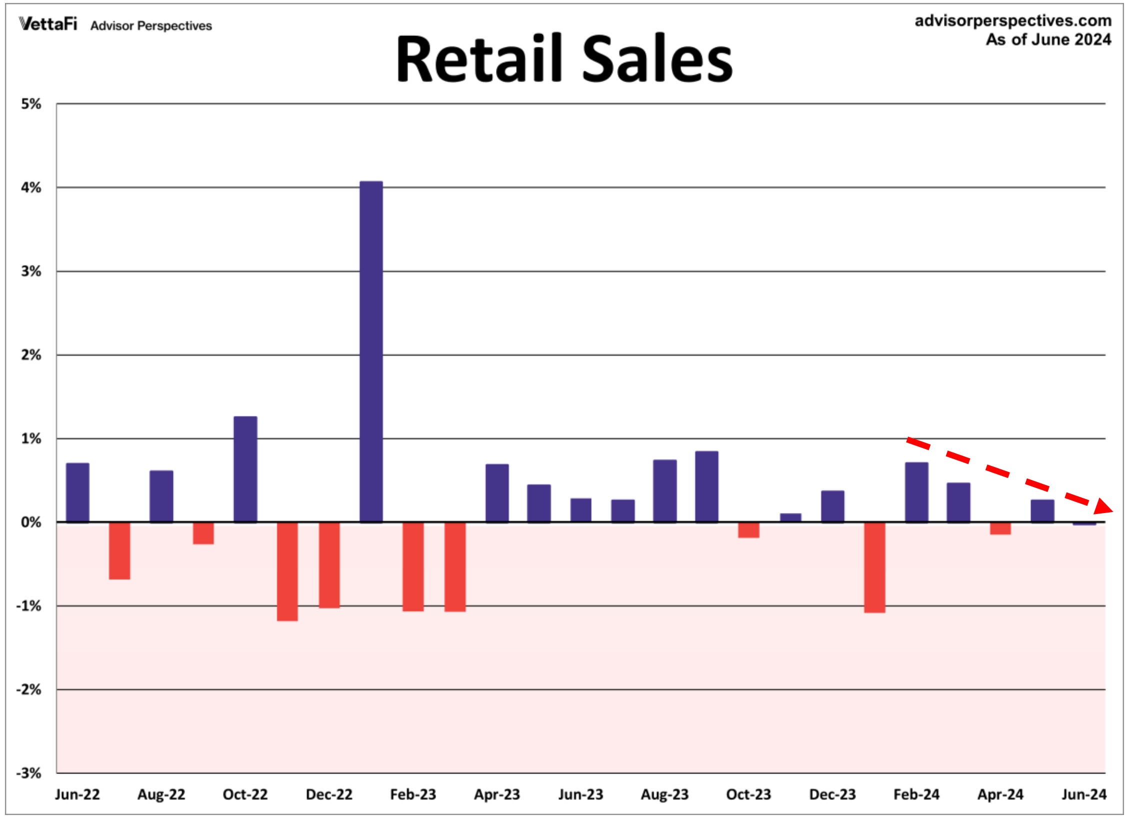
Excess savings are now negative in the US, and this is only the third time in 80 years that net savings has contracted. The other two in 2020 and 2009 saw recessions unfold.

The US consumer represents 70% of GDP growth, so if they are spending the economy is solid. Higher inflation costs may be starting to impact consumers' appetite to spend.

Cumulative pandemic-era excess savings



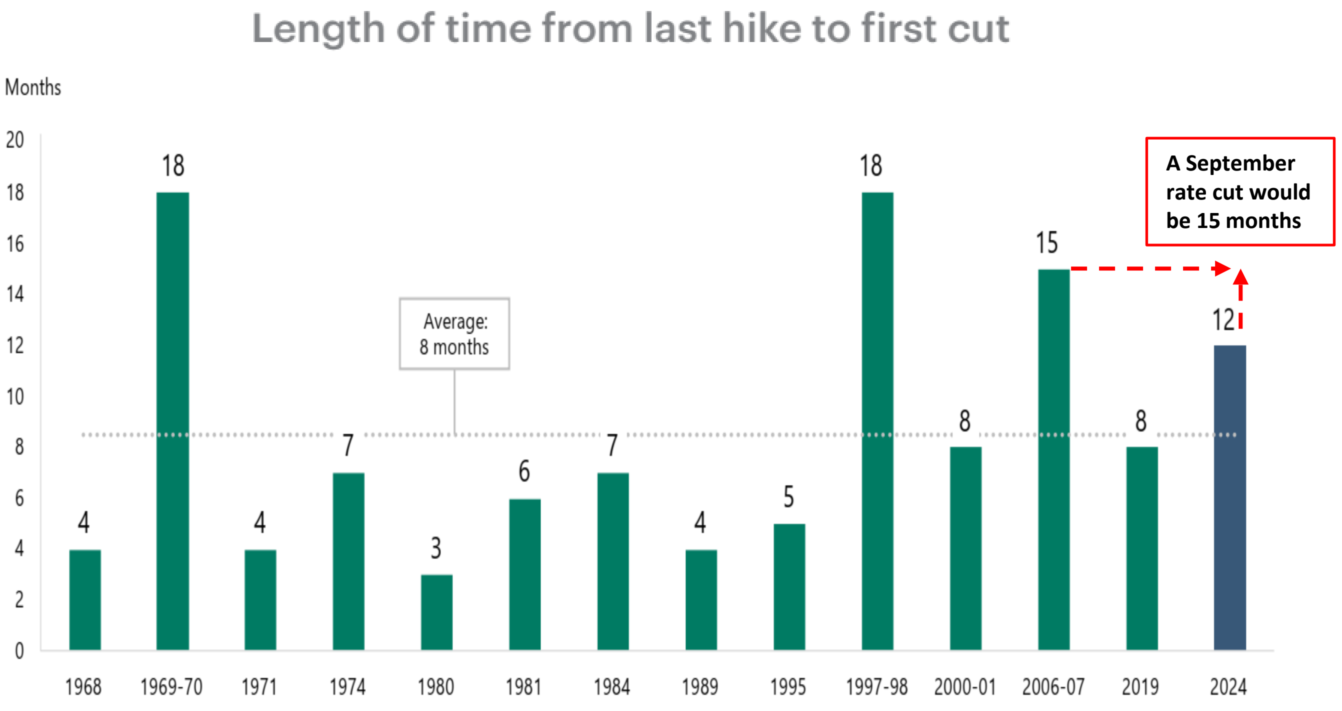
Source: Bureau of Economic Analysis



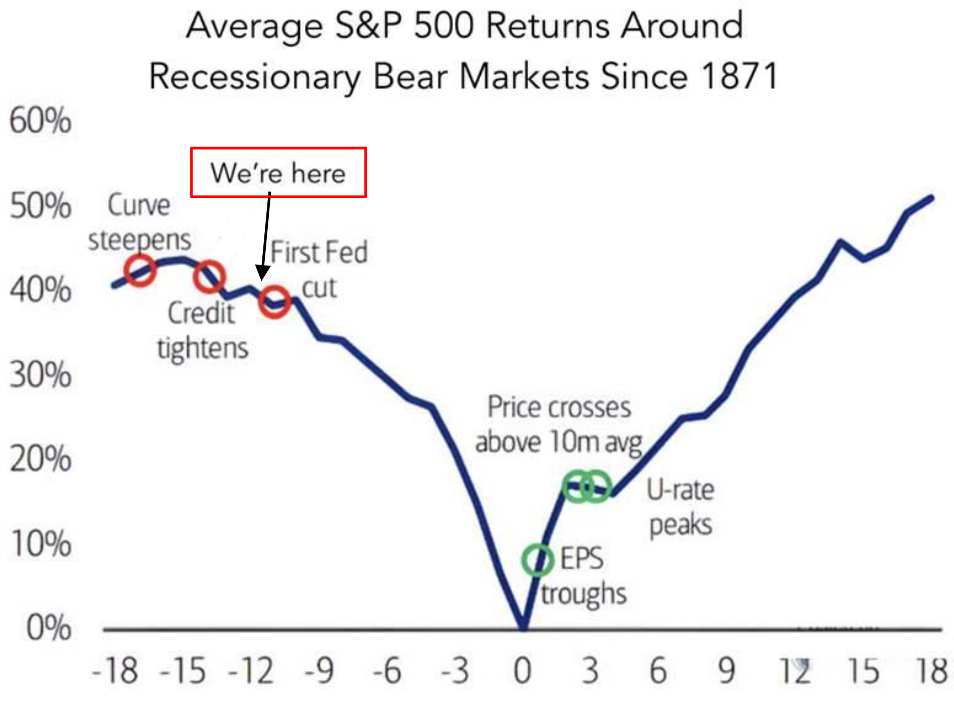
The Impact of Long Tightening Cycles

Markets are now fully priced for a US Fed interest rate cut in September, which will equal the third longest tightening cycle in the last 55 years. Hindsight will tell whether the US economy will already be in recession.

In each of the **past recession cycles** since 1871 stocks have declined on average 40%. Firstly, the yield curve start to steepen (tick), then credit starts to tighten (tick) and before recession hits the Fed cuts rates. How will 2025 play out?



Data as of June 2024.
Sources: FRB, Haver Analytics, Apollo Chief Economist

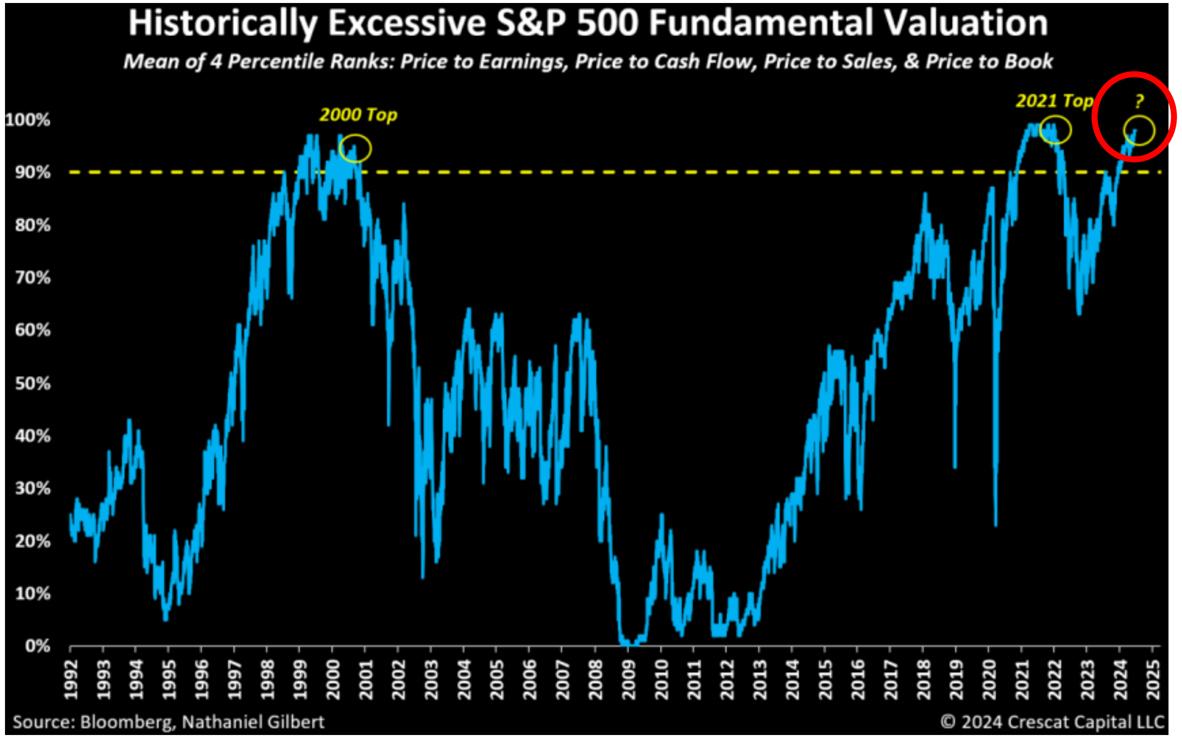


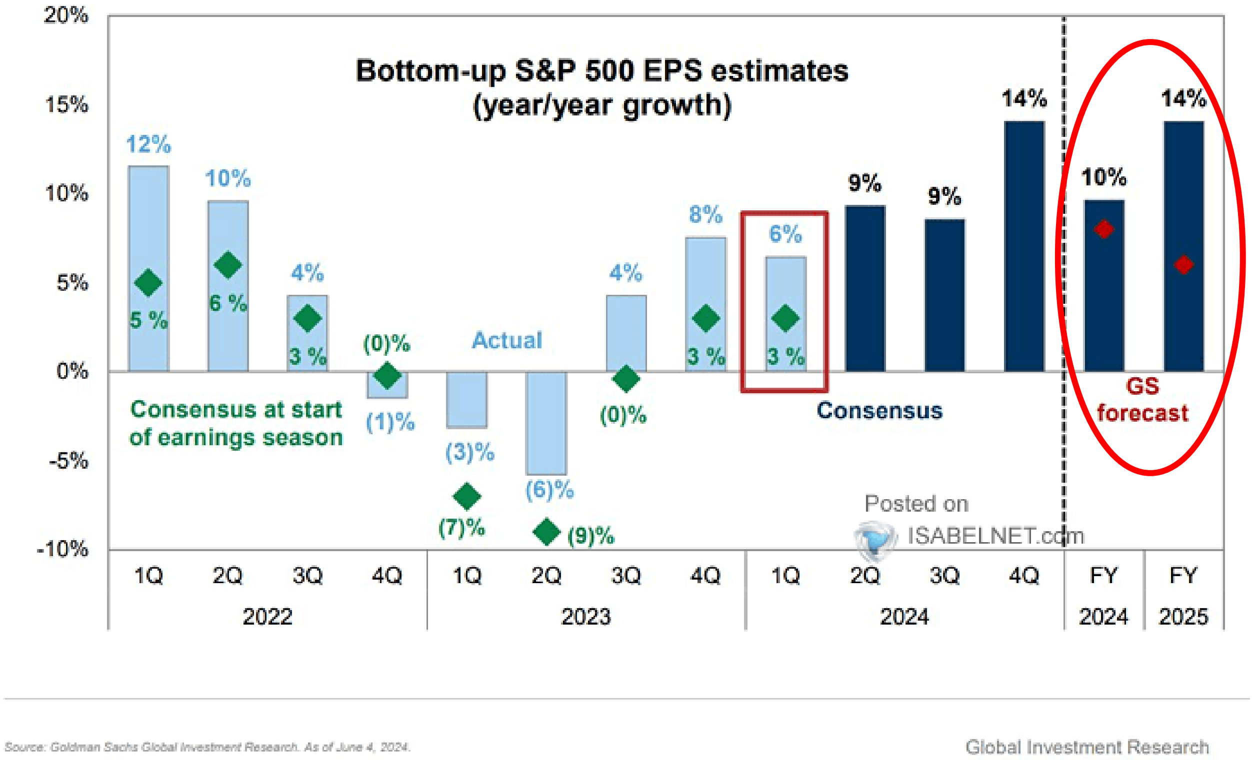
Source: BofA Research Investment Committee, Global Financial Data, Bloomberg

US Markets Are Priced For Perfection, Not Recession

Valuations relative to fundamentals such as earnings, cash flow from operations, revenues, and book value for the entire S&P 500 are as high as they have ever been.

Forecasts are for US corporate earnings to grow at 10% in 2024 and 14% in 2025. If the consumer and economy slows then this market runs a very high risk of rolling over.





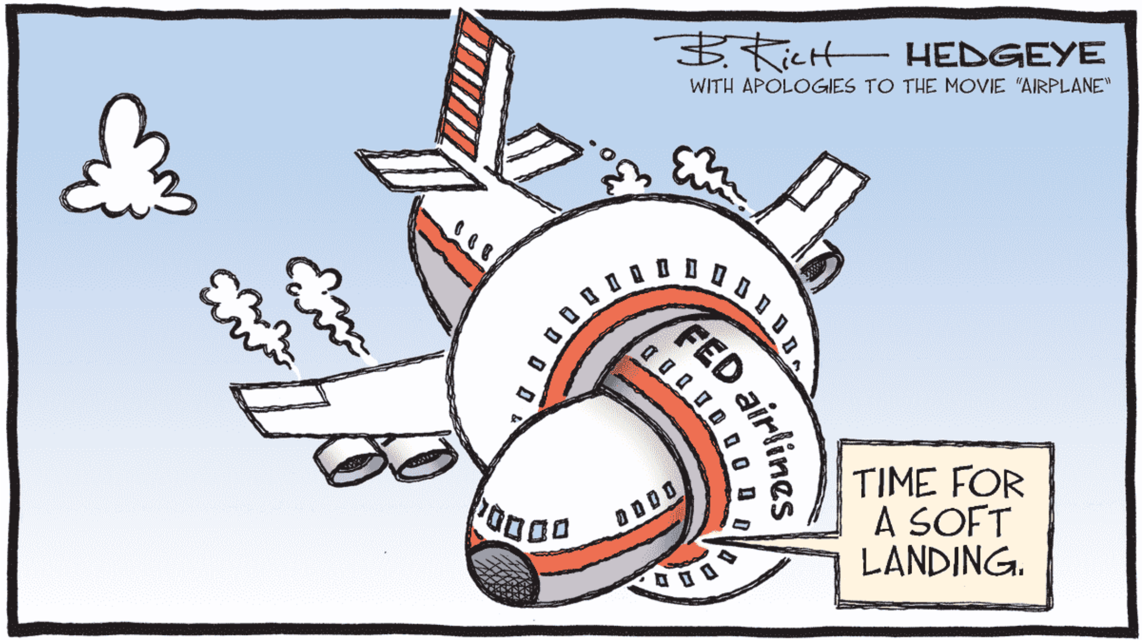
The US Election, Geopolitics & The Fed

The US Presidential election in November 2024 will increase market volatility, particularly now that Kamala Harris is running against Donald Trump.

This comes at a time when geopolitical risk is already elevated and global tensions are high.

The consideration here is what impact the election result will have on the US Fed, given both parties will ramp up fiscal spending, which is inflationary - an issue for 2025?

This could come at a time when the Fed is wanting to cut interest rates, not consider having to raise them again.



So What Does This Mean For Markets?

One of the most aggressive interest rate tightening cycles in history makes it very difficult to manage a soft-landing and avoid a recession, but consumers have been resilient.

Fed Rate Cuts = Soft landing if consumers hold up
Action: Selectively buy assets

But... If consumers and businesses start feeling the impact of higher interest rates on a lag effect as per history, then a recession is likely to unfold in the next 6-12 months.

Fed Rate Cuts = Recession as economy weakens
Action: Stay defensively positioned

MPW Recommended Portfolio Strategy

Asset Class	Tactical Position	Comment
Currency (AUD vs USD)	Neutral	Neutral hedge at current levels, AUD to fall into US recession and recover strongly out of it
Cash & Liquidity	Neutral to Over	RBA to raise rates 1-2 times, hold cash for better buying opportunities into late 2024
Government Bond Duration	Underweight	Long-duration bonds are pricing an economic slowdown, not recession. Prefer private debt
Corporate Credit & Debt	Underweight	Listed credit will fall further into a recession, but selective private credit is very attractive
Listed Property & Infrastructure	Underweight	Listed property is 'relatively' cheap but high risk, prefer to own selective unlisted assets
Listed Australian Shares	Underweight	Expensive, retain quality value bias, expecting better buying opportunities into late 2024
Listed International Shares	Underweight	Expensive, particularly the US, Emerging Markets are cheap but cautious into a recession
Liquid Alternative Assets	Overweight	Selective hedge funds, private debt and equity, commodities, and niche opportunities
Illiquid Alternative Assets	Overweight	Private debt and equity, niche illiquid strategies can provide a long-term return premium

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The Role of Alternative Assets In Portfolios

Framework-driven portfolio construction: What role do different categories play in the portfolio?

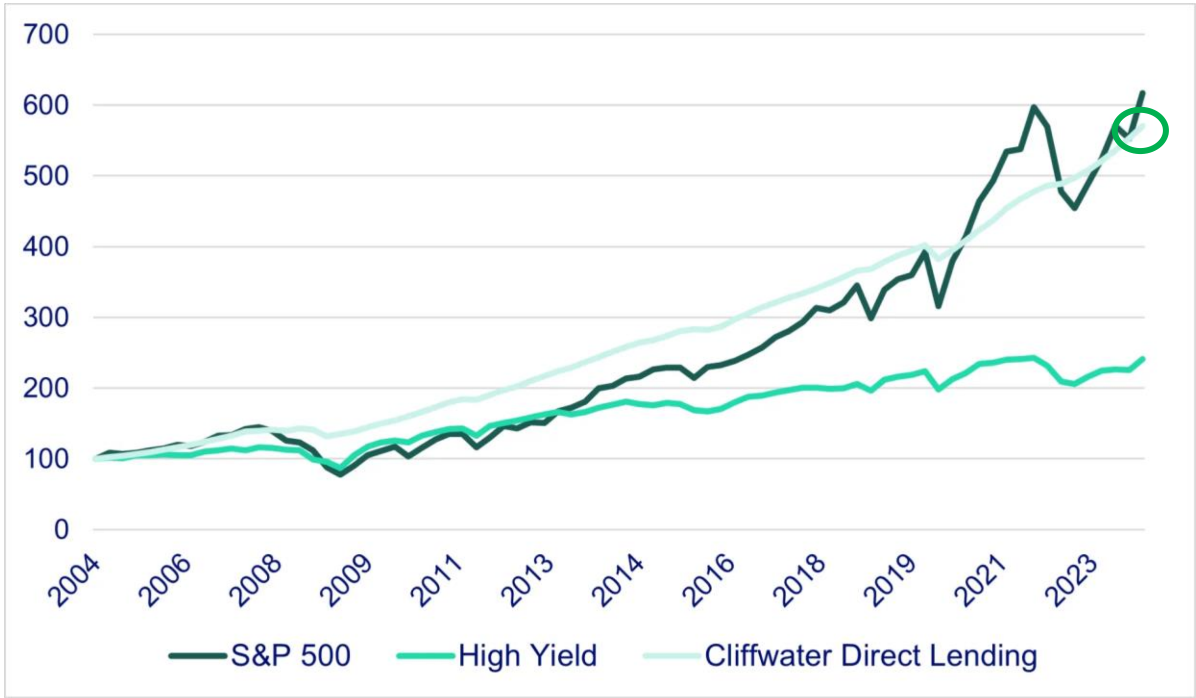
	Fixed income-like	Hybrids	Equity-like	
RETURN ENHANCERS Global diversification and tactical/ opportunistic returns	Distressed credit	Special situations	Private Equity, Venture Capital	LOWER Income/ HIGHER Volatility
CORE COMPLEMENTS Added diversification and/or enhanced returns	Corporate mezzanine loans	Hedge funds	Noncore real assets	
CORE FOUNDATION Stable Income with lower volatility, diversification ad inflation sensitivity	Core Private credit	Core real estate, infrastructure and transport	Low volatility core equity	HIGHER Income/ LOWER Volatility

= Overweight for a recession environment

Source: JP Morgan Asset Management Alternative Solutions Group & MPW

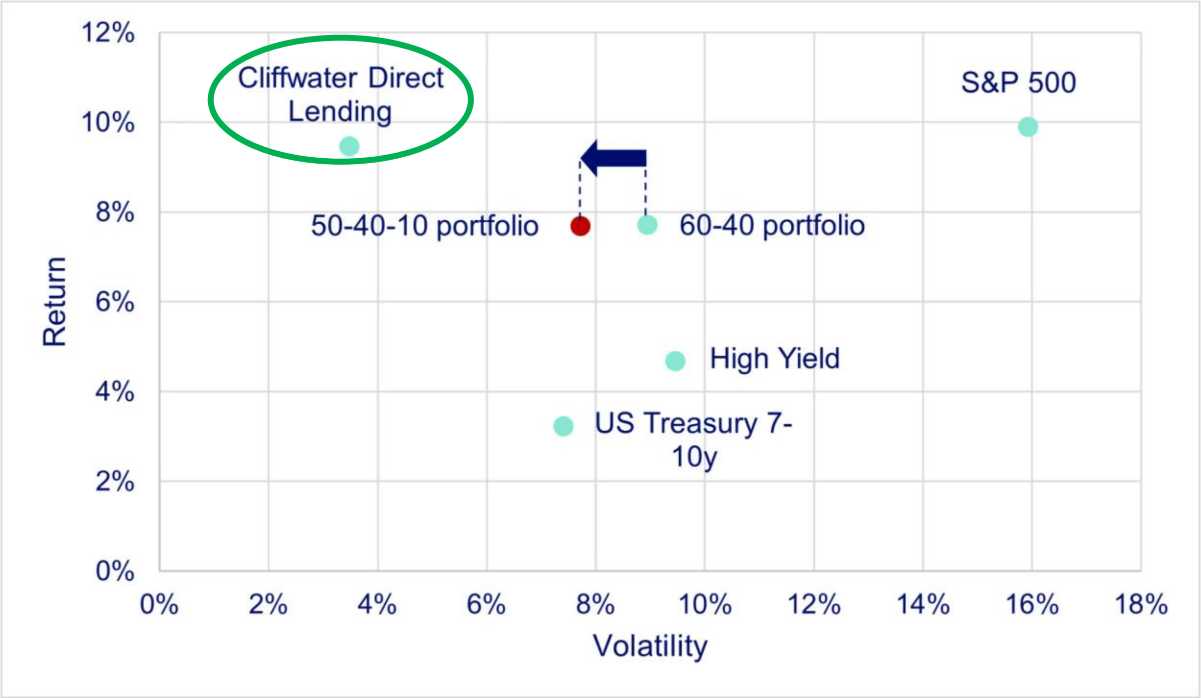
Why We Like Private Debt Over Listed Debt

Direct Lending Returns Compared to Public Markets



Source: S&P 500 Equity index; Markit iBoxx USD Liquid High Yield Index; Cliffwater Direct Lending Index, as of 31.12.2023.

Direct Lending Risk & Returns Compared to Public Markets

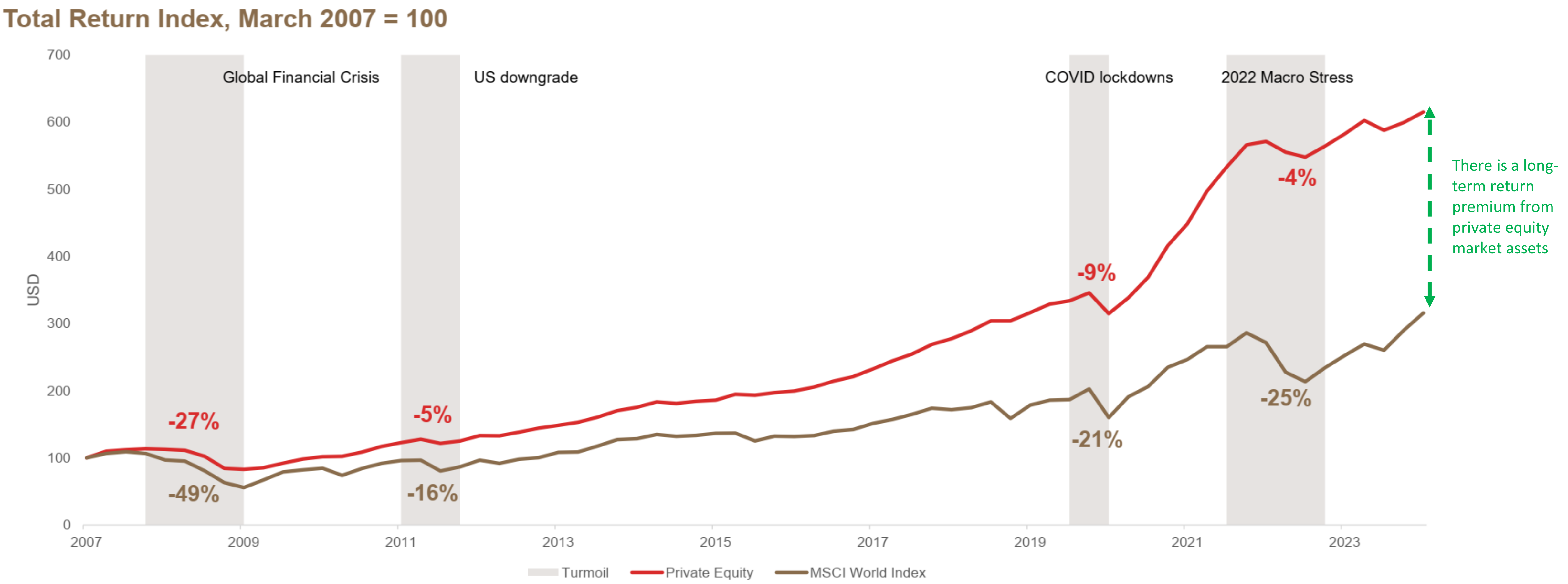


Source: Bloomberg, as of March 2024; Cliffwater Direct Lending Index, as of December 2023.

Private lending (debt) strategies are yielding +9% pa and provide equity-like returns with less volatility and the protection of being senior secured. These absolute returns are compelling and the risk-adjusted returns are even more compelling.

Our portfolios have a high weight to private debt for increased yield and strong risk-adjusted returns.

Why We Like Private Equity Over Listed Equity



For illustrative purposes only. Figures as of 31 March 2024. Drawdowns correspond to quarter end index values. **1**) Private Equity returns represented by the Bloomberg PE Buyout Index (PEBUY) through 31 Mar 2024. MSCI World total return in USD. Source: Partners Group (2024).

Our portfolios have a significant weight to private equity for strong long-term risk adjusted returns.

MPW Concluding Summary

MPW Outlook: Recession risk is real and markets are not cheap, so the downside risk outweighs the upside.

Soft Landing Scenario: *This is the consensus view and markets are pricing this outcome, believing interest rate cuts will save the day.*

- Current market valuations may not leave much room for further upside.
- **Probability: Already reflected by markets.**

Recession Scenario: *Inflation is still sticky and "higher for longer" interest rates will take their toll on businesses and consumers.*

- A recessionary environment means risk assets fall much further from here.
- **Probability: Not reflected by markets.**

Even if we avoid a recession, it might feel like one and market valuations will need to adjust to this reality.

Portfolio Implications:

- Be overweight alternative assets and private market strategies.
- Be patient, better opportunities should arise in listed markets.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