WILSONS

Stay Positioned for Global Reflation

Our second quarter asset allocation strategy.

29 March 2021

Issued by Wilsons Advisory and Stockbroking Limited (Wilsons) ABN 68 010 529 665 - Australian Financial Services Licence No 238375, a participant of ASX Group and should be read in conjunction with the disclosures and disclaimer in this report.

Q2 Asset Allocation Strategy

We remain moderately overweight equities (with a tilt toward cyclical value), and significantly underweight core fixed interest.

Given the significant global economic and profit recovery still ahead of us, we continue to see good prospects for equities over the coming year.

We retain caution toward core fixed interest as we still see upside to bond yields in the US and Australia over the coming year, albeit the pace of the sell-off should slow.

We remain overweight alternatives for 3 reasons:

1. Our caution toward relying on core fixed interest as a portfolio diversifier
2. The elevated level of equity valuations, albeit equities do not look expensive relative to the prevailing interest rate structure
3. The existence of attractive risk-adjusted return potential in the alternatives universe

Will Bonds End the Equity Bull Market?

On hopes of a post-pandemic world, a strong surge in equities through late 2020 and early this year has given way to range-bound performance in recent weeks. A surge in US bond yields beginning in February has weighed on equities in recent weeks, particularly the high-flying "long duration growth stocks" prevalent in the US tech sector. Concerns around the taxation implications of the burgeoning US budget deficit have also bubbled up recently.

Equities have historically been able to cope with higher bond yields. Yet the recent pace of the rise alongside elevated valuations in some parts of the equity market has caused some selective retracement.

"Cyclical Value" has outperformed growth over the past 5 months (since successful stage 3 vaccine trials were made public), and we believe value will retain market leadership over the next 6 to 12 months at least as global growth recovers.

We expect there is likely to be more volatility in the near-term, but believe the global growth revival will ultimately trump the rise in interest rates over the coming year, allowing equities to push higher.

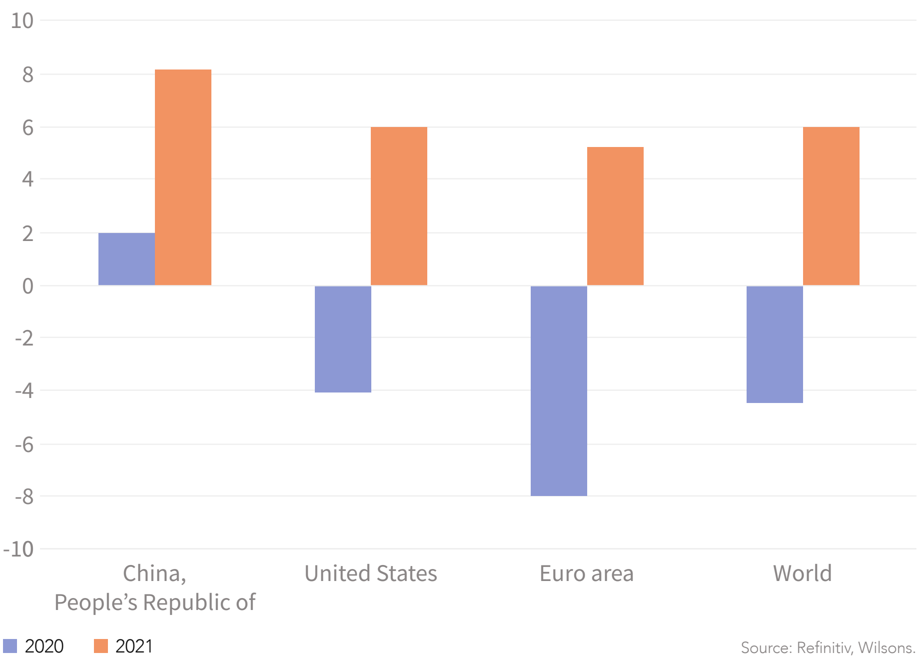
Supporting this view is our expectation that the pace of the rise in bond yields will moderate. We see a 2% US 10 year bond yield by year-end as a plausible central case target. Evidence of a global growth revival (and earnings growth recovery) should also continue to build through the year.

The Global Revival – Improving but Still a Stop-Start Process

The Global economic backdrop remains mixed as the global pandemic continues to extract a toll. However, we expect the global economy to build momentum over the balance of the year as the global vaccine rollout gathers pace.

The US is faring better than continental Europe in the pace of the vaccine rollout. At the same time, the huge incremental US$1.9 trillion stimulus package recently announced is also buoying sentiment toward the US growth outlook.

Exhibit 1: Global growth is poised to rebound strongly in 2021



Source: Refinitiv, Wilsons.

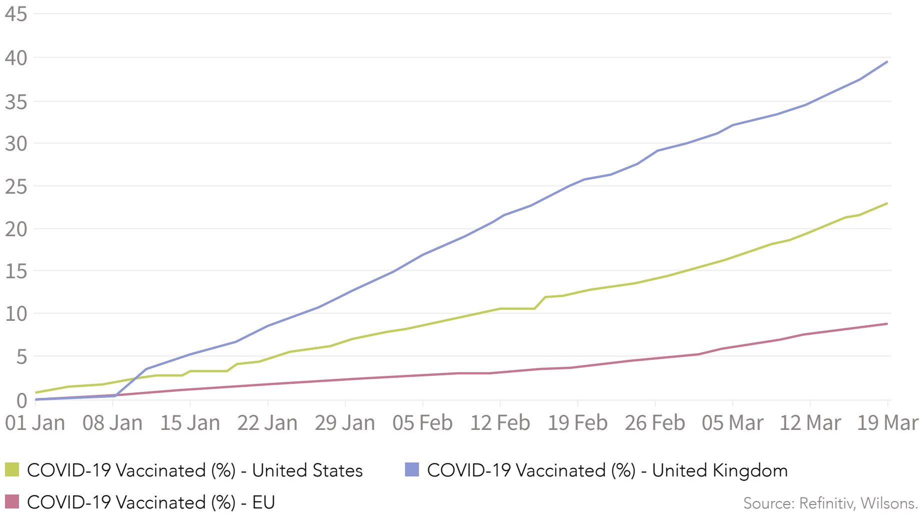
Key Asset Allocation Views

Asset Class	Tactical Tilt	Movement	Wilsons View
Cash	Underweight -1%	No change	Low weighting reflects near zero interest rate environment and relatively positive 6-12 month view on risk assets.
Fixed income (Domestic & Global)	Underweight -7%	Decreased	We retain a significant underweight in fixed interest due to very low yields and our view of a developing global recovery over the coming year. Absolute return fixed interest strategies not reliant on duration are preferred over traditional fixed interest strategies. We have reduced exposure to CPI linked bonds due to real rate concerns
Equities - Domestic	Overweight +2%	No change	We remain moderately overweight Australia. Economic performance continues to beat expectations with Feb reporting season reflecting this. Australia is outperfoming the rest of world in terms of virus control but should still participate in a global recovery rally so we think the risk return trade-off for the Australian equity market is still appealing.
Equities - International	Oveweight +2%	Increased	We edge up our global equities (UK) due to the prosect of a significant (vaccine-led) economic recovery which should unfold this year. We retain our 40% hedge back to the A$ rally as we still believe the A$ has medium-term upside, particularly against the US$. We continue to overweight emerging markets.
Alternatives	Overweight +4	No change	We retain our overweight given above average economic and policy uncertainty, and unattractive valuations in govt. bonds. A range of growth and defensive alternative strategies appeal i.e. private equity, infrastructure, long short global hedge funds and private credit. Gold still appeals as a long-term portfolio hedge but could be cyclically vulnerable to a rise in global real interest rates.

* Our tactical tilt represents our view over the next 6-12 months though active tilts could be held for shorter or longer periods depending on both asset class performance and fundamental developments.

Alongside the US, the UK appears to have the most scope for near-term "re-opening momentum" as the vaccination program is more advanced. The Eurozone and some key emerging markets (EM) countries (India and Brazil) are lagging, so a truly synchronised global growth scenario has been pushed into the second half of this year. We expect vaccination programs to gain traction across much of the world by the end of the year. While country-specific progress will be staggered, a progressively improving global economic and earnings backdrop gives us confidence that equities should ultimately push higher over the coming year.

Exhibit 2: The European vaccination program has lagged the UK and the US (2021)



Source: Refinitiv, Wilsons.

Steady Solid Growth from China

China led the way on re-opening in 2020. Investors are watching the China monetary policy/credit growth cycle carefully, given its historical importance to economic momentum in China (and increasingly the world). The China credit cycle has passed its maximum point of thrust, although we expect solid growth in China moving forward.

We expect China's real GDP growth to record a very healthy 8.% in 2021 after "only" 2% growth in 2020. We see the government's recently announced 6% growth target as deliberately conservative and not likely to result in significant policy tightening. Exports and stronger domestic consumption will lead the rebound.

Exhibit 3: China's credit pulse is likely peaking but should fade more gradually than previous cycles

Source: Refinitiv, Wilsons.

We expect the Chinese government to target total credit growth that is "broadly in line with nominal GDP growth", allowing China's macro leverage to stabilise this year following a sharp rise in 2020. Solid but contained growth in China should be a supportive backdrop for EM equities, all things equal.

Australia has Outperformed but Still has Ample Scope to Improve

The Australian economy experienced a less significant economic contraction compared to most other developed economies and has recovered quicker. The local economy is still well placed to grow at an above-trend pace this year, albeit the rebound may not be as spectacular as in some of the deeply depressed economies overseas.

The high domestic savings ratio provides plenty of consumer firepower. This savings drawdown and targeted incremental support measures will offset the March 31 expiry of emergency support measures such as the JobSeeker supplement and JobKeeper. We expect a rebound in services spending over the coming year to drive strong growth in total consumer spending. This services recovery will assist the labour market repair as we move through the year.

The rolling off of JobKeeper may cause a blip in the unemployment cycle, but the release of excess household savings into the services sector should push unemployment lower through the second half of 2021 and 2022. With monetary policy so accommodative, overheating is a long-term risk. Still, it is likely to be felt first in asset markets (particularly housing) rather than in the real economy, given substantial labour market slack.

The RBA has a difficult balancing act, but its mindset (like the US fed) has clearly shifted to pursuing full employment by facilitating a sustained period of strong growth. A strongly growing economy and a near-zero cash rate will likely be Australia's unusual macro backdrop for some time, which should support growth assets.

US$ Strength (A$ Weakness) likely Temporary

Relatively better economic growth from a faster start to the vaccination campaign in the US and accommodative fiscal policy has led to some renewed strength in the US$, particularly against the Euro but also against the A$. This near-term growth advantage should support the US$ over the next few months. Nevertheless, we expect the Greenback to decline modestly over a 6-12-month horizon.

The A$ is up 20% over the past 12 months, although it has eased back in recent weeks in line with the rebound in the US$ against most major currencies. Since announcing quantitative easing (QE), the A$ has actually risen from 72c to 77c (with a brief 80c peak), though the counterfactual is where the A$ might be in the absence of QE given the strength of commodity prices. The RBA commented recently that it would like the A$ "a little lower".

Our model suggests the A$ is moderately undervalued based on current commodity prices and interest rate differentials. We still think the A$ has at least moderate upside over the next 6-12 months. We retain an 80c year-end target with an upside risk skew due to our expectation that global growth ultimately surprises on the upside and the sheer weight of the US twin deficits weighs on the US$. Renewed upside pressure on the A$ will likely encourage the RBA to extend QE once again and keep talking a dovish story regarding cash rate guidance.

Path of the US Bond Market the Key to Equities

For investors, the key debate at present centres around how much upside remains in the long bond yield and how equities, particularly the US growth/tech sector, will react.

Intrinsic to this debate is the question of whether we are going to see a significant upswing in inflation given the mountain of stimulus being put to work, particularly in the US.

Exhibit 4: The A$ rise has paused but we see medium term upside

Source: Refinitiv, Wilsons.

Markets may have to negotiate a tricky Q2 which will likely be marked by a temporary spike in inflation. This will be due mostly to base effects from deflation in Q2 2020 but also some COVID19-related supply chain pressure (e.g. shipping costs) and the large year-on-year (YoY) lift in the oil price. While the Q2 consumer price index (CPI) spike is a near-term risk that markets will have to negotiate, inflation should drift lower again in H2, which will likely comfort both stocks and bond markets.

The monetary policy backdrop should also continue to cap bond yields and support stocks. The Fed rate hike cycle is not likely to start until CY23 at the earliest. Markets are now pricing a CY23 cash rate lift-off, although the Fed is still guiding to no hike until CY24. To the extent that policy tightening appears still 2 years away at least, we believe the monetary policy backdrop remains a key support for stocks.

This benign monetary policy backdrop also suggests bond yields can grind higher over the coming 1-2 years without the sell-off turning disorderly. Stocks have historically shown they can absorb a gradual move higher in bond yields, particularly as the growth backstop brightens.

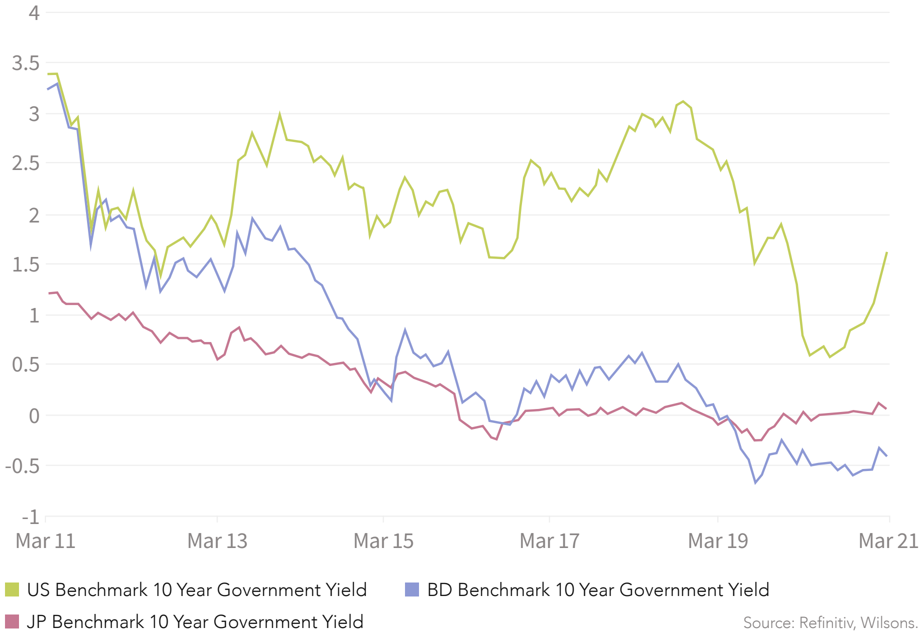
Exhibit 5: US bond yelds have lifted but remain very low

Source: Refinitiv, Wilsons.

The relative appeal of US and Australian bond yields (1.6% to 1.7%) versus the zero to negative yields in European and Japanese bond markets is another reason to expect any further rise from here as more gradual. Any further sell-off in bond yields over the coming year is likely to be constrained by a limited lift in inflation beyond the well-flagged Q2 blip.

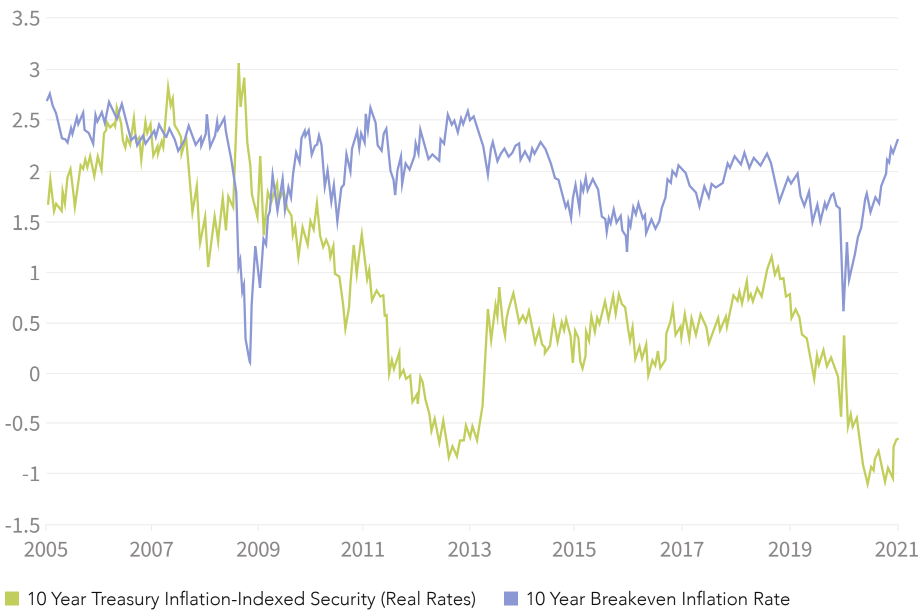
There is a risk that the next leg in the bond yield sell-off is driven by further increases in real rates even if inflation expectations remain contained. Inflation-linked bonds have performed well over the last year as inflation expectations have risen after collapsing in the eye of the pandemic last March. Inflation-linked bonds have subsequently weakened over the past month as the uptrend in bond yields has become more of a real rate story. With global growth set to strengthen, we do see some incremental risk to real rates.

Exhibit 6: US bond yields are currently attractive in a global context



Source: Refinitiv, Wilsons.

Exhibit 7: The rise in bond yields has mostly been driven by rising inflation expectations but real rates are now rising



Source: Refinitiv, Wilsons.

If Bond Markets Sell-Off Hard the Fed Will Act

We, of course, can't categorically rule out a sharp 1994 style adjustment in bond yields but see this as a risk case and not the central case. Apart from our view of a contained inflation outlook over the coming year, yields rarely rise significantly when the Fed is on hold. This is in contrast to 1994 when the Fed and the RBA were hiking quite quickly based on a view that inflation was a concern.

As well as being resolute in flagging they are not even contemplating rate hikes, the Fed would also likely step its QE program if the bond yield rise became disorderly by increasing the pace of long bond purchases. Fed Chairman, Jerome Powell recently noted that most of the rise in bond yields has so far reflected economic optimism and thus not a trigger for additional action. The Fed is focused on a range of financial indicators to assess overall "financial conditions" to signal the need for a step up in policy action. The key for additional Fed action would not just be the size of any further bond yield increases but also signs of stress in credit markets (well behaved at present) alongside significant weakness in the equity market and unwanted additional strength in the US$.

Ultimately, the Fed has the scope to significantly dial up its rhetoric (and action), stressing its ability to buy bonds in unlimited quantities in order to support the economy.

Equities Have Plenty of Earnings Recovery Ahead

We expect cyclical recovery to continue to be the dominant theme for equities over the next 6-12 months. The key bull case for equities is that we are at the early stages of a significant global economic recovery with strong earnings growth in prospect for CY21 and CY22 at least.

Valuations have likely peaked in terms of price to earnings (PE) multiples, but earnings per share (EPS) growth should be well above average in both CY21 and CY22. The global earnings revision cycle is already seeing broad-based upgrades and should remain positive for some time.

Exhibit 8: Tight US high yield credit spreads indicate minimal corporate stress

Source: Refinitiv, Wilsons.

Exhibit 9: Global PE multiples appear to have peaked

Source: Refinitiv, Wilsons.

Exhibit 10: Global Equities - consensus valution and earning growth outlook

	PE (12 Mth expected EPS)	CY20 EPS growth	CY21 EPS growth	CY22 EPS growth
World	20.4	-12	29	14
US	22.1	-9	24	14
Europe	17.0	-26	31	15
UK	14.2	-41	52	14
GEM	15.2	-7	36	16
Japan	17.8	-29	18	18
Australia	18.4	-20	22	10

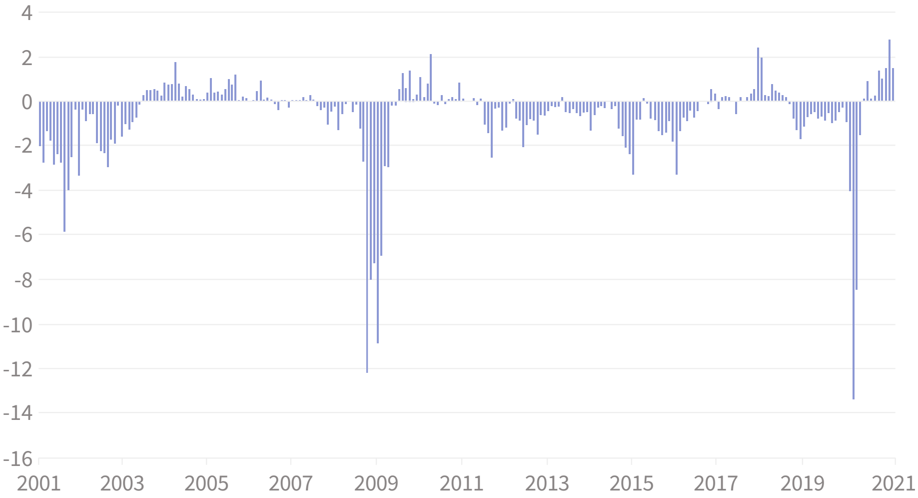
Source: Refinitiv.

This combination of earnings growth and upward earnings revisions will allow a further decline in PEs but still allow reasonable (average to moderately above average) capital gains.

A further backup in bond yields could cause stocks to retreat in the near-term. However, as we have discussed history suggests that as long as yields remain low in absolute terms, equities will recover fairly quickly, as they are now. While sharply rising yields can produce a temporary stock market correction, stocks have ample historical precedent for rising with increasing rates as long as the move in yields is contained and the Fed is not in a hawkish mood.

A stable or more gradual uplift in bond yields should allow equities to enjoy the benefits of synchronised growth as we move through the back half of 2021. A stronger and broader earnings growth cycle should favour cyclicals/value over growth, so we continue our underweight to the US on a 6-12 month view, with EM and UK being our favourite rest of world plays. While the US economy looks set to do well near-term, the US market is dominated by long-duration high PE growth stocks; so this may continue to weigh on US market performance. The UK looks more attractive as the economy also has cyclical upside, but it is arguably the deepest value play of all markets, so we have edged up our overweight.

Exhibit 11: Global earnings estimates have been in upgrade mode for 7 months



MSCI World Index - 12 Month Forward 1 Month %Change

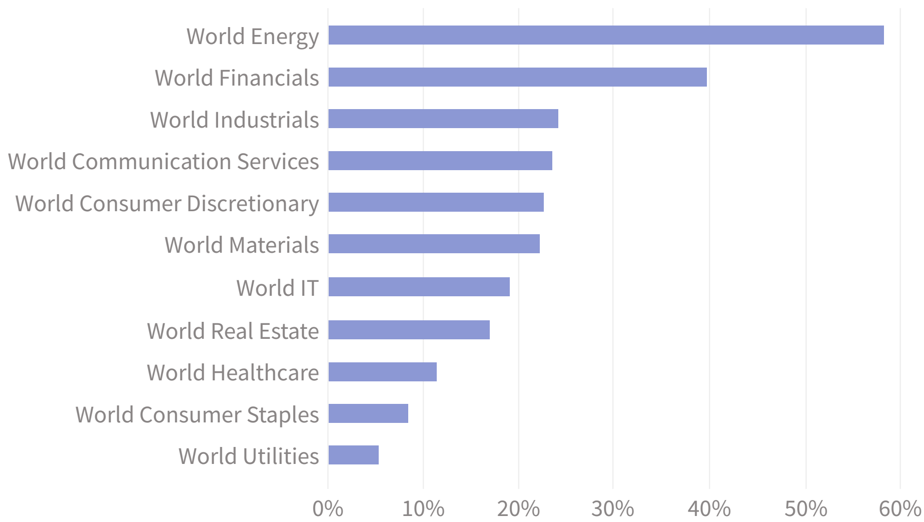
Source: Refinitiv, Wilsons.

Exhibit 12: After a long period in the wilderness value stocks have outperformed growth stocks since early November

MSCI World Growth Versus Value

Source: Refinitiv, Wilsons.

Exhibit 13: Since the early November vaccination inflection value cyclicals have led the rally



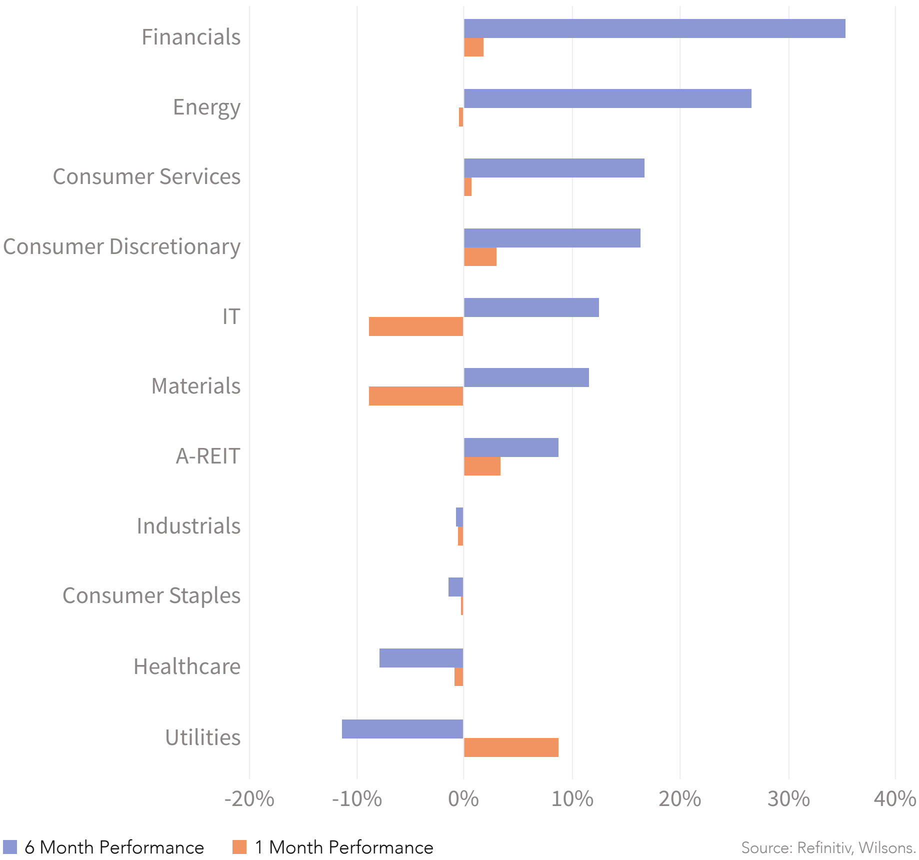
Source: Refinitiv, Wilsons.

EM Pullback likely Temporary

Emerging markets have performed very strongly on a 6 and 12-month timeframe buoyed by China's first in, first out economic recovery profile. EMs have retreated over the last month or so due to a combination of the restrengthening of the US$, the retracement in the China tech sector (a large part of GEM these days) and some concerns around China's policy tightening.

Some incremental weakness in EM is possible on the back of some further re-strengthening in the US$, though we still like EM on a 6-12 month view. We expect EM will revive as the US$ counter-end rally runs its course. Apart from the direction of the US$, building evidence of synchronised global growth should support EM outperformance. EM remains relatively good value with the appeal of superior cyclical and structural growth (see Exhibit 10).

Exhibit 14: The Australian tech and materials sectors have been weak recently



Source: Refinitiv, Wilsons.

Australian Equities still look well placed

The Australian market has outperformed since the big (vaccine-led) cyclical surge in global equities in early November. Strength in the A$ has added to relative performance over this period. With the economy doing better than expected, the heavyweight banks sector (we remain overweight) has been the star performer.

More recently, the market has drifted sideways, and the A$ has edged lower. The retreat in the iron ore price from very high levels has weighed on the mining sector recently. In addition, Australia's IT sector, while relatively small, has pulled back faster than the global IT sector, in part due to its very high PE nature.

With the economy doing well, we continue to moderately overweight Australia with more upside in the bank sector expected. There is potential for further weakness in the iron ore price in the near-term, but better global growth and ongoing solid demand from China should put an eventual floor under iron ore and buoy the broader commodity complex. Renewed strength in the A$ as global growth gathers pace should also help Australia's relative performance.

Australia's market PE multiple (12-month expected earnings) has edged back from a high of 20x in November to 18.3x, currently helped by ongoing earnings upgrades. We believe multiples will continue to edge lower, but continued earnings growth and more earnings upgrades alongside rebounding dividends should deliver a low double-digit capital gain over the coming year.

Exhibit 15: The Australian market PE multiple appears to have peaked

Source: Refinitiv, Wilsons.

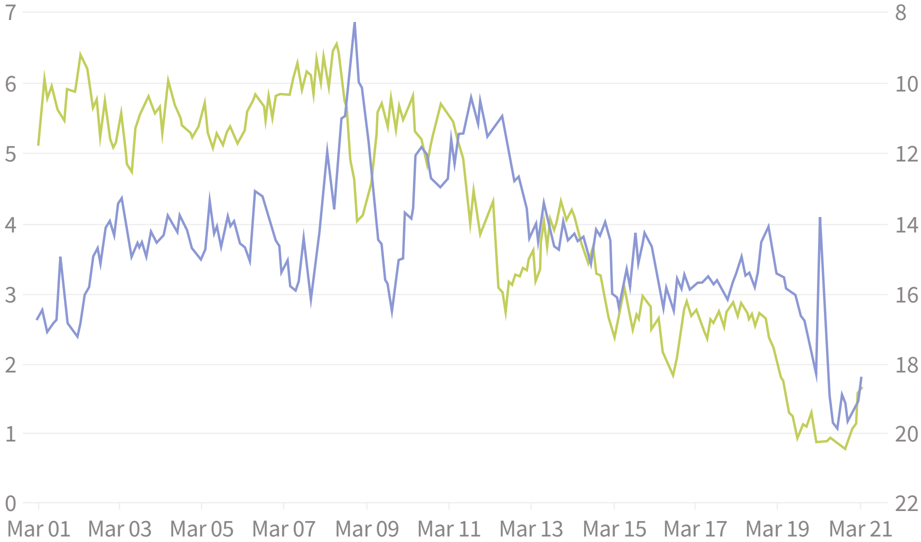
The opportunities in alternatives

We continue to overweight alternatives. We believe a significant allocation to a mix of growth and defensive alternatives appeals due to the very low level of interest rates, which diminishes the case for fixed income as both a portfolio diversifier and as a source of income. We see good risk-adjusted return opportunities in growth alternatives such as private equity, and real assets such as infrastructure. We also see the opportunity to earn attractive income streams in the order of 5-6% in defensive alternatives such as private credit.

We also retain some modest exposure to gold as a tail risk, a hedge against unexpectantly high inflation and also for the potential for a renewed decline in the US$. Gold has been under pressure lately due to a combination of the US$ rebound (which we think is temporary), rising real rates (which may well continue) and the rise in the popularity of Bitcoin as a store of value. We remain sceptical.

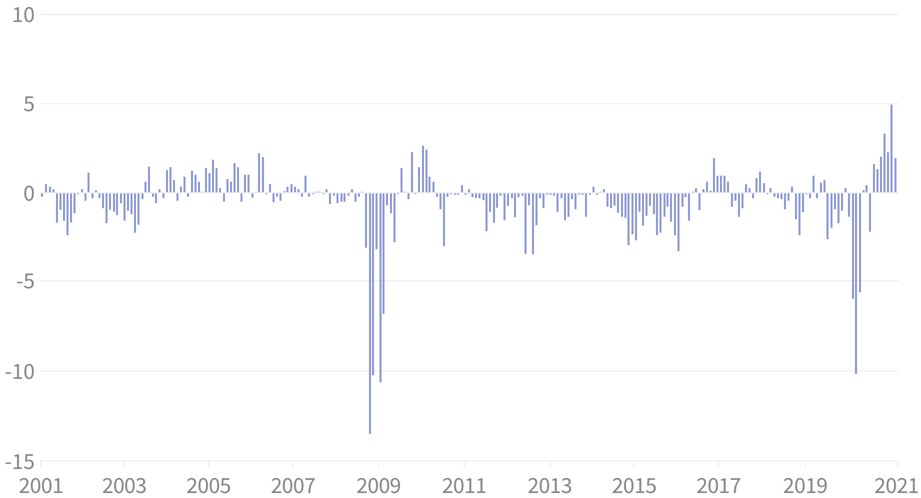
Read more on Bubble Trouble.

Exhibit 16: Australian PE multiples have broadly followed the rally in bond yields



Source: Refinitiv, Wilsons.

Exhibit 17: Australian earnings estimates have been in upgrade mode since mid 2020



Source: Refinitiv, Wilsons.

Exhibit 18: Wilsons expected asset class returns

	Long-term Expected Returns	12 Month Expected Returns
Domestic Equity	8.0%	9-13%
Int'l Equity	8.0%	8-11%
Fixed Interest	1.7%	-2 - 0%
Cash	1.5%	0%
Alternatives	6.5%	6.5-9%

Long term expected returns are 5 to 10 year passive expected returns based on both historical performance and current pricing/ yields. 12 month expected (passive) returns are shown as a range due to the inherent volatility of financial market returns.

Performance and risk projections are subject to market influences and contingent upon matters outside the control of Wilsons Advisory and Stockbroking Limited and therefore projections may not be an accurate indicator of future performance and/or risk.

Source: Wilsons.

Asset Allocation Summary

Asset Class	High Growth			Growth			Balanced			Moderate			Defensive		
	TAA	B'mark	Tilt	TAA	B'mark	Tilt	TAA	B'mark	Tilt	TAA	B'mark	Tilt	TAA	B'mark	Tilt
Cash	0%	2%	-2%	0%	2%	-2%	4%	5%	-1%	9%	10%	-1%	18%	20%	-2%
Fixed Interest	1%	5%	-4%	9%	15%	-6%	18%	25%	-7%	28%	35%	-7%	42%	50%	-8%
Equities - Domestic	44%	42%	2%	40%	38%	2%	33%	31%	2%	27%	25%	2%	15%	13%	2%
Equities - International	43%	41%	2%	39%	37%	2%	33%	31%	2%	26%	24%	2%	15%	13%	2%
• United States	23%	24%	-1%	21%	22%	-1%	17%	18%	-1%	13%	14%	-1%	7%	8%	-1%
• Europe/UK	13%	11%	2%	11%	10%	2%	10%	9%	2%	9%	7%	2%	4%	3%	2%
• Emerging Markets	6%	2%	4%	6%	2%	4%	5%	1%	4%	4%	1%	3%	3%	1%	2%
• Japan	1%	4%	-3%	0%	3%	-3%	0%	3%	-3%	0%	2%	-2%	0%	1%	-1%
Equities Total	87%	83%	4%	79%	75%	4%	66%	62%	4%	53%	49%	4%	30%	26%	4%
Alternatives	12%	10%	2%	12%	8%	4%	12%	8%	4%	10%	6%	4%	10%	4%	6%
Growth Assets	99%	93%	6%	91%	83%	8%	78%	70%	8%	63%	55%	8%	40%	30%	10%
Defensive Assets	1%	7%	-6%	9%	17%	-8%	22%	30%	-8%	37%	45%	-8%	60%	70%	-10%
Cash + Fixed + Equities + Alternatives	100%	100%		100%	100%		100%	100%		100%	100%		100%	100%	

Commentary references our Balanced Portfolio.

Disclaimer and Disclosures

Recommendation structure and other definitions

Definitions at www.wilsonsadvisory.com.au/disclosures.

Disclaimer

This document has been prepared by Wilsons Advisory and Stockbroking Limited (AFSL 238375, ABN 68 010 529 665) ("Wilsons") and its authors without consultation with any third parties, nor is Wilsons authorised to provide any information or make any representation or warranty on behalf of such parties. Any opinions contained in this document are subject to change and do not necessarily reflect the views of Wilsons. This document has not been prepared or reviewed by Wilsons' Research Department and does not constitute investment research. Wilsons makes no representation or warranty, express or implied, as to the accuracy or completeness of the information and opinions contained therein, and no reliance should be placed on this document in making any investment decision Any projections contained in this communication are estimates only. Such projections are subject to market influences and contingent upon matters outside the control of Wilsons and therefore may not be realised in the future. Past performance is not an indication of future performance.

In preparing the information in this document Wilsons did not take into consideration the investment objectives, financial situation or particular needs of any particular investor. Any advice contained in this document is general advice only. Before making any investment decision, you should consider your own investment needs and objectives and should seek financial advice. You should consider the Product Disclosure Statement or prospectus in deciding whether to acquire a product. The Product Disclosure Statement or Prospectus is available through your financial adviser.

Wilsons and Wilsons Corporate Finance Limited (ABN 65 057 547 323, AFSL 238 383) and their associates may have received and may continue to receive fees from any company or companies referred to in this document (the "Companies") in relation to corporate advisory, underwriting or other professional investment services. Please see relevant Wilsons disclosures at www.wilsonsadvisory.com.au/disclosures. In addition, the directors of Wilsons advise that at the date of this report they and their associates may have relevant interests in the securities of the Companies.

Wilsons contact

david.cassidy@wilsonsadvisory.com.au | +61 2 8247 3149

john.lockton@wilsonsadvisory.com.au | +61 2 8247 3118

rob.crookston@wilsonsadvisory.com.au | +61 2 8247 3101

www.wilsonsadvisory.com.au