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Global Outlook

In a Transition (back) to Normal.

Jason Todd, CFA
Head of Wealth Management Investment Strategy
Macquarie's Banking and Financial Services group

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Threats and **opportunities** are omnipresent

The future is not the past … But normal is not terrible.

1. The global (& Australian) economy is on a policy driven correction that takes it back closer to *“normal”*. We expect this to be a orderly transition. A deeper recession would require a shock or sustained credit tightening.

2. The adjustment (rates, inflation, growth, asset markets) is likely to be short & shallow versus other *“end of cycle”* recessionary periods. Demand is decelerating not destructing and supply side constraints have been largely alleviated.

3. Sticky (smouldering) inflation reduces CB policy flexibility but a rolling recession / solid consumer / strong labour market are solid offsets to tighter policy conditions from central banks and private sector credit providers .

4. Longer term, the *“path of least resistance”* for growth and market returns is **slower** or **lower** particularly if *“unaided”*.

5. There are always headwinds and challenges to deal with but on balance, the headwinds become stronger vis-à-vis the tailwinds of the past 3-4 decades …

The Good		The Bad		Result
Prompt policy response (willingness)	−	Slowbalisation (deglobalisation)	=	Slower economic growth
Excess capital (decades of easy money)		Demographics (ageing population)		Higher inflation / rates
Eroding inflation (cyclical deflation)		Productivity (labour / tax reform)		Higher volatility
Technology (AI, robotics)		Geopolitics (multi-polar world of blocs)		Lower asset returns
		Elevated debt levels (debt growth)		

Empowered investors require resilient portfolios.

6. Lower returns, higher volatility and greater correlations mean the future is much harder to predict … and like riding a bicycle the slower you go, the easier it is to fall off.

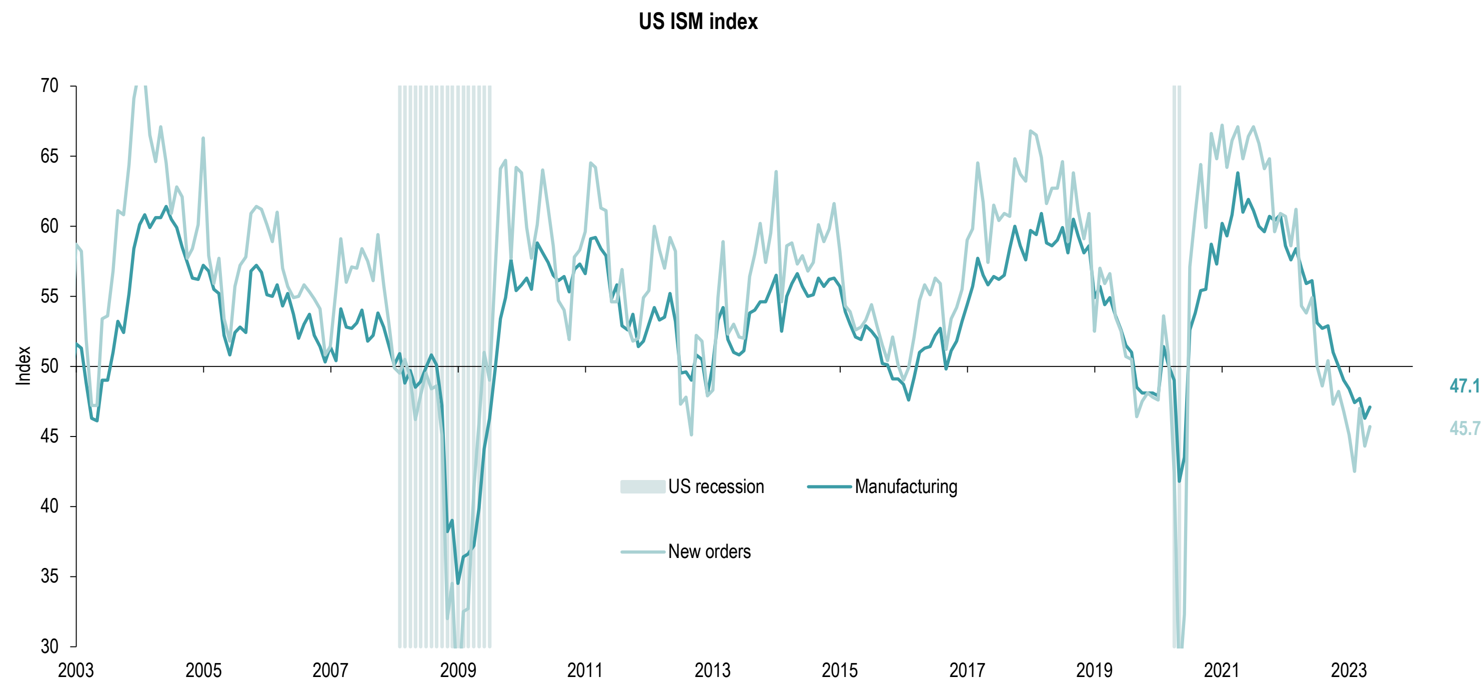
7. Investment markets enter a new regime driven by slower growth, higher inflation and rates. Empowered investors require:

   A. Increased “Diversification”
   B. Greater “Downside protection”
   C. Focus on “Structural growth” opportunities
   D. “Inflation hedging” more important
   E. “Illiquidity premium” required for adding to returns
   F. “Non traditional asset” exposure to achieve historic returns

Recession is coming but it should be short/shallow.

Growth should bottom around 3Q23 and begin rising into 2024

LEI's point towards an "Average" recession … a "Deep" recession would need sustained tight credit conditions

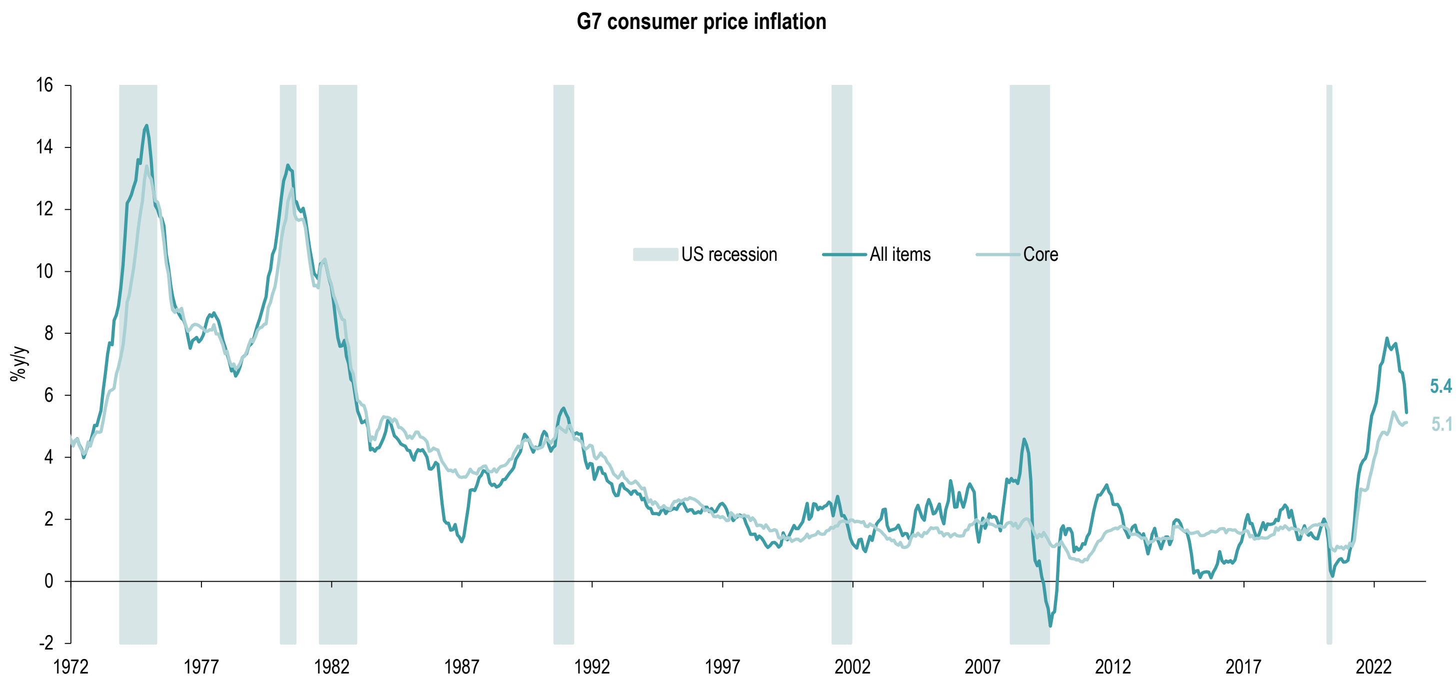


Source: Factset, MWM Research, May 2023

Headline inflation has/is peaking across the world.

Supply driven disruptions have normalized but core inflation is (still) too high

Higher inflation is not great … but it's a long way from terrible

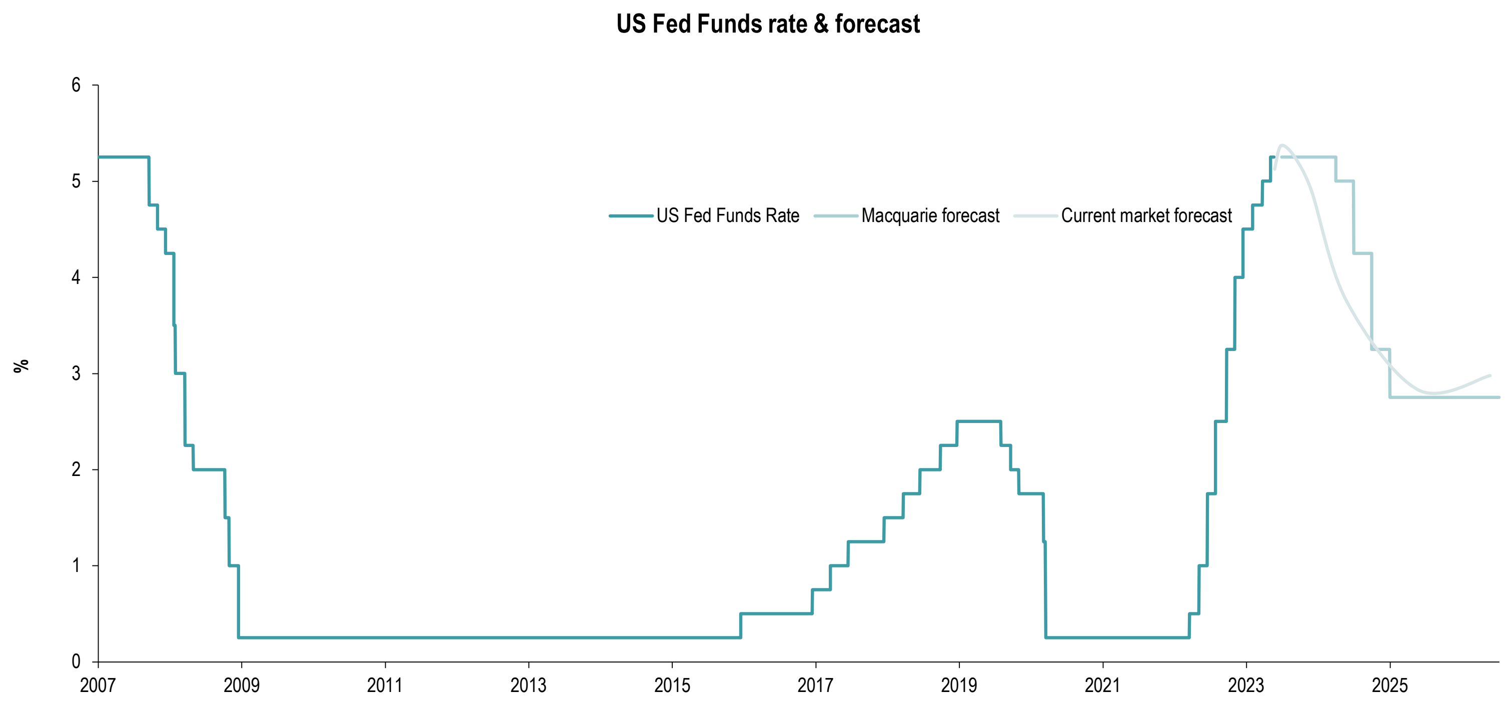


Source: Factset, MWM Research, May 2023

Slowing growth means policy rates are near/at peak.

Elevated inflation means 2023 rate cut expectations appear optimistic

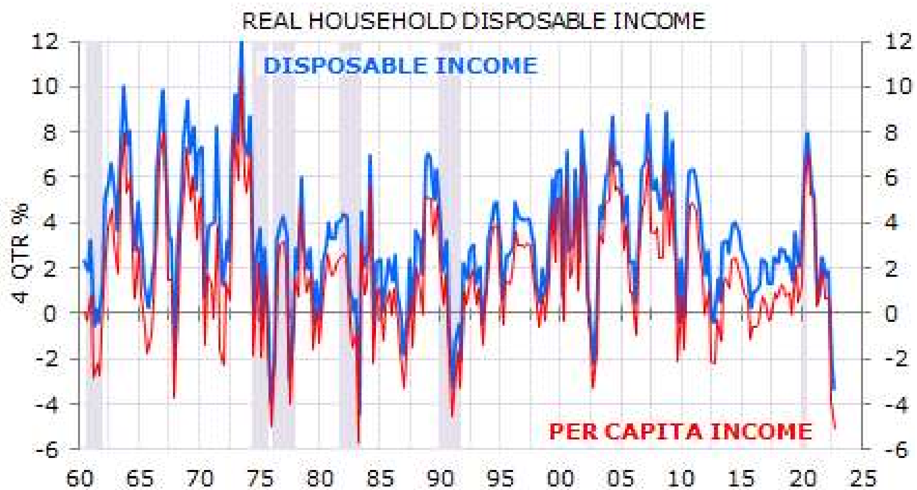
Central banks credibility requires inflation is brought back under control



Source: Bloomberg, Factset, Macquarie Macro Strategy, May 2023

Australia: On the precipice of a recession that's not necessary.

A rapid consumer slowdown is approaching



Source: ABS, Melbourne Institute, Minack Advisors, May 2023

Policy tightening is doing its job – albeit slowly

- Fastest policy tightening cycle since 1994 but the RBA has already done the hard work
  1. Real incomes falling at fastest ever rate
  2. Consumer sentiment has collapsed
  3. Inflation still too high

- But the economy has positive offsets
  1. Excess savings supporting spending (17% of GDP)
  2. Fixed mortgage (~40% during pandemic)
  3. Tight labour market (hording)
  4. Immigration is booming (bigger pie / smaller slice)
  5. No systemic cracks (housing or debt)

To sum … short term headwinds drive a return to “normal”.

1. The longer you operate outside “normal” the greater the build up of externalities (inflation) and the harder the adjustment back to “normal”.

2. The world can live with “stickier” inflation which prolongs the transition to a new normal but a policy mistake (overtightening) poses a bigger threat.

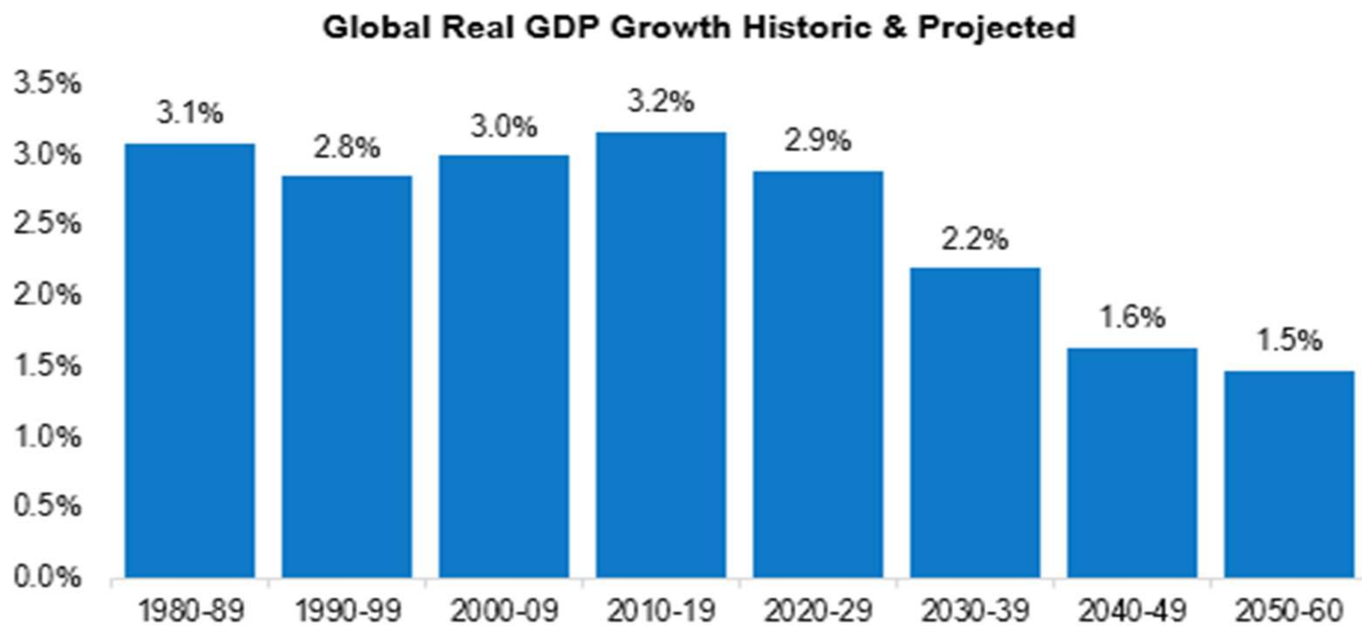
3. A lack of structural overhangs suggest economic scarring should be minimal and a recovery off recessionary conditions quick.

Source: World Bank, June 2023

A transition to lower growth / higher inflation is underway.

Prosperity and Growth drivers of recent decades are now in decline

Global Growth is set to halve out through 2050 …

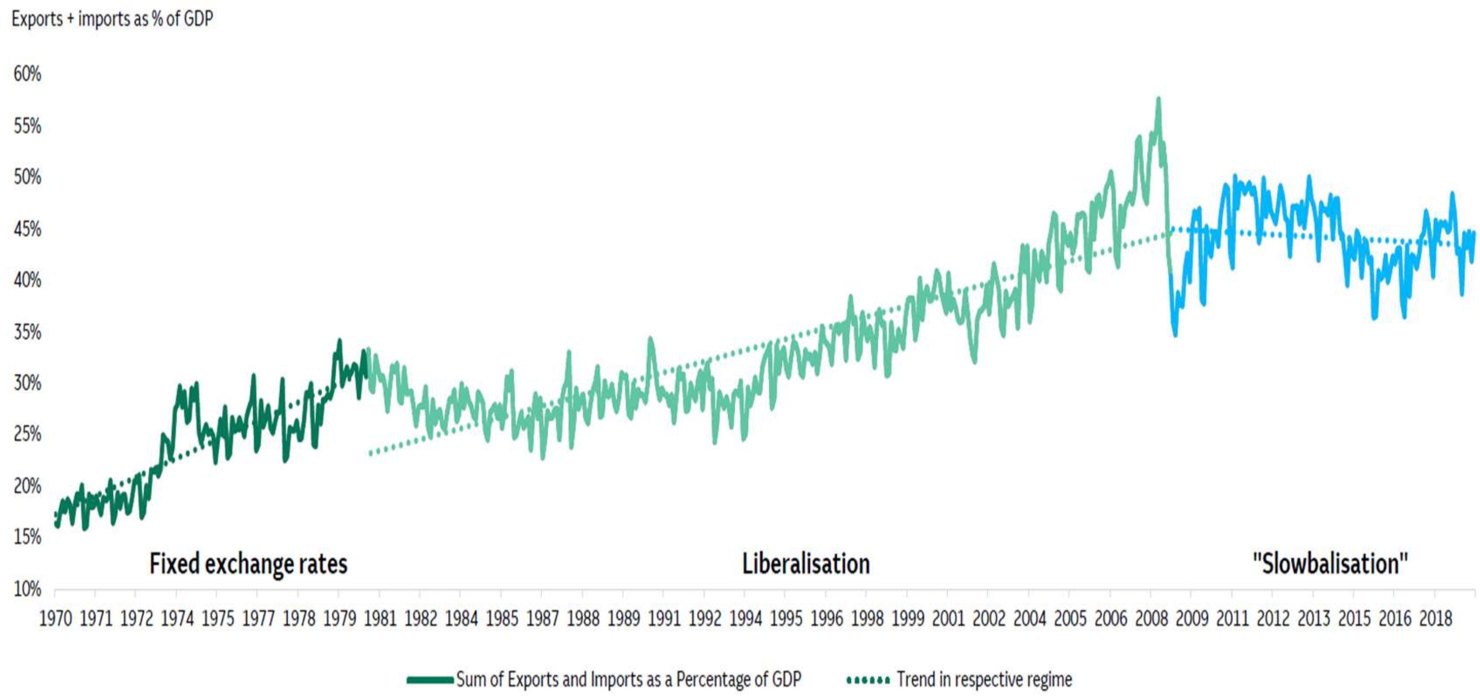


Source: OCED, World Bank, MWM Research, May 2023

Force 1: (De)globalization trend to accelerate.

Globalization transitions to "slowbalization"

Greater regional trade but less global trade as the world breaks into "blocs"

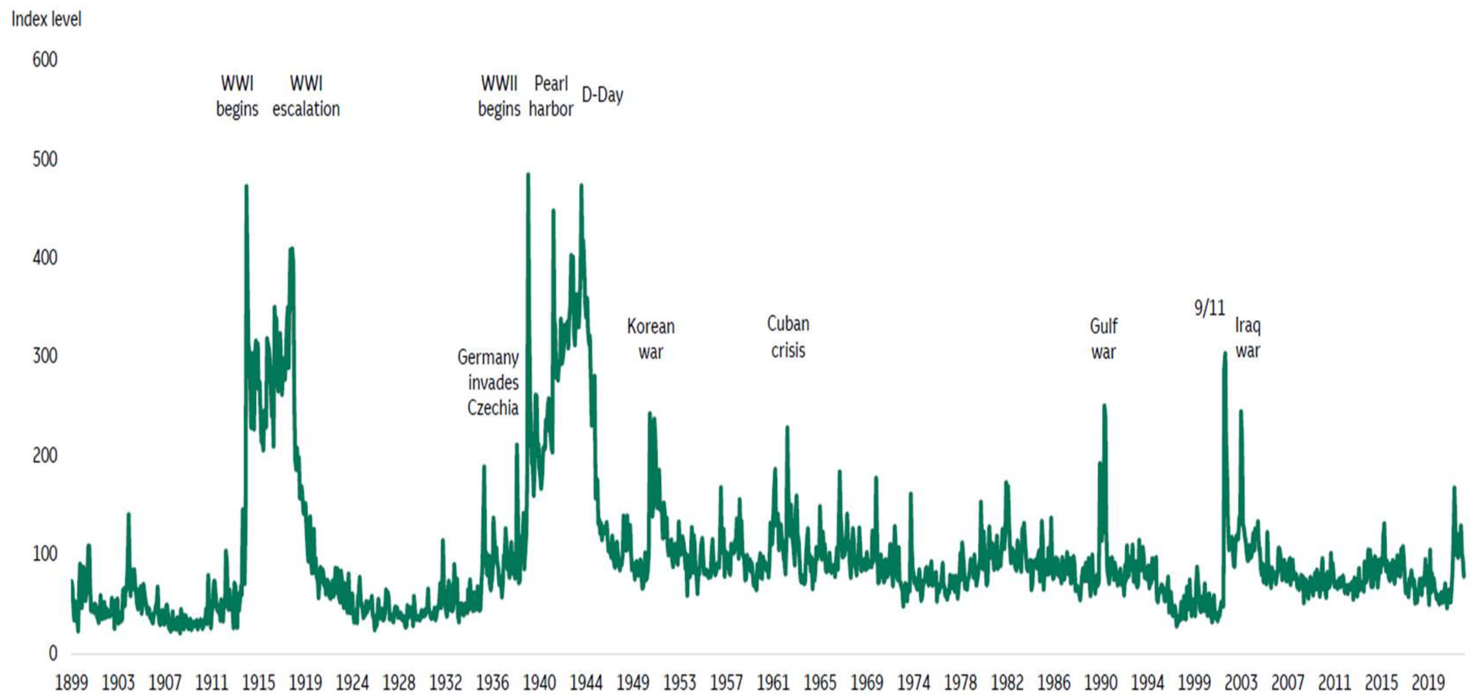


Source: Macrobond, MAM, April 2023

Force 2: Rising event risk (geopolitics).

Geopolitical risks raise economic and financial fragmentation costs

Reduced cross border capital flows, investment and rising borrowing costs to follow

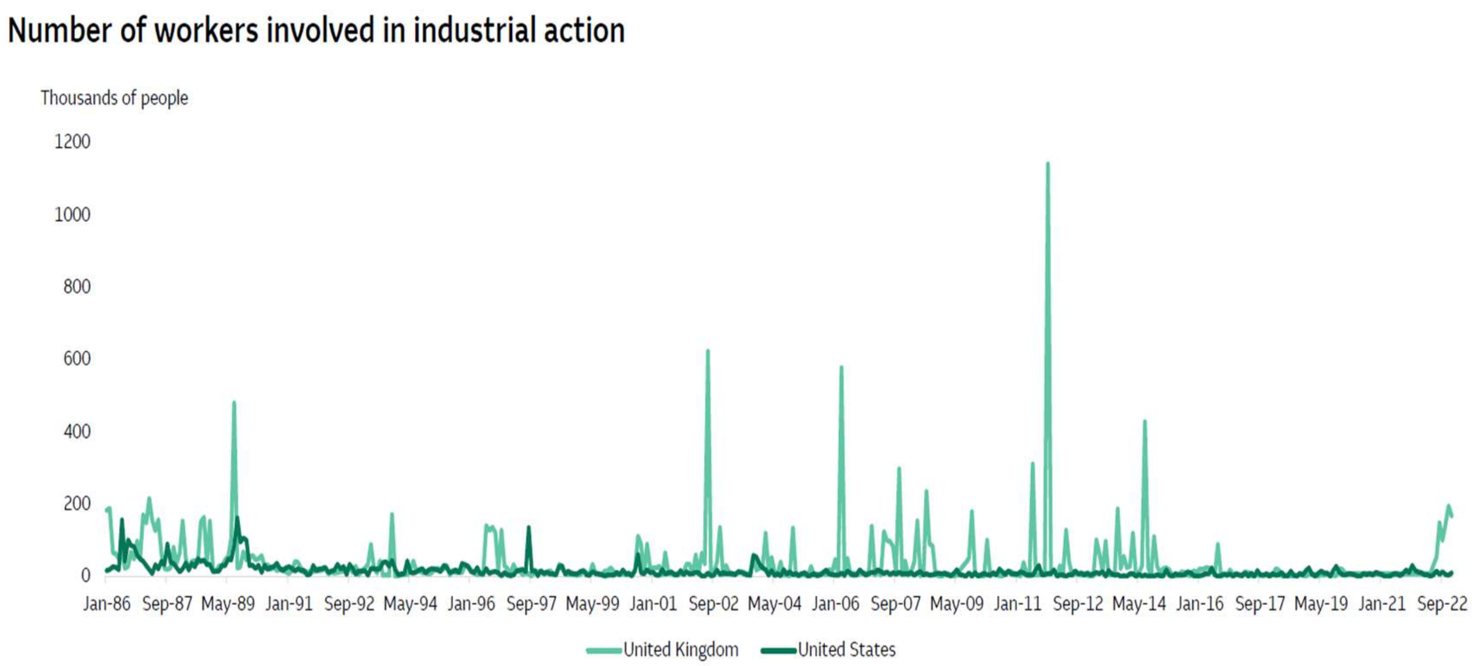


Source: Macrobond, MAM, April 2023

Force 3: Security is everything but it comes at a cost.

"Just in Time" is replaced by "Just in Case"

Securing supply chains, food, energy, data (onshoring)

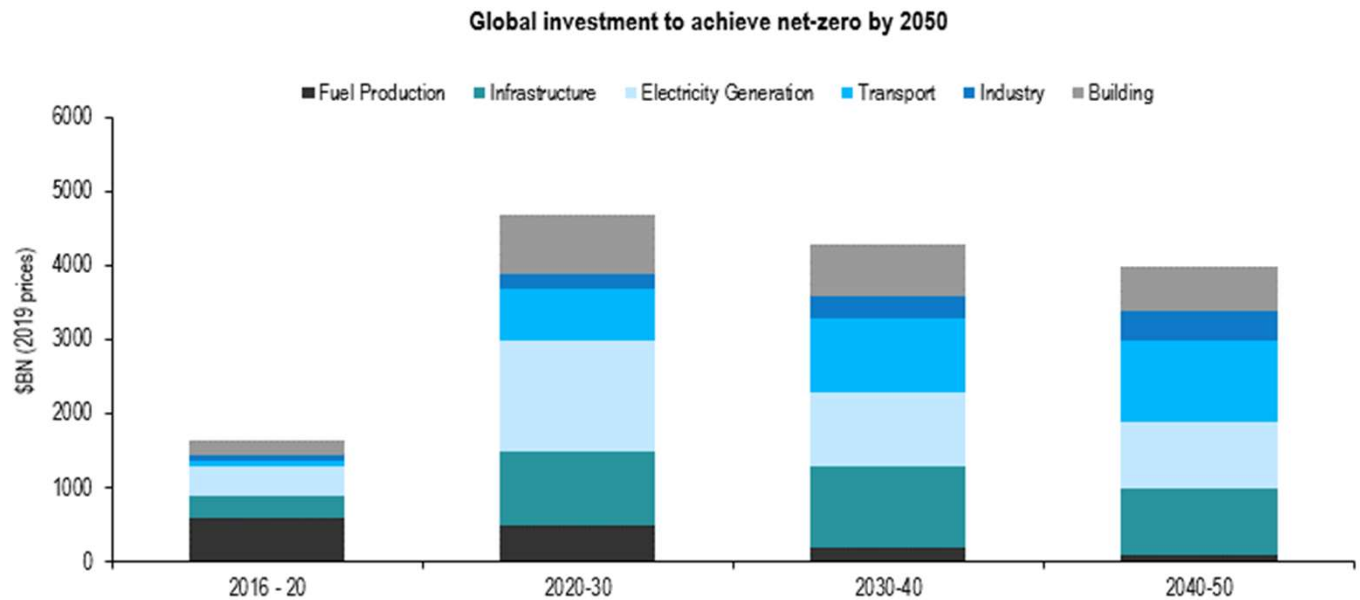


Source: Macrobond, MAM, April 2023

Force 4: The greening of the global economy.

Net-zero requires financial, operational, technological, behavioural and cultural support

The size of the required investment does not imply that everyone exceeds the cost of capital

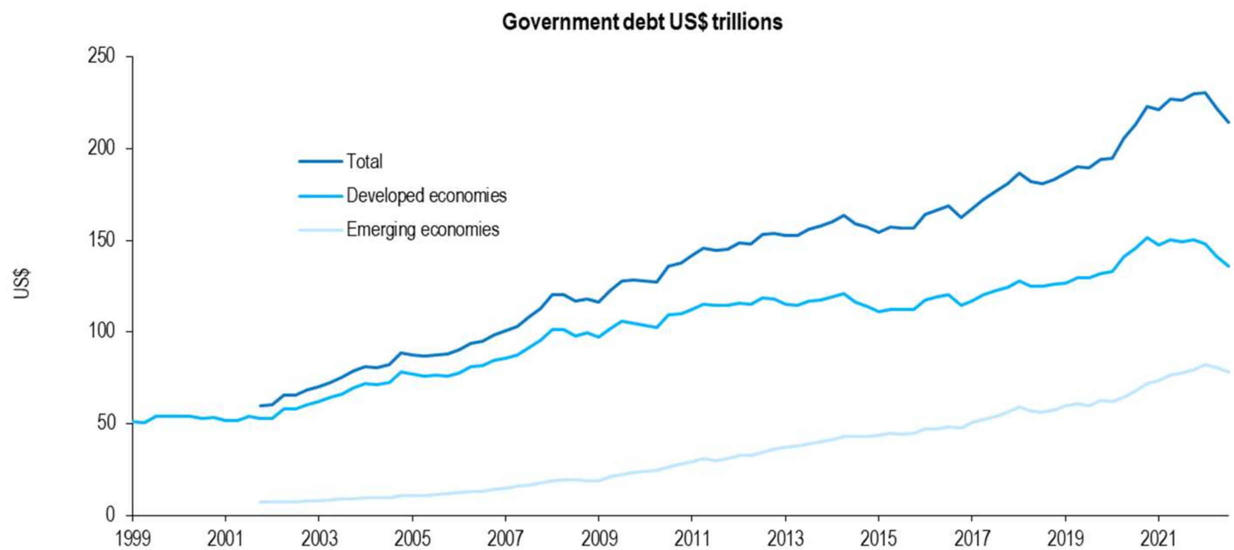


Source:IEA, MWM Research, May 2023

Force 5: Rising indebtedness driving slower debt growth.

Leverage has risen substantially, exacerbated by COVID policy responses

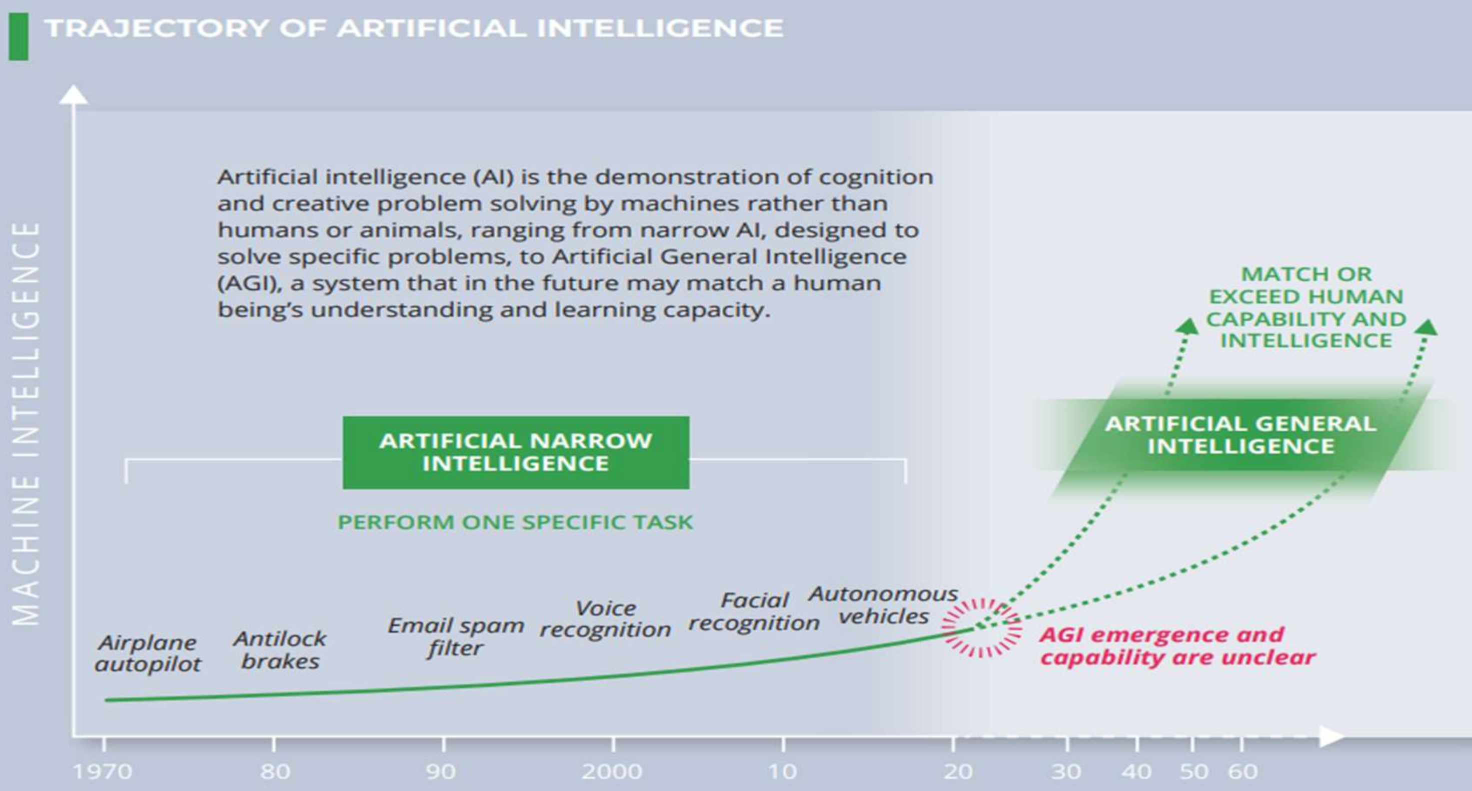
It now requires $3-4 of debt to generate $1 of GDP …
and unsustainable backdrop at higher borrowing rates



Source: FactSet, MWM, May 2023

An Unknown … How will technology boost productivity.

AI becomes mainstream (alongside IoT, robotics, VR and advanced computing)



Source: MWM Research, May 2023

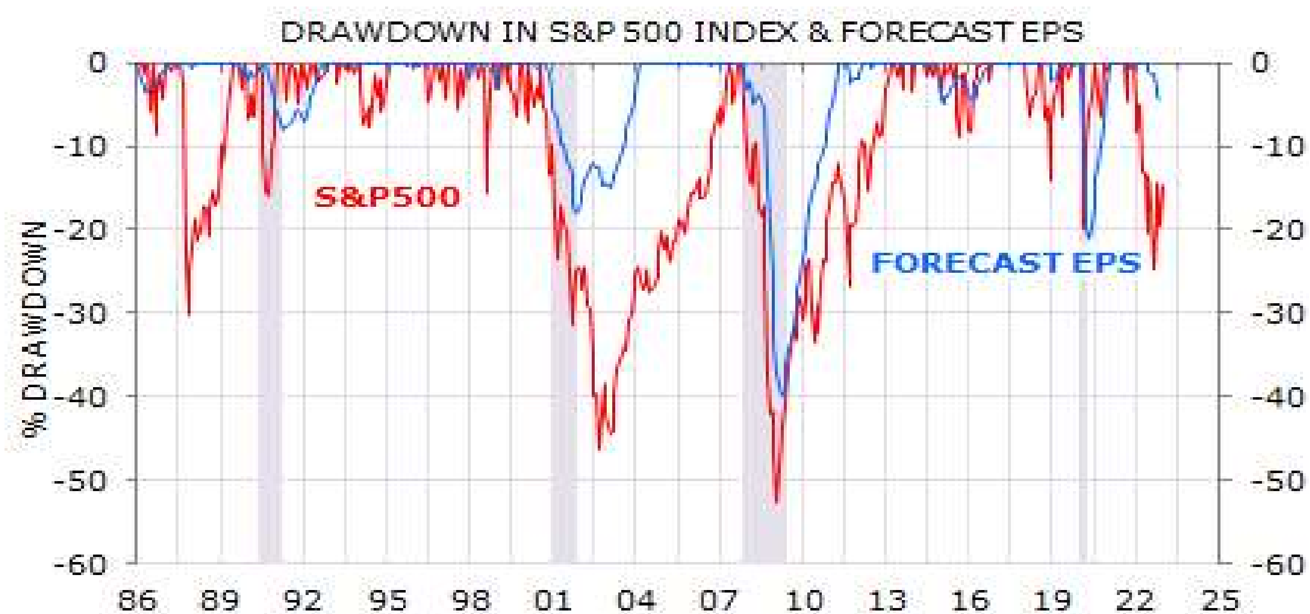
But … structural headwinds also have positive offsets.

- **Excess capital** - Remains plentiful after decades of easy policy conditions
- **Low policy hesitancy** - Policy makers continue to show their commitment towards offsetting downside risks
- **Falling correlations** – De-synchronized growth (rolling recessions) limits depth / duration of corrections
- **Supply disruptions cyclical** – Supply disruptions are not structural in nature

In the short term … Equities historically have <u>always</u> fallen during recessions.

Earnings expectations are yet to reflect even a modest downturn

Cheap(er) valuations mean prior 2022 lows should not be revisited

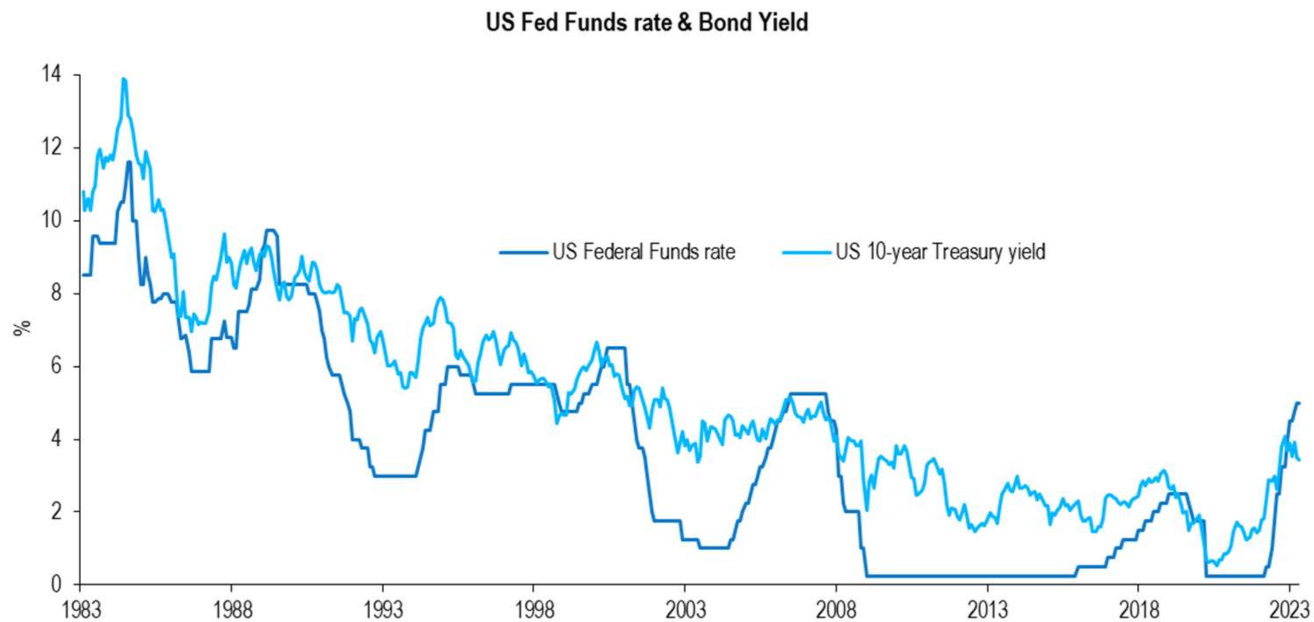


Source: Mnack Advisors, February 2023

But … so do Bond Yields.

Bond yields historically tend to peak within a few months of policy rates

The more bearish you are on the economic outlook the more bullish you are on bonds as a hedge



Source: Factset, MWM, May 2023

What does the future hold for investment markets?

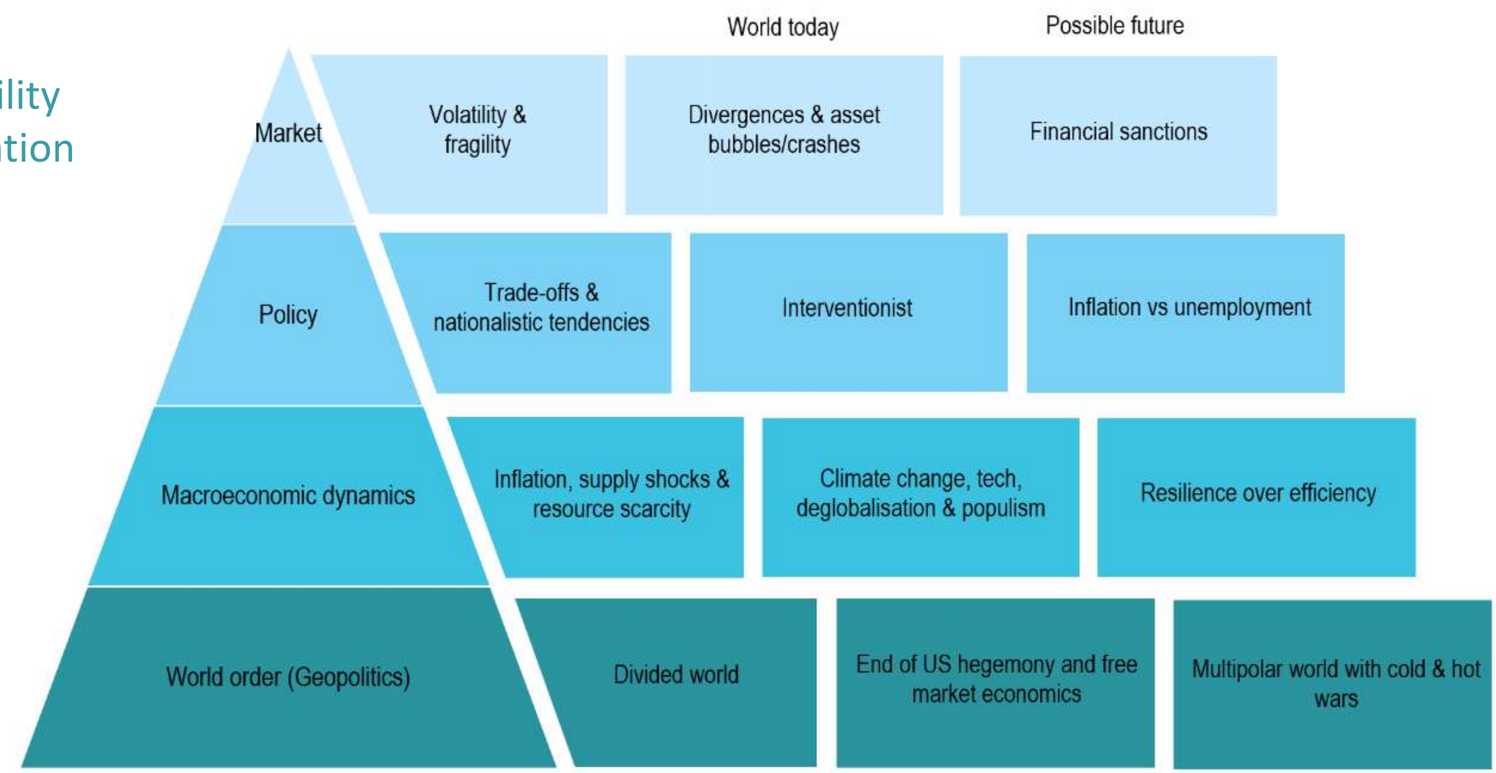
A more uncertain world with slower growth and higher rates means:

1. Greater diversification across asset classes
2. Greater focus on downside protection
   (introducing hedging and non correlated assets)
3. Exposure to structural growth opportunities
   (versus cyclically lower growth)
4. Hedging inflation (real returns will matter)
5. Seek an illiquidity premium (for locked up investments)
6. Greater exposure to non traditional assets
   (private markets – equity & debt)
7. Income will become more important
   (a greater proportion of returns)

Portfolio construction needs to be more granular cutting across regions, sectors, asset classes and across a changing client base … it should be proactively led

Building “resilient” portfolios required in a volatile world.

More uncertainty & volatility require greater diversification and downside protection

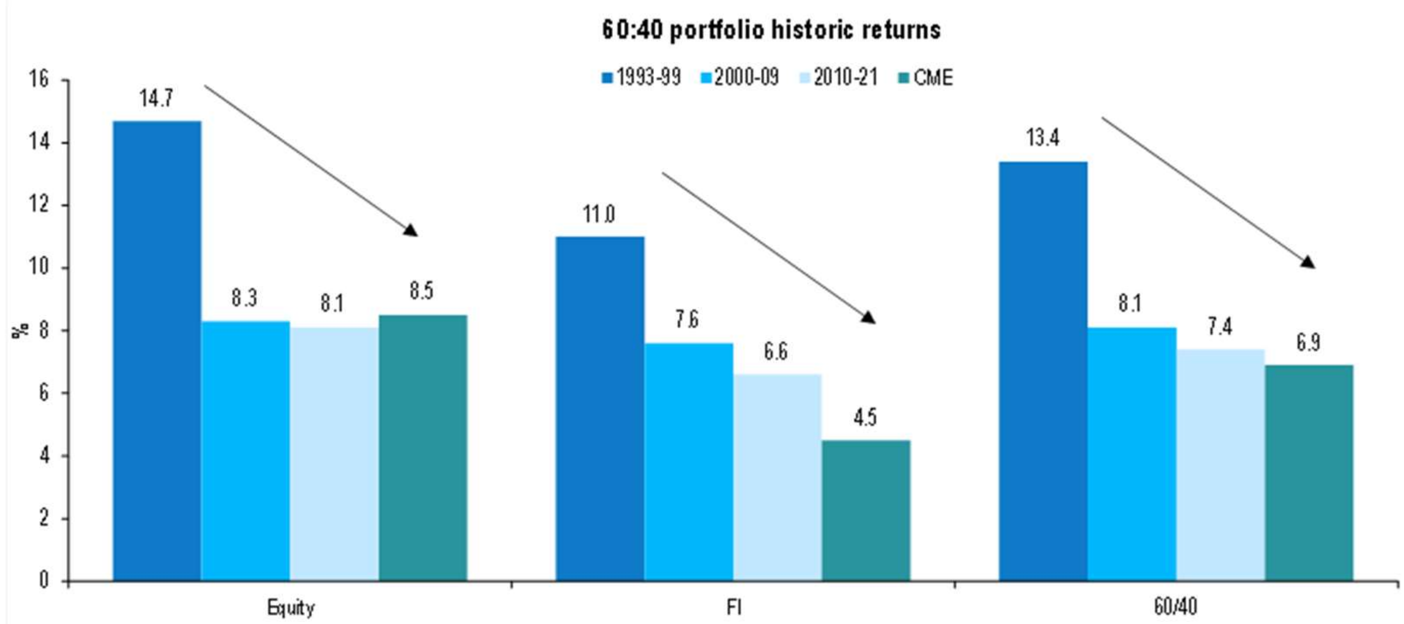


Source: Future Fund, April 2023

The return outlook has dimmed as “zero” rate benefits fade.

Making money should never have been so easy

Portfolios require greater risk (to achieve prior returns) or lower returns (to achieve prior risk)



Source: Factset, MWM, April 2023

Consistency in asset class returns is low throughout history.

Diversification will take on more importance as uncertainty & volatility rise

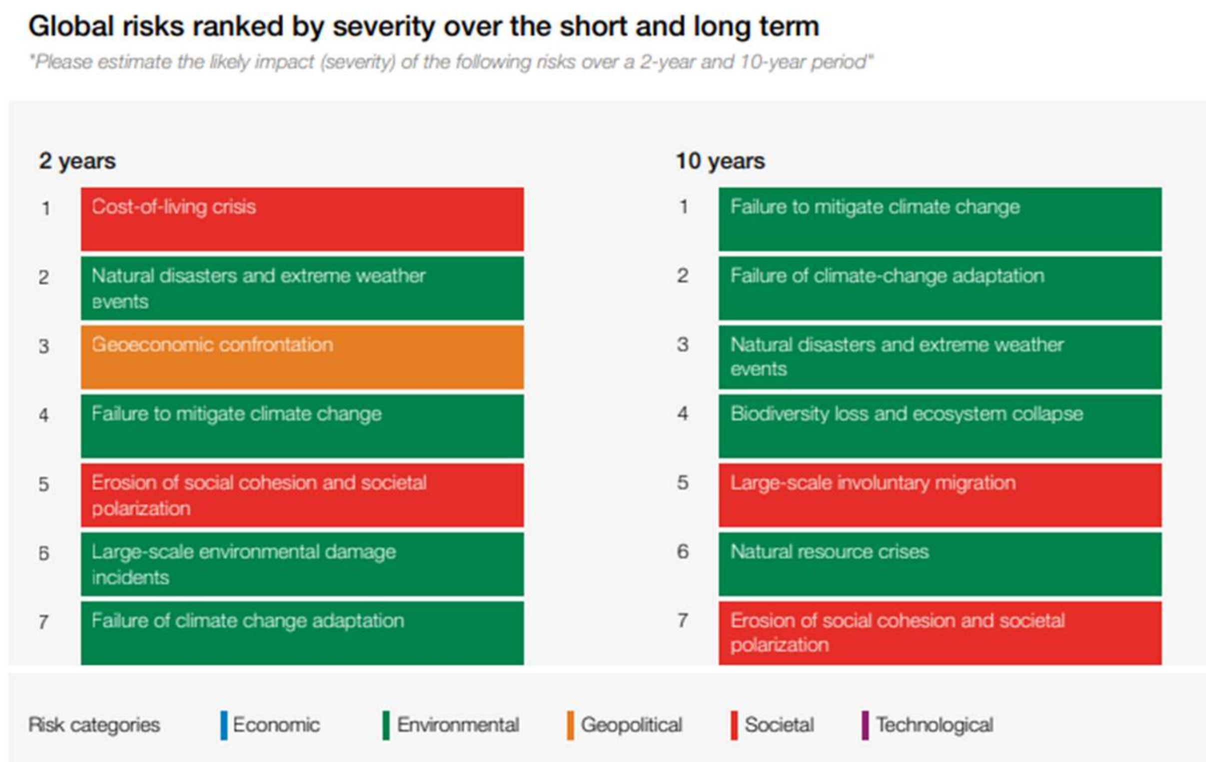
Asset Class Total Return (AUD)

2013	2014	2015	2016	2017	2018	2019	2020	2021	2022
Cash 2.9%	High Yield Bonds 4.8%	High Yield Bonds 1.3%	Hedge Funds 5.5%	Global Bonds Hdg 3.7%	Hedge Funds - 4.8%	Hedge Funds 10.5%	Cash 0.4%	High Yield Bonds 2.2%	Global Infrastructure 1.3%
US Small Cap 61.1%	US Large Cap 23.8%	Emerging Mkt Bonds 13.9%	US Small Cap 21.9%	Emerging Mkt Equities 27.1%	Emerging Mkt Bonds 6.0%	US Large Cap 31.6%	Hedge Funds 11.8%	US Large Cap 34.2%	Cash 1.3%
US Large Cap 54.4%	Global REITs 22.4%	US Large Cap 13.5%	High Yield Bonds 16.8%	Aust Small Cap 20.0%	US Large Cap 5.8%	Global Dev Equities 27.9%	US Large Cap 10.2%	Global Dev Equities 29.3%	Aust Large Cap - 1.8%
Aust Small Cap - 0.8%	Aust Small Cap - 3.8%	Global Infrastructure - 5.4%	Cash 2.1%	Emerging Mkt Bonds 1.2%	Aust Small Cap - 8.7%	Cash 1.5%	Global REITs - 13.7%	Aust All Maturities -2.9%	Hedge Funds - 4.3%
Aust All Maturities 2.0%	Cash 2.7%	Emerging Mkt Equities -4.3%	Aust All Maturities 2.9%	Cash 1.7%	Global Infrastructure - 6.7%	Global Bonds Hdg 7.2%	Global Infrastructure - 11.9%	Global Bonds Hdg -1.5%	Aust All Maturities - 9.7%
Emerging Mkt Equities 13.0%	US Small Cap 14.7%	Global REITs 4.3%	Aust Large Cap 11.8%	Aust Large Cap 11.9%	Global Dev Equities 1.4%	Aust Small Cap 21.4%	Global Dev Equities 5.6%	Aust Small Cap 16.9%	Emerging Mkt Bonds -10.4%
Emerging Mkt Bonds 8.4%	Aust Large Cap 5.3%	Cash 2.3%	Global REITs 6.0%	US Small Cap 6.1%	Global REITs - 4.0%	High Yield Bonds 11.9%	Aust Large Cap 1.7%	Emerging Mkt Equities 3.4%	Global Dev Equities -12.2%
Global Infrastructure 17.7%	Global Dev Equities 14.7%	US Small Cap 7.5%	US Large Cap 12.6%	US Large Cap 12.6%	Global Bonds Hdg 1.7%	Aust Large Cap 23.8%	Emerging Mkt Equities 7.8%	Aust Large Cap 17.6%	Global Bonds Hdg -12.3%
Global REITs 9.1%	Aust All Maturities 9.8%	Aust Large Cap 2.8%	Emerging Mkt Bonds 10.7%	Hedge Funds 8.6%	High Yield Bonds - 3.0%	Emerging Mkt Equities 18.6%	Aust All Maturities 4.5%	Hedge Funds 10.2%	High Yield Bonds - 12.6%
Hedge Funds 9.1%	Global Bonds Hdg 10.4%	Global Bonds Hdg 3.3%	Emerging Mkt Equities 11.7%	High Yield Bonds 9.0%	US Small Cap - 1.1%	Global REITs 21.1%	Global Bonds Hdg 5.1%	Global Infrastructure 13.7%	US Large Cap - 13.3%
High Yield Bonds 9.0%	Emerging Mkt Equities 6.9%	Aust All Maturities 2.6%	Global Dev Equities 8.0%	Global REITs 8.2%	Aust Large Cap - 3.1%	Emerging Mkt Bonds 14.6%	High Yield Bonds 3.5%	Emerging Mkt Bonds 4.5%	Emerging Mkt Equities -14.3%
Global Bonds Hdg 2.3%	Hedge Funds 3.0%	Hedge Funds - 1.1%	Global Bonds Hdg 5.2%	Aust All Maturities 3.6%	Emerging Mkt Equities -5.1%	Aust All Maturities 7.3%	Emerging Mkt Bonds -3.6%	Cash 0.0%	US Small Cap - 14.7%
Global Dev Equities 47.0%	Global Infrastructure 21.3%	Global Dev Equities 11.5%	Global Infrastructure 14.1%	Global Infrastructure 14.4%	Aust All Maturities 4.5%	US Small Cap 25.7%	US Small Cap 9.3%	Global REITs 28.6%	Aust Small Cap - 18.4%
Aust Large Cap 19.7%	Emerging Mkt Bonds 15.4%	Aust Small Cap 10.2%	Aust Small Cap 13.2%	Global Dev Equities 13.3%	Cash 1.9%	Global Infrastructure 25.3%	Aust Small Cap 9.2%	US Small Cap 21.9%	Global REITs - 24.2%

Source: Morningstar, MWM Research, January 2023

What is everyone worried about? …

Environment
(via many avenues)
is the most significant long
term concern



Source: World Economic Forum, MWM Research, May 2023

The future is not the past … But normal is not terrible.

1. Risks are omni present.

2. A new world order will drive greater volatility – forecasting becomes more difficult.

3. The capacity to smooth / offset downside risks is lower - less fiscal and monetary flexibility.

4. Structural drags are reducing growth and prosperity drivers of the past 50 years:
    1. Demographics / Extreme inequalities
    2. Slowbalization / Social tensions
    3. Debt levels / Financialization
    4. Technology (??)
    5. Climate

5. Rules for investing will change as growth slows, volatility picks up, inflation & rates stay higher and cyclical tailwinds slow:
    1. Seek out structural growth – strong domestic markets, commodity independence, policy independence
    2. Greater downside hedging & diversification
    3. Private over Public markets – illiquidity premium

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