Quarterly Update

31 December 2022

Issued by
InvestSMART Funds Management Limited
ACN 067 751 759
AFSL 246441

Professionally Managed Accounts
ARSN 620 030 382

# InvestSMART Conservative Portfolio

## Conservative Portfolio: 2022 in review

The Conservative portfolio finished the year with a solid gain of 2.4 per cent after fees in the final quarter of the calendar year. This saw it outperformed peers by 0.2 per cent.

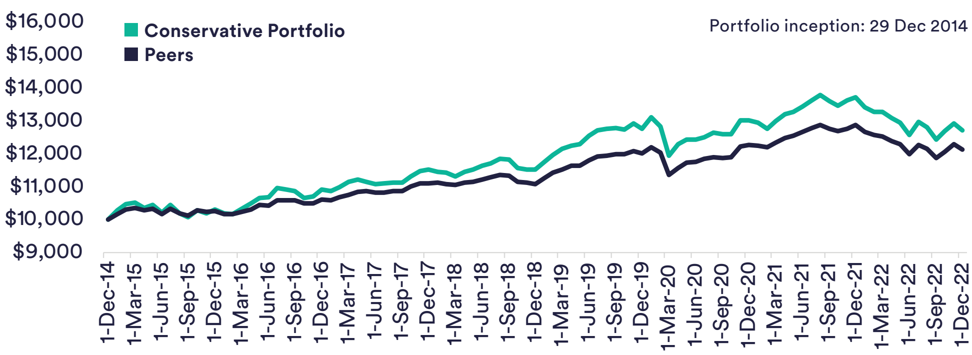
For the calendar year 2022, the portfolio declined 7.2 per cent after fees as global and domestic issue took hold more on this below. We note that since inception the portfolio is averaging 3.0 per cent after fees per annum 0.6 per cent better than our peers.

The quarterly review of the portfolio was conducted by the Investment Committee on the 14th of November 2022. It was agreed that all current ETFs used in the Conservative portfolio were fit for purpose no changes apart from any rebalancing changes below were recommended.

Over the December quarter the Conservative portfolio was rebalanced to meet weighting obligations of a Conservative profile in the following way:

AAA increased 1 per cent to a 28 per cent weighting, while IOZ increased by 0.5 per cent to a weighting of 11.5 per cent.

**Peformance of $10,000 since inception**




**Performance vs Peers**

| | 1 yr | 2 yrs p.a. | 3 yrs p.a. | 5 yrs p.a. | SI p.a. |
|---|---|---|---|---|---|
| Conservative Portfolio | -7.2% | -1.1% | -0.1% | 2.0% | 3.0% |
| Peers | -5.8% | -0.6% | 0.2% | 1.7% | 2.4% |
| Excess to Peers | -1.4% | -0.5% | -0.3% | 0.3% | 0.6% |

Fees: InvestSMART Conservative fees are 0.55% Vs Average of 424 peers 1.27%
Note: Our InvestSMART Conservative is benchmarked against Morningstar® Australia Moderate Target Allocation NR AUD+
Portfolio inception (SI): 29 Dec 2014

## Portfolio mandate

The Conservative Portfolio is the ideal option if you have short term goals (2+ years) and your focus is on protecting capital while earning higher return than cash.

The objective is to Invest in a portfolio of 5-15 exchange traded funds (ETFs), with an emphasis on investments like bonds and cash that deliver regular, reliable income still with some exposure to equities to help beat inflation.

**$10,000**
Minimum initial investment

**2+ yrs**
Suggested investment timeframe

**5 - 15**
Indicative number of securities

**Risk profile: Low - Medium**
Expected loss in 1 to 2 years out of every 20 years

**Morningstar AUS Conservative Target Allocation Net Return (NR) AUD**
Benchmark

IFRA, VGS, VAP all decreased by 0.5 per cent seeing IFRA and VAP moving to a 2 per cent weighting from 2.5 per cent. While VGS moved down to 12 per cent weighting from 12.5 per cent weighting. All other holdings remained the same.

| Conservative Portfolio weightings as of 31 Dec 2022 | | | |
|---|---|---|---|
| Security | Sep | Dec | Change |
| IAF | 24.00% | 24.00% | **0.00%** |
| VBND | 19.50% | 19.50% | **0.00%** |
| IFRA | 2.50% | 2.00% | **-0.50%** |
| IOZ | 11.00% | 11.50% | **0.50%** |
| VGS | 12.50% | 12.00% | **-0.50%** |
| VAP | 2.50% | 2.00% | **-0.50%** |
| AAA | 27.00% | 28.00% | **1.00%** |
| CASH | 1.00% | 1.00% | **0.00%** |
| | 100.00% | 100.00% | |

## Performance of Individual Holdings

### AAA – Betashares Australian High Interest Cash ETF

Cash had something of a renaissance in 2022 as interest rate rises saw cash yield at their highest levels in a decade. This led AAA to power ahead in 2022, with its interest jumping from low a 0.2 per cent in January to 3.2 per cent by the close.

This is pushing the total returns on AAA to levels not seen in its history and helped offset some of the decline seen in its defensive fixed income peers. It is good to see cash is providing a solid defensive asset in your portfolio during this period.

### IAF – iShares Core Composite Bond ETF

It needs to be pointed out that 2022 was one of the most difficult and unrelenting years for bonds in recent memory.

2022 had to price in the risk of rapid rate rises from the Reserve Bank of Australia (RBA) and other central banks. Bonds also had to deal with inflation levels not seen since the 80s and increases to the Australian cash rate faster and harder than any time in its history going back to 1990.

The Australian Commonwealth Government Bond (ACGB) 10-year bond yield started 2022 at 1.61 per cent and finished the year at 4.04 per cent. This movement was not exclusive to the ACGB 10 year either -- similar appreciation in yields were seen across all maturities, which collectively hindered IAF in 2022 and it logged its worse year since its inception in 2012.

Looking forward, the very large and dramatic declines seen in the first half of 2022 are unlikely to recur in 2023 as rate rises are now priced in, which should limit further downsides. There is also an argument to be made that with bond pricing at a discount to face values, conservative investors looking to hold to maturity will see the benefit of a higher yield and a capital return at a future point in time.

### VBND – Vanguard Global Aggregate Bond Index ETF

There is no way to sugar-coat what has happened in the global aggregate bond index -- 2022 was its worse year on record and not by a small margin either -- falling 20 per cent for the calendar year is four times worse than its previous record. Thankfully, VBND, which replicates this index, had the benefit of the Australian dollar falling to offset some of the losses.

VBND is heavily dominated by US bonds. In 2022 the US Federal Reserve increased the Federal Funds Rate from record lows to 4.25 to 4.50 per cent in the space of 10 months. It has also signalled there is more to come in 2023 as it continues to try bust its inflation problem. It is a major reason for VBND's performance in 2022.

However the US was not the only drag on VBND. UK gilts (bonds) were severally impacted by the government's decision to launch unfunded tax cuts in the third quarter of the year, so much so that the Bank of England had to step in and stabilise the system by buying long-dated gilts, unprecedented in modern times.

Looking at 2023, central banks across the world continue to talk tough on inflation and this could lead to further bouts of volatility in the global fixed income markets. However, what has caught our attention is US short duration bond yields have stopped their march higher, suggesting the market now believes that the hiking cycle is at or near its peak.

**VGS – Vanguard MSCI Index International Shares ETF**

Difficult year for international equities. 2022 saw the first war on the European continent since the World War II, global inflation hit its higher levels since the 1980s and central banks increased their respective cash rate to levels not seen since before the GFC in some cases.

With VGS representing the weighted average of global markets excluding Australia, it is dominated by the US S&P 500. 2022 was unfortunately the worst year for US markets since 2008, down 18.5 per cent. However, that overlooks the fact the S&P 500 rose 28.7 per cent in 2021, 18.4 per cent in 2020 and has returned 56.9 per cent over the past five years, all on a total returns basis.

The interesting components of VGS have been Japan and the UK. Both had negative years but outperformed both the US and Europe despite these markets having several negative domestic issues facing them.

Overall VGS finished 2022 down 12.3 per cent on a total return basis, but just like its other equity peers, that ignores your investment timeframe for something like VGS which should be at a minimum three years but more likely five. On these timeframes VGS on a total returns basis has given you 20.2 per cent and 55.6 per cent respectively.

Looking to 2023, the legacy themes of 2022 will linger to start 2023 for global markets, this being the high probability of recession in Europe and America. However, recessions have historically signed the bottom of short term sell offs, something that could occur this year. It is something we watch with keen interest.

**IOZ – iShares S&P/ASX 200 ETF**

We have had to dive back into the history books to find another year like 2022. Intra-year up and down movements on the ASX 200 (which is replicated by IOZ) were the biggest since 2008. There were three major downturns last year, triggered by the rapid rise in global inflation rates, the Reserve Bank of Australia raising the cash rate by 3 percentage points in just nine months, and the growing concern that we could see a global recession. This reads like something out of a 1980s finance book and the doom and gloom in 2022 was large.

What was missed by the pessimism, which always attracts more attention, was that those three downturns were accompanied by three major upturns.

In the final quarter of 2022 IOZ returned over 9.1 per cent on a total returns basis and completely recouped the loss in the second and third quarter of the year. What some also forgot about 2022 was that the ASX-200 saw a record $43 billion in dividends returned to shareholders which IOZ also benefits from.

We also think the performance of IOZ in 2022 is a textbook example of why you invest for the long term. We have always stated that one day, month, year is too short a timeframe for your investment strategy. At the close of trade on December 30, IOZ on a total returns basis was down just 0.7 per cent from the close of trade a year earlier. No one predicted or expected this especially with all the issues that arose in 2022. However, if we expand our timeframe to a conversative investment time of three years, which captures the entire COVID-19 era, IOZ on a total returns basis is up 19.9 per cent. On a balance timeframe of three to five years, IOZ on a total returns basis has given you 43.1 per cent.

As IOZ enters 2023, the pessimism of 2022 will linger. It will likely mean intra -day, -month and -year trading will be volatile just like last year. But as history shows "one year does not make an investment" and IOZ in five years is likely to give you its historical return.

**VAP - Vanguard Australian Property Securities Index ETF**

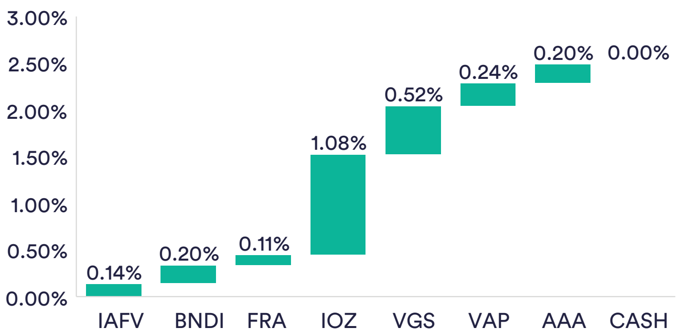
Very tough year for Australian property. Its exposure to interest rate rises was laid bare in 2022 as property became one of the worse performing sectors in the market. Property is a high-cost asset and with a high cost comes the need to borrow.

With property's exposure to high funding costs due to increased increase rates plus the fact commercial rents in the post-COVID world have not return to pre-pandemic levels, VAP fell 19.8 per cent on a total return basis.

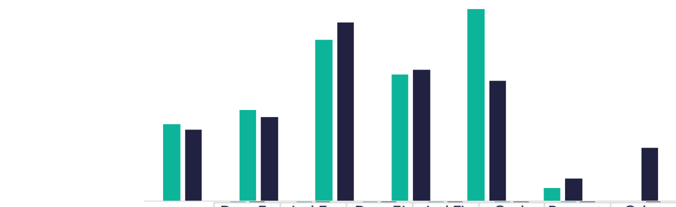
VAP is well diversified and holds high quality assets in a range of property fields from industrial to commercial to residential. This diversification however was, and is, being ignored and with the threat of further rate rises in 2023 VAP remains in the short term a risk.

But, like its peers, VAP's longer term performance needs to be taken into account. Over the last 5 years VAP has returned 12.8 per cent on a total return basis, over the past 10 it's a massive 173.8 per cent. VAP remains a long-term investment in our view

## Attribution performance

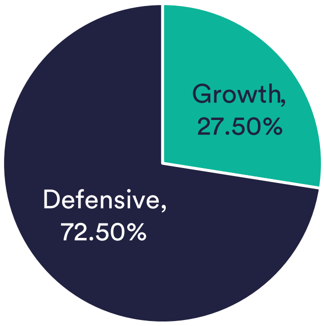



## Asset allocation vs Peers

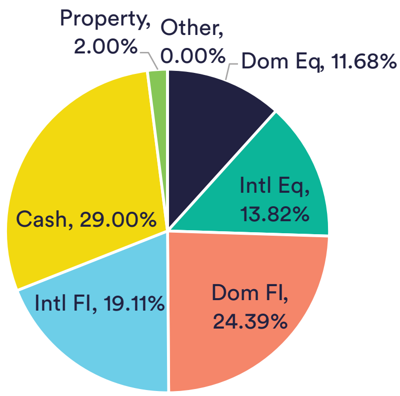


| | Dom Eq | Intl Eq | Dom FI | Intl FI | Cash | Property | Other |
|---|---|---|---|---|---|---|---|
| InvestSMART Conservative | 11.68% | 13.82% | 24.39% | 19.11% | 29.00% | 2.00% | 0.00% |
| Peers | 10.84% | 12.70% | 26.92% | 19.83% | 18.22% | 3.42% | 8.07% |

## Asset allocation




## Asset allocation




## Our Investment Committee

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### Important information



**All table and chart data is correct as at 31 December 2022.**