Drummond Dynamic Portfolio

Quarterly Investment Review – Q3 2021

We believe we are in an era of increasing 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 were again positive in the third quarter despite rising concerns over growth and inflation

Rising uncertainty over stagflationary economic conditions wasn't enough to stop global equity markets moving higher, albeit at a slower pace than recent quarters. Asia was again a laggard given tightening credit conditions, a weakening property sector and regulatory action. Inflation data continued to surprise to the upside over the quarter led by a combination of supply shortages and robust economic growth. Likely in response, the Federal Reserve brought forward their forecast for interest rate hikes.

Despite the increased inflation concerns, there was minimal change in longer dated bonds for the quarter with investors pulled between potential for slowing growth and higher inflation bringing with it faster QE tapering. The threat of a stagflationary environment saw fairly even performance between growth and value during the quarter with quality doing better which is of little surprise given global equity markets suffered one of their worst months over the past year in September.

Australian shares outpaced global equities (in USD terms) over the quarter, rising 1.7% with small caps faring even better. Large increases in energy commodity prices (oil, coal, gas) helped lift global commodity prices despite a 45% fall in the iron ore price. Gold however has found little favour, falling -2.5% driven by a rising USD.

Portfolio Performance & Review

The portfolio continues to perform strongly despite shifting market conditions

Over the quarter, the Dynamic Portfolio returned +0.6%*. This was behind the institutional peer composite that rose +1.0% over the period. As is shown in the table below, the portfolio continues to perform strongly when compared to the institutional peer group. Pleasingly the portfolio is also delivering on the CPI +4% objective for investors coupled with strong risk management.

DRUMMOND DYNAMIC PORTFOLIO PERFORMANCE HISTORY

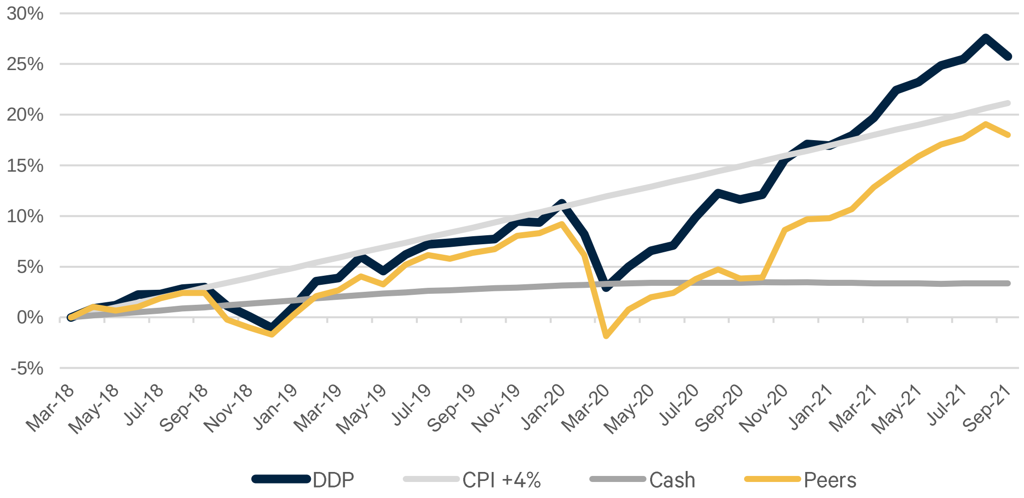
	3 month	6 month	1 year	3 year p.a.	Inception p.a.
Dynamic Portfolio*	0.6%	4.9%	12.5%	6.8%	6.6%
Peers**	1.0%	4.7%	13.0%	4.9%	4.7%
Outperformance	-0.4%	0.2%	-0.5%	2.0%	1.8%

Source: Drummond Capital Partners, BT Panorama, Refinitiv; **Composite of Institutional real return funds

The portfolio lagged peers over the third quarter with our slight tilt towards active growth managers benefitting the portfolio as market conditions took on a more negative tone as the quarter wore on. Our diversifying global alpha managers were also of benefit to the portfolio in this environment as was our underweight exposure to government bonds as bond prices began falling. The portfolio remains well diversified by asset class and managers that are well placed to outperform over the coming year.

The changes made to the portfolio during the quarter consisted of reducing our exposure to growth assets (Australian and international equities) as we removed the last remaining emerging market exposure from the global equity allocation of the portfolio. We added to cash and corporate loans which we think benefit from healthy economic growth. We remain underweight bonds. Combined, these changes took overall growth asset exposure from 54% at the beginning of the quarter to 46% at quarter's end.

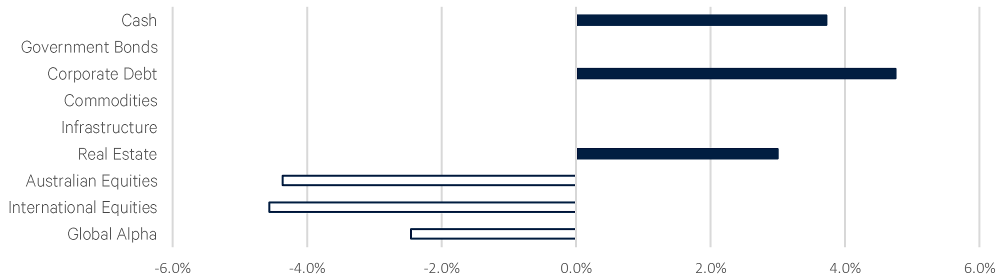
DRUMMOND DYNAMIC PORTFOLIO RETURN vs. PEERS**



Source: Drummond Capital Partners, Refinitiv, BT Panorama; ** Composite of Institutional real return funds

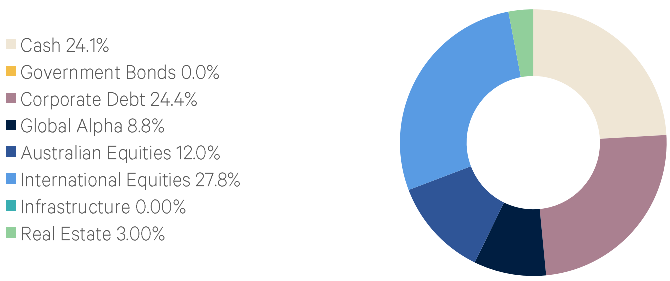
Allocations to growth assets were reduced over the quarter in favour of cash and corporate loans

PORTFOLIO ASSET ALLOCATION CHANGES – Q3 2021



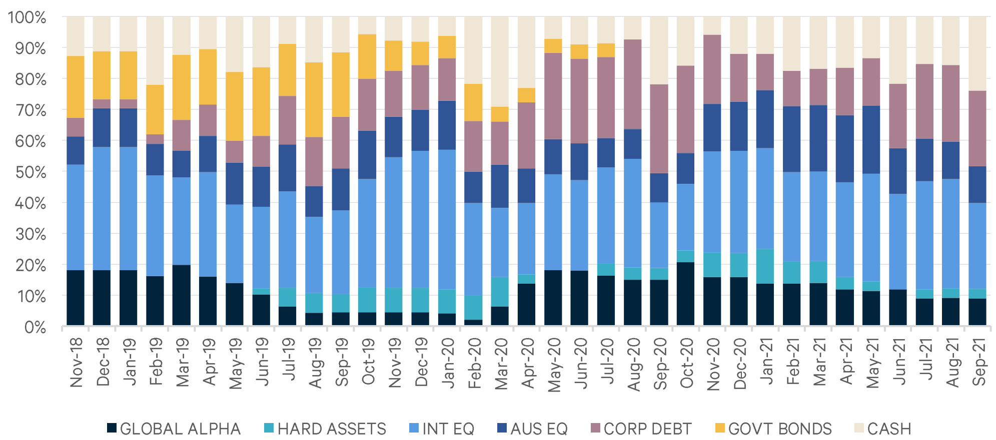
The portfolio is now underweight growth assets, overweight cash and credit, and underweight government bonds

PORTFOLIO ASSET ALLOCATION – Q3 2021



International equities and corporate debt are the biggest asset class exposures

PORTFOLIO ASSET ALLOCATION HISTORY

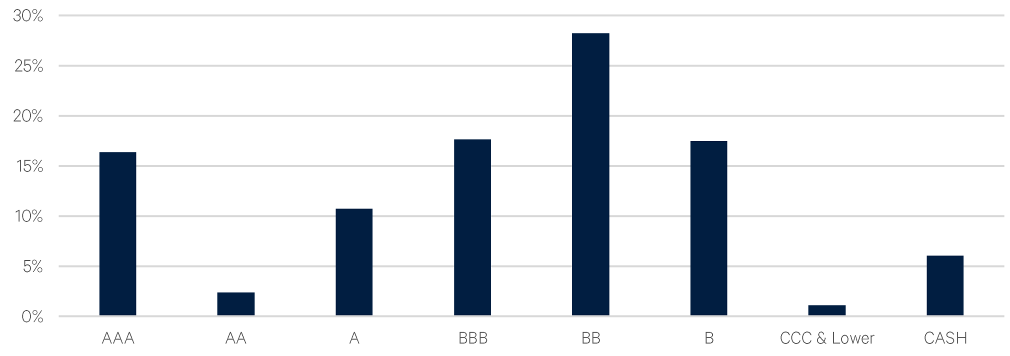


Corporate Debt

We prefer floating rate credit and loans that provide reasonable risk adjusted returns

Despite growing concerns over the health of the Chinese economy and the prospect of global stagflation, investment grade corporate spreads finished almost exactly where they started during the quarter. Solid economic growth and friendly central banks support corporate debt markets given the strong profit environment is positive for serviceability and solvency. We prefer floating rate credit and loans that provide reasonable returns and are positively exposed to higher interest rates compared to longer term fixed rate bonds.

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



Source: Drummond Capital Partners, Manager Reports

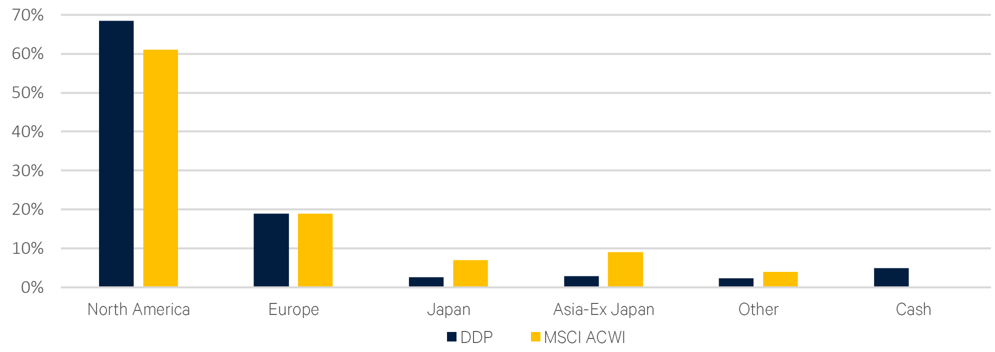
Government Bonds

We continue to avoid government bonds with further weakness likely as central banks withdraw stimulus

Government bond prices rallied early in the quarter, with Chinese property concerns rising as an Evergrande default became more probable. However, bond prices began to weaken in the second half of the quarter, driven by confirmation from Federal Reserve Chair Jerome Powell that tapering of bond purchases would begin during 2021 with a quicker than expected end date of mid-2022. This along with ongoing inflationary pressure, transitory or not, saw bond prices finish almost exactly where they started for the quarter. The rate of global growth suggests bond prices should be lower still (yields higher) and will most likely drift as tapering begins yet we think this should be a gradual process that can be controlled by central banks if volatility increases dramatically.

International Equities

PORTFOLIO LOOK THROUGH COUNTRY EXPOSURE vs. BENCHMARK



Source: Drummond Capital Partners, Manager Reports

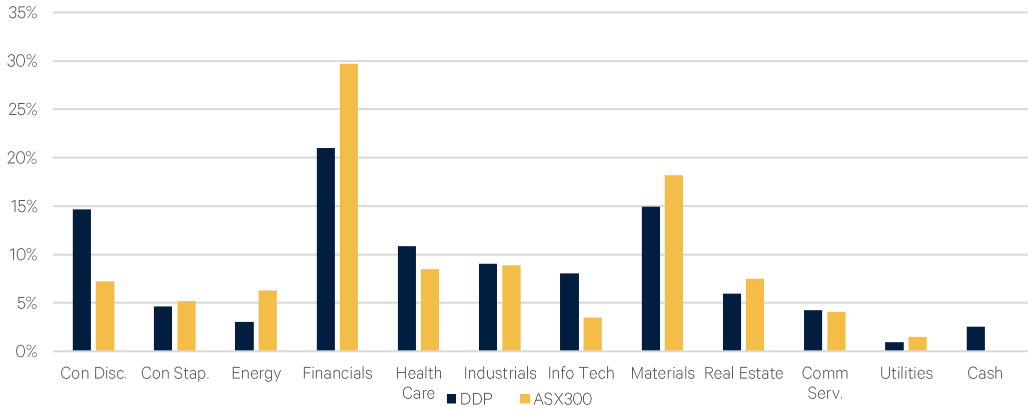
Equity markets were able to look through increased global growth concerns in the quarter with valuations beginning to compress

World equity markets eked out a rally in the third quarter despite growing economic concerns, rising 0.6% in USD terms and 4.0% in local terms as the AUD fell. Asian shares remain laggards as rising concerns over ongoing Chinese regulation and the Chinese property sector continues to bode ill for growth in the world's second biggest economy. Growth orientated managers fared marginally better than value managers over the quarter with the reflationary pulse waning driven predominantly by actions in China. This was favourable for the quality growth tilt within our global allocation with these active managers outperforming over the quarter while we also took the opportunity to reduce the portfolio currency exposure via increased allocation to hedged active managers while removing the remaining emerging market exposure within the portfolio.

Australian Equities

Australian shares delivered another positive quarter, with volatility in resources increasing

AUSTRALIAN EQUITIES SECTOR EXPOSURE vs. BENCHMARK



Source: Drummond Capital Partners, ASX Data

Australian shares outpaced global equities (in USD terms) over the quarter, rising 1.7% with small caps faring even better. Large increases in energy commodity prices (coal/gas) weren't enough to offset a 45% fall in the iron ore price that drove the materials sector to a 9% fall over the quarter though the tech sector fared worst due to rising interest rate concerns. Transport, energy, and financials were strong. Overall exposure to Australian shares was decreased over the quarter as we became more concerned over the prospects for Chinese economic growth.

Hard Assets (Infrastructure / Real Estate / Commodities)

We maintain minimal exposure to real estate and infrastructure within the portfolio

Portfolio exposure to infrastructure and real estate remains minimal with the prospect for rising interest rates relatively unfavourable for these sectors with our recent research suggesting both will struggle versus other growth asset classes over the long-term investment horizon.

Global Alpha

Relative performance of our global alpha growth managers improved this quarter as volatility in equity markets provided increased opportunity rather than markets simply going up as has been the case for most of the last year. We believe that non-directional global alpha defensive funds are well placed to outperform low yielding government bonds as well as providing diversification benefits to the portfolio.

Outlook

A risk on mentality was evident early in the third quarter. Ignoring high valuations, the powerful tonic of strong economic growth and corporate profits, effective vaccines and economies re-opening buoyed by abundant liquidity continued to embolden investors. Despite fears of inflation, yields on government bonds touched recent lows and credit spreads similarly tight highlighting the need to invest cash paying next to nothing.

Weaker Chinese growth and higher interest rates are paramount to risk asset performance medium term

The mood changed in September. China's economic growth is deteriorating, driven by a weakening housing market and a collapse in confidence around highly leveraged property developers. Supply chain problems intensified, with energy prices, shipping costs and reports of goods shortages rising sharply. The US Federal Reserve was more hawkish than market expectations, outlining a pace of QE tapering and flagging a higher path of short-term interest rates than previously.

Both issues have tangible solutions. China can provide more policy stimulus and ease some of the restrictions around property purchases. This would signal that the Government is not going to allow a hard landing in the sector (though does nothing to ameliorate the structural issues in the economy). Similarly, central banks have the flexibility with respect to interest rate hikes and QE tapering if goods shortages and price spikes lead to weaker consumer spending.

Until the market gets clarity on the above, we think the narrative will remain around stagflation risks, which limits upside for both equities and bonds. Significant downside also looks unlikely at this stage given strong economic growth and low rates. Credit markets in China and the US have shown little sign of any major stress during this recent bout of volatility and will be key to watch for signs of investor angst over current conditions.

We are positioned for ongoing underperformance from emerging market equities. China's intent to regulate industries not acting in the country's best interest is clear and a decelerating property market brings further risks. Unless China's slowdown accelerates, global economic growth should however get back to around "normal" rates sometime next year. We think interest rates will stay low (though probably a bit higher than they are now) given inflation should subside as reopening related base effects fade from the data. Earnings growth is still strong but will slow next year alongside economic growth.

Far from a goldilocks scenario, this shouldn't feel too different to many periods during the decade prior to Covid. Equities generally trend sideways with volatility as markets digested various macro problems but should still outperform bonds. Like in those periods, the optimal tactical strategy will be one which is highly responsive to fiscal and central bank policy shifts.

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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