Perspectives

Creating equitable economic prosperity:
The convergence of monetary policy and societal issues.

Private Wealth Global Investment Services

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Introduction

In early 2020, our Perspectives considered a range of political risks defined by the US Presidential election and Brexit, opportunities empowered by structural drivers, as well as the fight for global technology supremacy between the US and China.

Instead, a global pandemic that will be remembered in our lifetime dominated the year and the pace of change, as a result, has never been faster. For a few years now, our assessment has been that there are several foundational pillars of consideration that, in their own right, were significant before the COVID-19 pandemic.

These elements have since intensified and accelerated, and in our view, will have longer-lasting effects on the world for years to come. These are:

Technological advancement

The enabling forces of technology and digital transformation, where the structurally defined opportunities, such as cloud adoption, digital payments, tailored aspects of e-commerce and cybersecurity, have now become further validated by the COVID-19 dynamics.

Rising inequality

The increased level of the economic divide between asset poor and asset rich citizens, with increasing levels of social inequality and a commensurate increase in the pace of populism in the Western World. In addition, the pandemic has deepened social and economic inequality in areas like education, pay and healthcare access, with developing economies suffering the most (source: the World Bank).

Rising levels of debt globally

The growing levels of debt at both a government and corporate level, which has increased in light of the much-needed pandemic-led stimulus support. This, in turn, further increased global gross debt to world output to circa 400% by the end of 2020 (source: IMF).

The peak in globalisation is behind us

Globalisation has not only peaked, but we expect it to reverse. Prior to the COVID-19 pandemic, it was primarily driven by the determination of the US to maintain global technological and economic supremacy ahead of China. However, the COVID-19 pandemic has exposed the concentration, dependencies, and vulnerabilities of supply chains.

As a result, we believe the gradual reversal of globalisation will accelerate further with the commensurate re-orientation of global supply chains towards local markets. At the heart of this re-orientation is our expectation that we are at the onset of a modern US industrial and advanced manufacturing renaissance.

Faster pace of healthcare innovation

It is becoming increasingly clear that the changes we have seen in how healthcare is being delivered during the COVID-19 pandemic are here to stay, including the fundamental role of digital healthcare. Investment in healthtech (the intersection of technology and healthcare) will only grow in our view, given the global rise in standards of living, an ageing population and the associated fiscal burdens they impose, especially in developing markets.

We believe these forces are significant in their lasting effect in terms of how they are shaping businesses, society, politics, and the changing risk-reward dynamics across financial markets, for many years to come.

Lastly, we expect a far more **complex geopolitical environment over the next few years**, as a two-world order division emerges globally, in terms of political alliances being formed, where the US, UK, Japan and Australia are solidifying their regional ties while China is cementing its strategic partnership with Russia, Iran and other parts of the world.

The global green capex supercycle is finally upon us

As governments move beyond their most immediate and pressing fiscal support objectives defined by the COVID-19 pandemic, we expect them to recognise the importance of the intelligent deployment of their remaining fiscal capacity towards achieving two overlapping objectives:

1. **Creating sustainable industries**, especially in areas that are lagging from a technology, infrastructure, or climate perspective, and
2. **In the process**, create durable drivers of permanent employment in domestic markets.

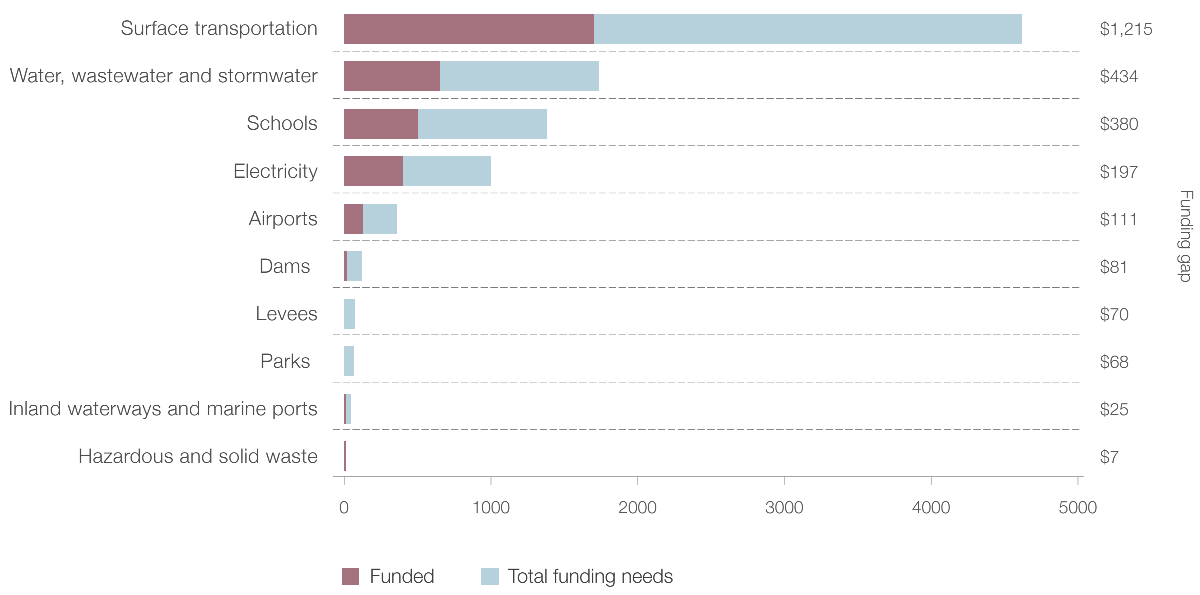
To that end, we anticipate the opportunity arising from significant investment in decarbonisation and sustainable infrastructure in the US and Europe to gain faster momentum over the next few years. This will enable the transformation of those economic blocs into more modern platforms driving change and opportunity across various domestic sectors such as industrials, agriculture, construction, energy and transportation.

We expect the US to prioritise its attention to the lagging US infrastructure, focusing on a cleaner platform of modern utilities and the build-up of 5G-enabling capabilities.

On the former, according to the American Society of Civil Engineers, the amount of investment needed by the US to rebuild its infrastructure is estimated to be US$4.59 trillion by 2025, and $11 trillion by 2040. This is to address its degraded roads, bridges, airports, transit systems and other infrastructure-related projects. To measure the opportunity impact this can deliver, circa US$10 trillion in GDP terms will be lost by 2039 (source: ASCE) if such underinvestment remains at current rates in the US.

In our assessment, this is already starting to provide a favourable opportunity in the areas of construction, building materials, engineering, and advanced industrials in the US. When we consider the importance of domestically oriented opportunity in the US market that is far less dependent on global sensitivities, this one ranks highly in importance.

Cumulative infrastructure investment needs in the US from 2020 to 2029 (in US$ billions)



Source: American Society of Civil Engineers. Past performance is not a reliable indicator of future performance.

We believe we are at the onset of a US industrial and manufacturing renaissance. We also believe US industrial and manufacturing businesses have built significant operating leverage in the last few years, a feature that remains underappreciated by the market. We expect that this will support sustainable earnings growth in those sectors, thus have the potential to rival traditionally faster-growing sectors such as technology.

One does not need to look any further than the US homebuilding sector, which already has delivered earnings growth of 75%+ in the last year, a level only seen amongst few leading technology businesses and platforms.

Meanwhile, Europe is the leader in the green capex initiatives. The opportunity for significant investment in sustainable infrastructure will present itself on the back of the planned one trillion-euro European Green Deal, which focuses on transforming the post-COVID-19 European Union (EU) into a modern, resource-efficient and competitive economy (source: the European Commission).

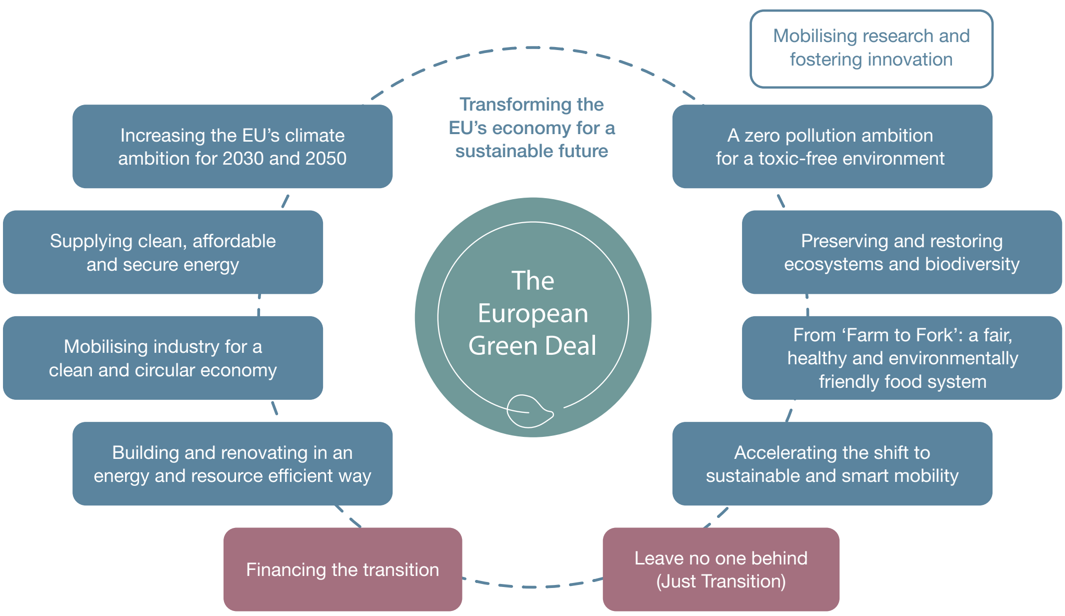
We see this as a catalyst for change and exploitable investment opportunity in equity markets across various sectors, such as industrials, transportation and agriculture. In the European industrials sector, we believe there will be a shift towards more sustainable materials to ensure effective recycling, opening an opportunity for new products to replace those that are environmentally harmful (plastics etc).

In the transportation sector, we expect the proposed 90% reduction of greenhouse gases from transport by the European Commission in striving to become carbon neutral by 2050, will result in changes to fossil fuel production.

These initiatives will support a fast shift towards alternative transport fuels and corresponding growth of recharging stations and electric cars. For context, transport is Europe's largest source of carbon emissions contributing 27% to the EU's total CO_2 emissions, with cars representing 44% of these emissions, according to the European Environment Agency. In agriculture, a greater focus on organic and vertical farming to ensure animal welfare and more sustainable and cost-effective agriculture industry is underway in Northern Europe over the last twelve months.

This evolution is only possible given the improving cost curves for advanced industrials and green energy alternatives to fossil fuels. In turn, this has implications for market leadership and profit pools within each sector and corresponding winners and losers amongst incumbents and innovators.

"As transformative as the euro" – New EU Green deal explained



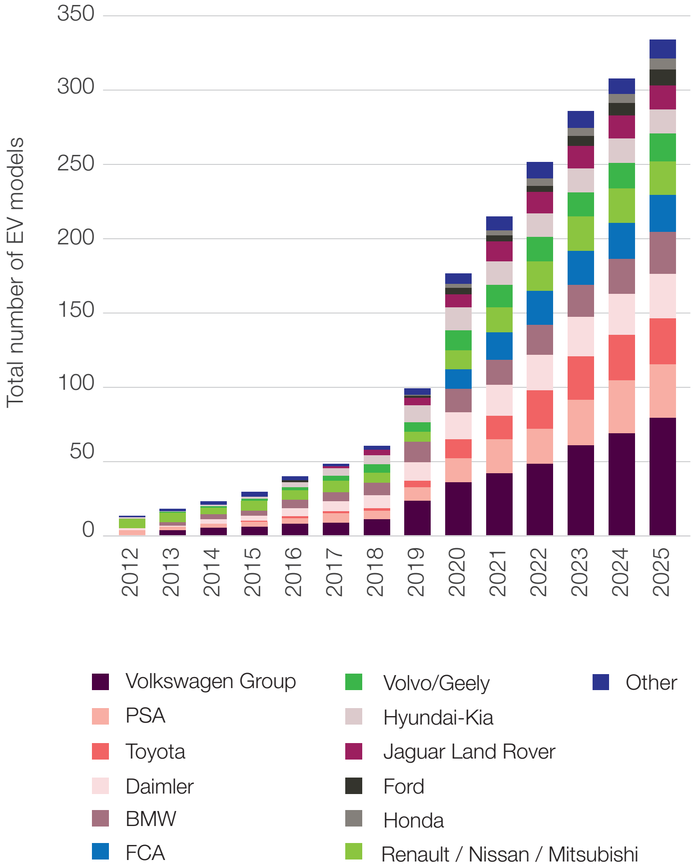
Source: European Commission

One example is the global automotive industry, which is arguably undergoing the fastest pace of change in its structure, profit margins, and partnerships to achieve modern fleets and electric vehicle (EV) development. In the US, the EV industry will be dominated by Ford, GM and Tesla, whilst in Europe, Volkswagen and PSA are expected to be the EV leaders which together are forecast to deliver 120 models of electric car vehicles by 2025 (source: Transport and Environment).

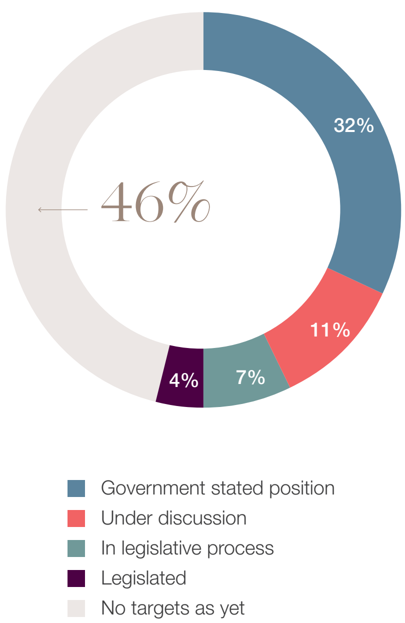
These are decisions that have been, or are being, made in recognition of the circular nature of the global economy. Despite the COVID-19 pandemic having slowed the pace of annual emissions, this has not arrested the long-term trend. For context, 2020 was the second-warmest year on record for the planet. To date, just over half of all global emissions are now covered by advanced or formalised net-zero targets.

Hydrogen, the first, lightest and most abundant element in the universe, could supply a significant part of our energy needs. Hydrogen technology has been around for decades, but has yet to reach its tipping point in mainstream use. We believe this has the potential to outgrow other sources of clean energy in the next five years with positive implications for the environment and infrastructure investment.

Total number of available EV models in Europe



Global emissions covered by advanced or formalised net zero targets



Source: Transport and Environment.

Source: BNEF. Past performance is not a reliable indicator of future performance.

The changing landscape for global commodities

As the world gradually emphasises investment in more sustainable initiatives, we expect there will equally be a gradual but visible shift in the demand and supply attributes of various commodities.

We anticipate that the biggest beneficiaries of this focus are palladium, copper, and natural gas at the expense of commodities such as oil and coal, given the increasing number of countries providing legally binding pledges for net-zero carbon emissions by 2050.

We expect copper to emerge as the key beneficiary of the global green transition, underpinned by the increased demand from electric vehicles, renewable energy and a broad range of modern industrial and commercial buildings needs. **The critical direct and indirect role copper will play in achieving the Paris climate goals cannot be underestimated.**

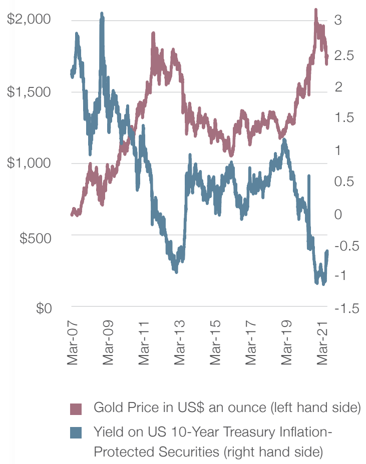
At some point in the future, we also expect green hydrogen to play a major role in achieving the goals too, with hydrogen estimated to generate 24% of our energy needs by 2050, versus 4% right now (sources: BNEF and IEA). Meanwhile, natural gas will continue to play a role in the delivery of a cleaner energy mix until such time renewables achieve a significant scale, which we believe is unlikely before 2030.

Overall, we expect the US and European industrial and chemical sectors to benefit from this changing energy supply mix over the long-term.

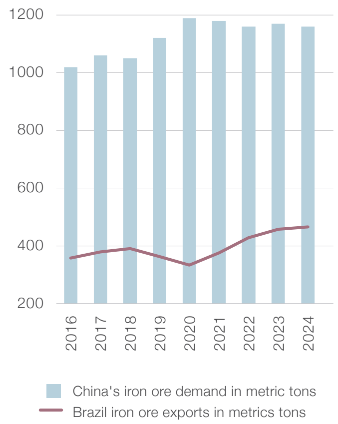
As for iron ore, we expect China's high priority focus on environmental issues and its decarbonisation policy advancement will gradually start to constrain its domestic furnace-based steel sector production and emissions from late 2021. With that, we expect such policies will elevate the importance of other commodity steel inputs such as scrap metal, while these heightened ESG (Economic, Social and Corporate Governance) risks will limit its already high demand levels for seaborne ore. As a result, we expect supply and demand will become more closely aligned as we approach 2022, leading to a gradual easing of ore prices over the medium-term.

A tempered price range is also what we expect gold to experience, settling in a lower price range than in 2020, as the peak demand for gold has passed and US real yields are gradually improving from their negative yield levels.

Gold and US 10-year real yields



China's iron ore demand and Brazil's iron ore exports (in metric tons)



Copper supply and demand growth forecast (%) using 3 year moving average

Source: Bloomberg, Wood Mackenzie, Private Wealth. Past performance is not a reliable indicator of future performance.

Central banks to finally develop a medium-term focus on underlying societal issues

Last year brought major central banks rigour to the test, not just in the form of monetary support to markets, but the judgements needed to understand the underlying issues within economies.

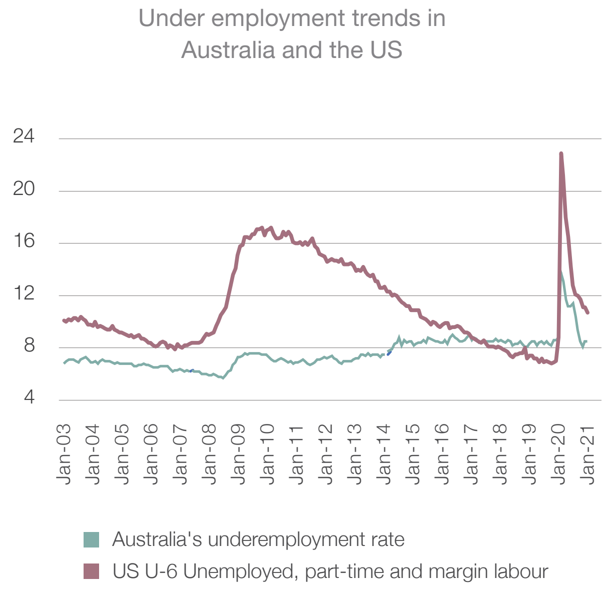
Outcomes based as opposed to forecast driven

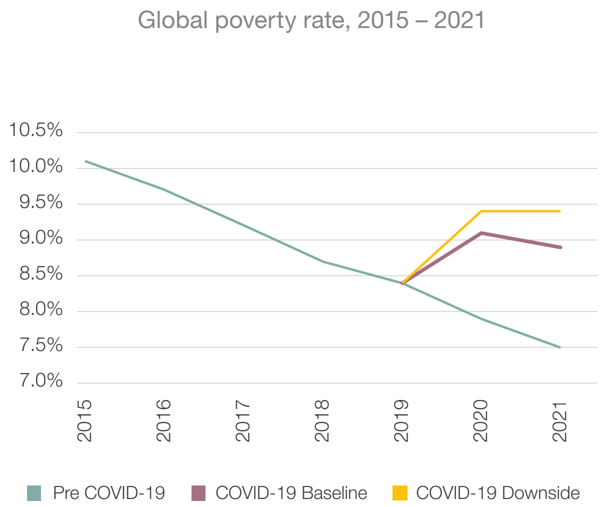
The US Federal Reserve continues to distinguish itself by being very focused on societal issues, be it permanent loss of lower-paying jobs or businesses that have permanently closed. We have long valued this distinguished attribute, and we expect more central banks to surprise markets by striking a balanced tone between short-term economic recovery and the fundamental issues around long-term and **equitable economic prosperity**.

This will challenge conventional market thinking about monetary policy and create a higher level of yield volatility. We expect this to be most visible through tensions between low short-term interest for up to 2 years and markets pushing yields higher for 2-year tenors and above.

To further highlight how monetary policy is increasingly focusing on these societal issues, consider these two additional developments as emerging issues of consideration by some central banks:

1. The European Central Bank (ECB) is starting to push for deeper analysis of inequality to gauge and develop the path for its monetary policy. The ECB announced that further efforts must be made to understand what the unequal distribution of income and wealth across the euro area means for the impact of its monetary policy, given that households differ substantially in terms of sensitivity to business cycles and consumption patterns. This move echoes recent efforts by the US Federal Reserve which has faced growing pressure to acknowledge the uneven impact of its policies in recent years, and committed to a more inclusive approach to monetary policy.





Source: Bloomberg, the World Bank, Private Wealth. Past performance is not a reliable indicator of future performance.

2. In relation to climate considerations, we believe carbon pricing is essential as it creates incentives for decarbonisation by incorporating the cost of greenhouse gas emissions into the price of goods and services. Central banks are now telling businesses to do so. The Bank of England will launch its stress tests on UK banks and insurers against the effects of different climate change scenarios in June 2021, by testing their balance sheets to see how they would cope with more frequent severe weather events like floods and subsidence. It will also test them on the effect of a sudden fire sale of "at-risk assets" and on when banks suddenly step back from lending to high-carbon sectors or insurers sharply increase the price of flood insurance.

A dormant but potentially major competitor in digital currencies

Lastly, central banks are working on the development of their own digital currencies. If successful, in our view, they will gradually be disintermediating the commercial innovators of non-central bank supported digital currencies and tokens.

From a central bank perspective, this is about creating digital alternatives to cash, and to maintain monetary sovereignty in the face of rapid development of private payment alternatives. Key to this development is that a central bank digital currency cannot compromise monetary or financial stability and that such a digital currency could coexist with and complement existing forms of money, promoting innovation and efficiency.

Whilst not visible to markets today, we expect the convergence of monetary policy with societal issues to become clearly visible over the next few years.

Fundamental divergences to lead currency and interest rate markets

The challenges of obtaining enhanced yield have been amplified

We expect short-term Australian real yields (after adjusting for inflation) will at best only move from negative to zero levels over the next few years. This, in our view, will continue to guide the importance of identifying risk-considered Australian yield enhancement opportunities at a time when credit spreads globally are at levels below those where markets stood before the COVID-19 pandemic in early 2020.

In addition, this is occurring at a time when the global credit markets have propelled to a record size, led by the US high yield market, which has grown to US$1.5 trillion in size as of March 2021 (source: Bloomberg).

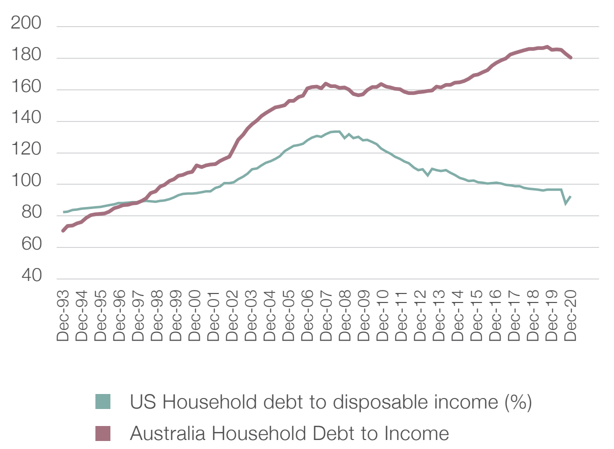
We, therefore, believe that (a) active management in corporate credit markets, (b) strategies that emphasise low-interest rate duration, floating-rate attributes, with strong credit underwriting skills and the ability to identify sound relative yield value, and (c) select opportunities in private credit markets, are the key to extracting considered yield outcomes for the next few years.

Global medium to long-term rates to further rise, led by the US

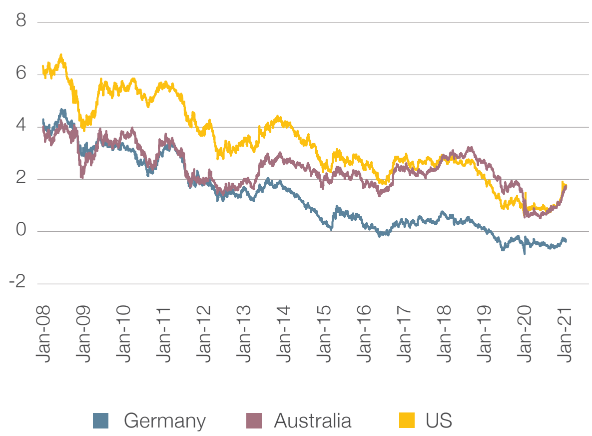
The disconnect between economic progress from late 2020 onwards and low long-dated bond yields globally was increasingly unjustified. Hence the fast increase in long-dated bond yields led by the US in the last few months. Looking forward, we expect US long-dated bond yields to continue to rise and lead other developed market yields.

This largely reflects **our longer running conviction that US economic momentum is more superior to those of many parts of the world**, before and even after COVID-19, and the higher level of government debt issuance over time. In particular, we expect US 10-year real yields to rise from their current level of -0.60% to positive territory in the next year.

US and Australian household debt as a % of disposable income



10-year government bond yields (%)



Source: Bloomberg, Private Wealth. Past performance is not a reliable indicator of future performance.

Positive medium-term interest rate differentials to re-emerge in favour of the US

We are alone in this view, but we anticipate a positive interest rate differential backdrop in favour of the US economy will manifest itself again over time, between 2-year yields all the way to 5-year yields. We expect this to be empowered by the strength of the US consumer, which continues to be underestimated by global investors, the solid foundations of the banking and real estate sectors in the US, and the revitalised activity across many advanced segments of the US industrial sector.

From an Australian perspective, a central pillar in our unconventional thinking is that 2-year to 5-year yields in Australia will lag those in the US. We believe there will be several reasons for this, namely (a) the lack of progress with the medium-term trend in underemployment in Australia, (b) lack of wages growth, (c) higher levels of consumer mortgage-related debt, (d) the lack of effective Australian business reform agenda as an opportunity through the pandemic period, and (e) lower Australian fiscal impulse than the US, are likely to transpire in lower growth in Australia than the US for the next few years. Embedded in this assessment is the principle that the positive multiplier effect of the recent Australian government initiatives is not permanent in nature.

Medium to long term inflation to stay within its lower bounds

One point of critical consideration is the rise in core consumer price inflation over the next year or so. However, we believe the combined forces of high levels of global debt, demographics (ageing population), lack of broad-based wages growth, and the long-term and structural deflationary impact of technology will keep medium to long term inflation trends within lower bounds.

Whilst most of the current debate centres on the rise in prices of input industrial commodities where we mainly expect factory gate prices to rise, we attribute a higher degree of emphasis on supply chain re-orientation and global food price inflation as key sources of shorter-term inflation. We believe rising global food price inflation is being caused by; (a) a deteriorating climate and increased volatility in weather conditions for a range of soft commodities; (b) robust global demand for protein and feedstock, and; (c) speculative trading activity. Lastly, most alarming to us is the markets' ill-informed globalisation of the inflation issues, where - unlike countries like the US - we expect countries like Australia will not experience a material rise even in consumer price inflation due to the different composition of its growth drivers.

Over the medium-term though, we believe that only a subset of businesses domestically and globally have pricing power and hence have the ability to pass such higher input prices to end customers on a permanent basis.

The trajectory of consumer price inflation is one about a higher path over the upcoming two years, and a stabilised lower point over the medium term

The next two years	Beyond two years
– Localising some supply chains initially comes with price pressures. – Structurally higher global agricultural price. – Higher commodity price inputs to lead to lower profit margins for some companies and higher end product prices for consumers now.	– Rising levels of global debt to diminish the productive use of what otherwise is more unencumbered capital. – The burden of an ageing population on national budgets continues to be significant. – The deflationary forces of technology.

Source: Private Wealth.

As we continue to focus our attention on the next two to five years, we believe the role and opportunity afforded to alternative providers of debt and growth capital will expand in scope and attractiveness in Australia. As a result, **we expect alternative providers of capital will eventually represent circa 20% of the total supply of credit to the Australian economy by around 2025**.

This would be a significant milestone given that, at the turn of this century, little to no presence existed for these non-bank lenders. However, the importance of their role in relation to the Australian economy remains underappreciated, given that their existence and value proposition is generally centred on delivering the certainty of capital and the right price competitiveness to consumers, corporates, and real estate developers.

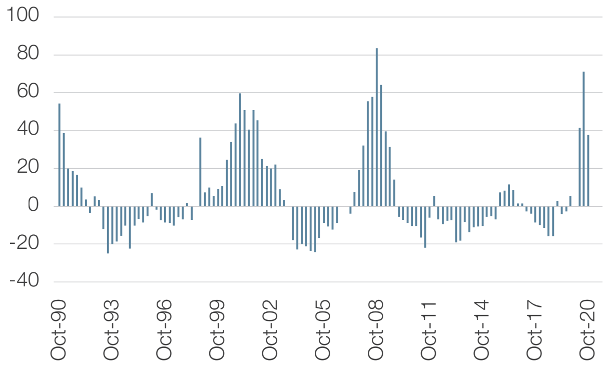
We also expect these attributes to be prevalent in the US market, where the combination of sound underlying fundamentals and a less reliable source of traditional funding empower an attractive opportunity set for alternative lenders.

We believe that currency markets have entered into a state of notable fundamental divergence, having been largely driven by global risk and vaccine influences.

Therefore, we anticipate the state of currency markets to be nuanced over the next one to two years. The US$ is being buffered by competing forces: (a) rising geopolitical risks around the world combined with the strong US economic recovery and fiscal stimulus-empowered growth advantage, offset by (b) the structural drag from rising trade deficits. We therefore expect the US$ to be broadly range bound over the medium term. However, we take note of the self-fulfilling industrial renaissance of the US going forward, and the increasingly debt-light US consumer, that when combined can drive periods of US$ strength within such broad range.

Our assessment of the Australian dollar is that it already reflects the relevant constructive fundamental conditions, be it sound economic recovery or the strong iron ore price and volume conditions that are benefiting our country. As these forces mature, we expect them to offset any progressive decline in the US dollar, thus keeping the Australian dollar in the 0.72 to 0.76 range to the US dollar over the medium term.

Net percent (%) of domestic bank respondents tightening standards for commercial real estate and industrial lending



The Bloomberg US Dollar Index

Source: Bloomberg, US Federal Reserve, Private Wealth. Past performance is not a reliable indicator of future performance.

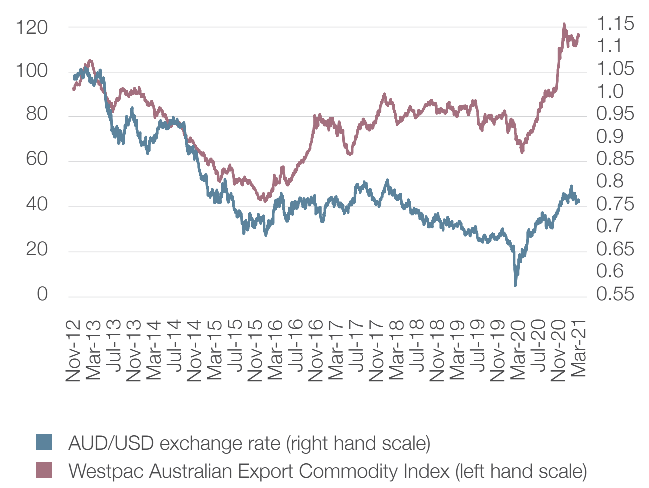
As for the development of the cryptocurrency industry, whilst its formation is based on a vision and ambition for the use of digital instruments going forward, we believe its development faces a number of immediate fundamantal hurdles, largely centred around three factors.

1. The first is about ensuring the cryptocurrency industry does not attract harmful or illegal sources of capital that are intended to enter the legal financial system.
2. An extension to the first factor is how the industry will inevitably adjust to a regulatory environment that is just starting to consider the basic requirements for a widely available crypto market.
3. The third factor is about the significant progress that is yet to be achieved to have a stable and reliable market for crypto instruments, where a far lower level of price volatility, better price discovery and a deeper level of two-way liquidity are essential. These characteristics go to the heart of the interest in this space that is quite often defined by attributes such as store of value and its emergence as an market segment.

Meanwhile, the foundations for a stronger British pound are being laid given (a) its ongoing innovation in a number of industries, (b) its leading role in the global decarbonisation scene, (c) its improved strategic ability to start defining a number of bilateral trade relationships with some of its key trading partners, that can be done with clear benefits to the UK as opposed to being hostage to Europe, and (d) the improved potential for foreign direct investment flows over time.

We expect the currencies of Canada and Mexico to distinctly benefit from US economic vitality, given the strong linkage between the three nations. We believe this is an outcome of what we expect to be a **North American manufacturing renaissance** that is a direct result of the gradual localisation of supply chains in North America. As for Asia, we anticipate a weaker tone to some of the South East Asian currencies as they continue to be vulnerable to pandemic developments, whilst rising medium-to-long term US interest rates act as a deterrent to flows into that region.

Westpac Australian Export Commodity Index and the A$



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Source: Bloomberg, Private Wealth. Past performance is not a reliable indicator of future performance.

The next ten years will be the golden era of healthcare innovation

No crisis should go to waste without instigating positive structural change. This is especially the case given the world cannot afford another pandemic of significant proportions similar to the COVID-19 pandemic.

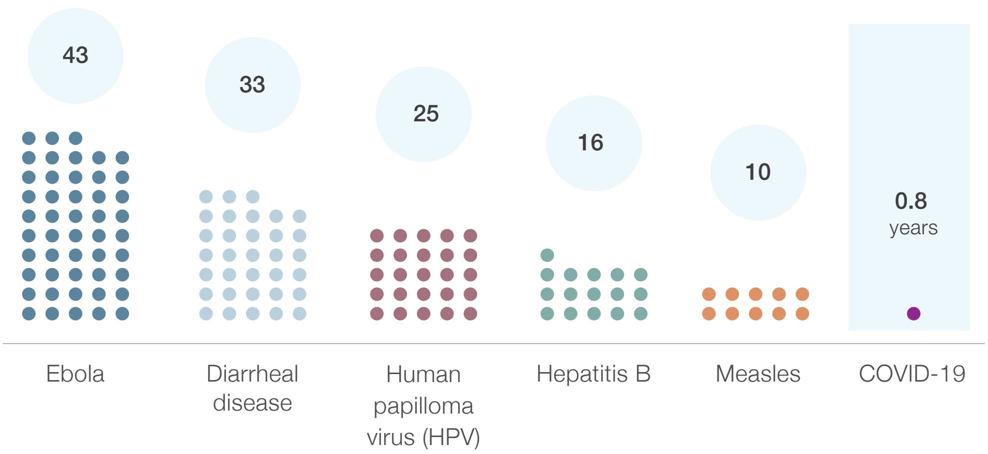
Operation Warp Speed delivered a SARS-CoV-2 vaccine in approximately ten months, and as a result, the world has developed COVID-19 vaccines in record time. For all the medical breakthroughs that have been seen, this is an incredible achievement for our world, when other diseases took much longer to address, as shown in the diagram below.

We believe the COVID-19 crisis is a seismic catalyst for progress. We expect a marked acceleration on a number of fronts in the overall spectrum of healthcare innovation; from better collaboration between government and private sector, to a significant increase in resources committed to research excellence, breakthrough therapies, diagnostics and medical technologies. Moreover, we see promising evidence of healthcare regulators expediting their assessment of drug discoveries and approvals, hence we expect them to play an ever-increasing part in supporting the global health innovation engine going forward.

We also expect governments to partly underwrite a larger amount of primary research in healthcare going forward as the cost of doing so (in the billions of US dollars) has now been clearly understood to be a tiny fraction of what they have recently spent on economic recovery (in the trillions of US dollars). We anticipate this to set the foundations for another accelerating innovation cycle and a more productive opportunity set in broad research, drug innovation, personalised health treatments, precision oncology, smartphone-connected pacemaker devices, increased access to telemedicine, as well as modern solutions to rare diseases, immunotherapies, gene and cell therapy.

By 2030, we expect the healthcare industry will have shifted from reactive to proactive and preventative.

Time (years) from infectious agent identification to vaccine license in the US



Source: FDA, McKinsey & Company, Private Wealth.

In some parts of Asia such as China, healthcare innovation is a national priority. Historically, China's high-end drugs and medical products markets were dominated by multinational companies (MNCs) equipped with innovative technologies, while domestic companies mostly produced components for those MNCs. Through its "Made in China 2025" strategy, China is implementing this blueprint, which is intended to transform itself into a global high-end manufacturing powerhouse over the next decade, including in areas such as biopharma and high-performance medical products.

As a result, we believe the healthcare investment opportunity in China is widening in breadth. This is in part due to the fact that different sectors of the Chinese healthcare industry are growing at a rapid pace because of ongoing urbanisation, a fast ageing population, a continuous rise in wages and living standards for Chinese citizens, as well as broader access to healthcare.

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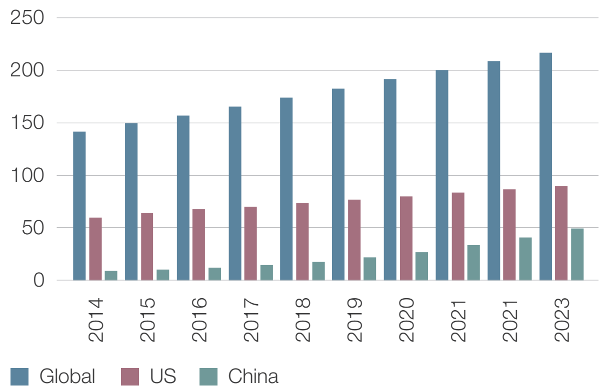
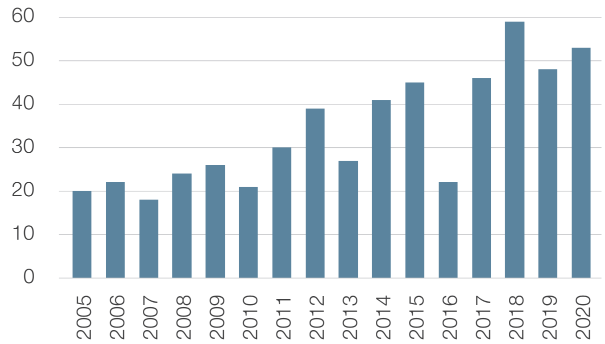
Global, US and China pharmaceutical R&D spending (in US$ billions)



US Federal Drug Administration (FDA) number of drug approvals a year



Source: Bloomberg, Statista, US FDA, and Private Wealth. Past performance is not a reliable indicator of future performance.

Real estate markets entering their most critical phase in our modern times

For us, real estate is about quality.

The COVID-19 pandemic has only magnified the importance of that foundation, which is defined by asset-specific attributes, the critical role of an asset, and tenant business model sustainability. We expect differentiation between prime and secondary assets, as well as A-grade and B-grade assets to persist and widen over time.

However, there is also a limit to the level of price premium one should pay for high-quality assets. And this is the discipline we believe is now immensely needed given the record low levels of medium-term interest rates, the shrinking supply of high-quality opportunities and the increasing valuations for these assets.

That said, we believe sound opportunities continue to exist for those with a competitive advantage and a fundamental understanding of the forward and evolving real estate needs of economies. For us, this also includes identifying emerging trends for the next five to ten years and to be opportunistic in identifying assets close to replacement value with sound potential.

Challenges remain for low-quality office and retail assets across the world, especially in terms of the ongoing revenue generation that has continued to soften to unprecedented levels. Outside the challenged commercial retail and hotel sectors globally, high-quality real estate assets are heavily sought after, with two factors defining the state of global market conditions in general:
(a) premium pricing for quality assets in sectors such as industrials, logistics, healthcare and life sciences and (b) the shortage of high-quality investment opportunities.

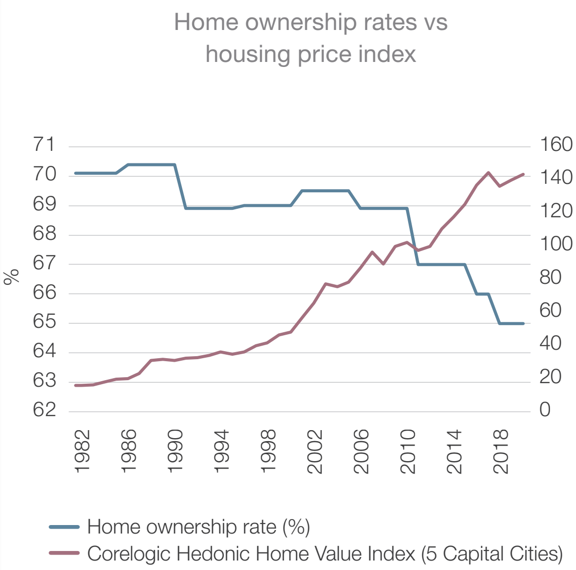
Australia's housing affordability is reaching a record low

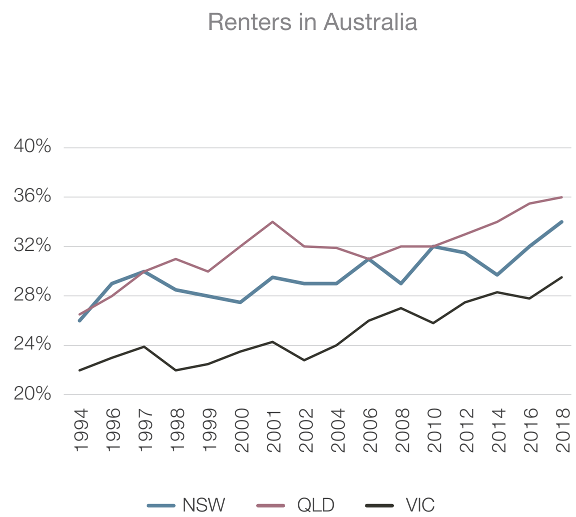
As we turn our attention to the future, we believe housing affordability in Australia has deteriorated further for our future generations, given no real wage growth in sight, thus diminishing the capacity to spend on productive areas.

Build-to-rent to gain traction over time

This affordability challenge adds to our conviction that it is only a matter of time before build-to-rent trends accelerate and Australians return to the rental market. This is due to two significant drivers:

1. Firstly, we anticipate that the end of government incentives will lead to softer first home buyer's activity. This will expose the unaffordable state of housing which has been due to the fast pace at which house prices increased in 2020.





Source: Bloomberg, ABS, Corelogic, and Private Wealth. Past performance is not a reliable indicator of future performance.

2. Secondly, a policy is being developed to encourage more investment into the build-to-rent sector, such as reducing land tax by 50% for the next 20 years for new build-to-rent (BTR) schemes and exempted BTR developers from foreign investor surcharges in NSW. We expect the opportunity to emerge initially in inner urban locations with acute supply shortages, matched with a demographic that has a demonstrated capacity to pay reasonable levels of rents reflective of the incremental quality, service and amenity being offered.

From urban to suburban

Calendar year 2020 marked the greatest movement of people out of capital cities and into regional hubs. In the US, the move from gateway cities (such as San Francisco and New York) to semi-gateway markets, such as Austin, Denver and Raleigh, was also mirrored by similar moves in Australia. A sharp increase in the number of people searching for and acquiring property in regional Australia has registered a record high. We don't expect this trend to reverse.

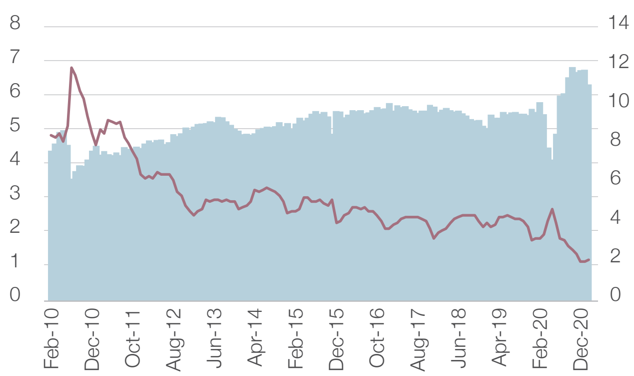
In the US, companies are leading that transformation, making the shift in employment and housing permanent, whilst in Australia, we expect the return to office work can elevate the demand for regional areas on the outskirts of capital cities. We are increasingly constructive on the state of US housing as housing formation is lagging natural demand by about 900,000 single-family homes at a time when existing home inventory is at a 20-year low, which is also brought about by a decade of underbuilding.

Our conviction in our thematic focus on the value creation through various segments of US housing remains in place, and is further emboldened given the undemanding valuations that a number of these subsectors offer.

Sustainability through intelligent design

Europe and some parts of the US are leading the imperative of real estate asset sustainability and adaptability when it comes to the delivery of health requirements for the workforce and diminished carbon footprint. To that end, in time we expect a major source of value differentiation to emerge in commercial markets, favouring real estate assets that are agile.

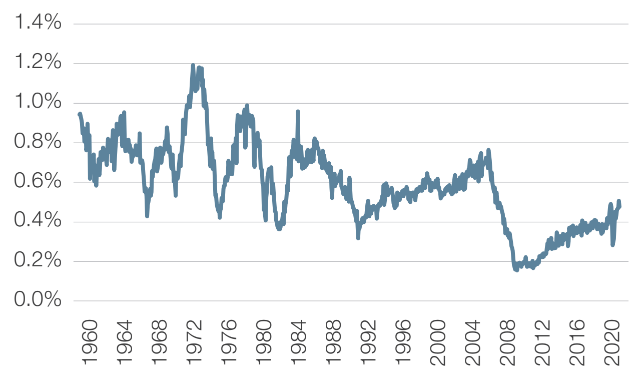
US existing homes: Annual sales in millions and available supply in number of months



Available inventory of months' of supply (right hand scale)

US existing home annual sales (in millions) (left hand scale)

Housing starts as a % of US population



Source: Bloomberg, Federal Reserve Bank of St. Louis. Past performance is not a reliable indicator of future performance.

Over time, we expect a distinct and growing pool of global liquidity that will only engage in real estate assets of such attributes.

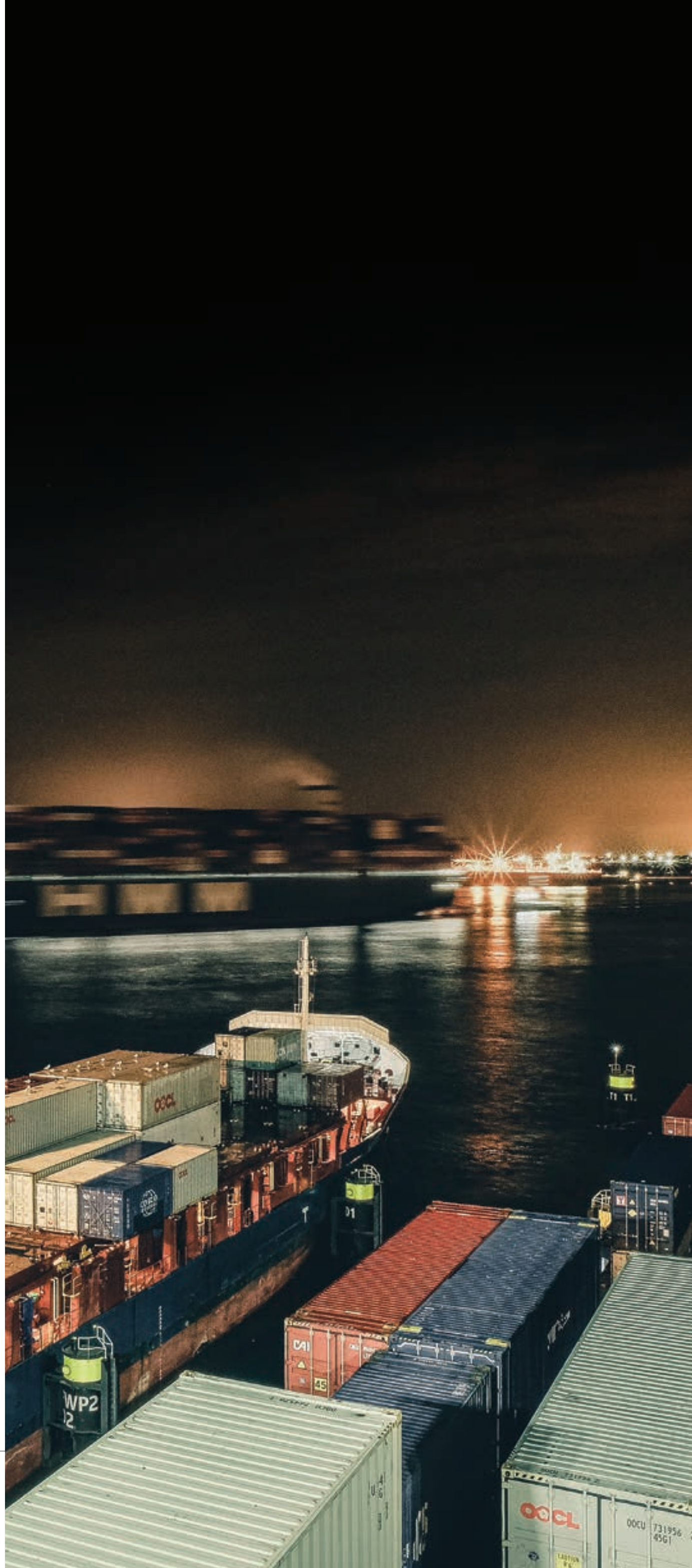
We expect these changes to be also embodied in the form of increasing legislated requirements over time. We believe that assets that are unable to be remodelled and respond to the evolving needs of healthy work design and energy efficiency are likely to have a declining institutional investor interest and therefore develop "orphan" characteristics.

From first mile to last mile

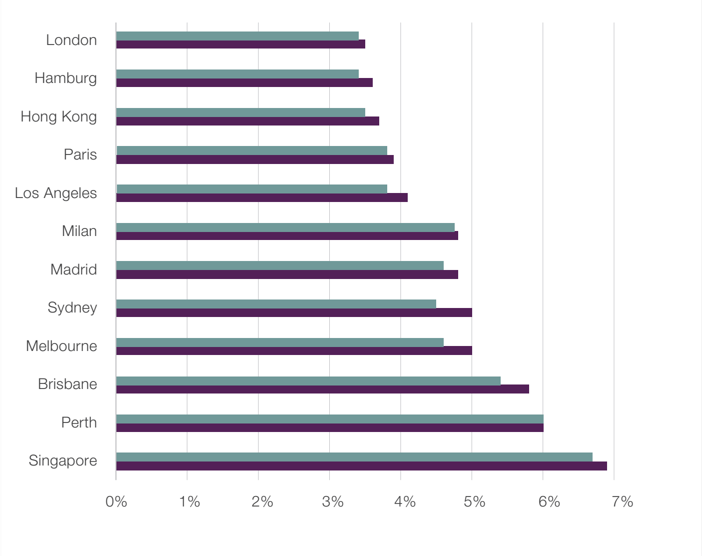
For the large part of the last decade, we have been constructive on the unique fundamentals that underlie the prime logistics sector globally and domestically. We continue to do so given our assessment of the sustained growth in demand for e-commerce and from first to end mile transport and storage facilities.

However, our conviction for the next few years is particularly driven by our view that e-commerce will become 30% larger than what it is today, and that localising, or reshoring manufacturing will generate additional demand for industrial facilities from across a wide number of sectors. It then falls down to the premium we are willing to pay for these reliable cash flows being delivered by resilient business models.

However, our conviction for the next few years is particularly driven by our view that e-commerce will become 30% larger than what it is today...



Global industrial prime yields



Source: CBRE, Knight Frank, JLL, Private Wealth.

Learning to live with higher and demanding asset market valuations

In 2020, the global economy decelerated as various parts of the world went into a sudden economic halt. However, global equity markets (as measured by major equity indices) fully recovered by the end of 2020 in anticipation of better economic conditions in 2021 and beyond.

While this reflects the forward-looking nature of equity markets, corporates now have to prove that they can deliver on their medium-term earnings priced in the current valuations. Consequently, we expect equity indices in 2021 and beyond to remain in a narrow range, except for certain parts of Asia. With that comes **an attractive environment for fundamental investing, supported by high levels of discipline and active management.**

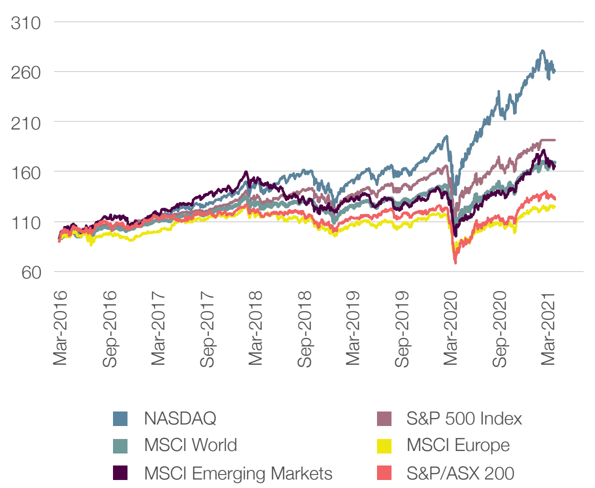
Before we address the evolving landscape for risk and opportunity in equity markets, we believe two forces can derail the overall state of equity markets, including (a) a rapid and meaningful increase in real yields and (b) misguided fiscal stimulus. In our view, medium to long-term bond yields have disconnected from the state of global economic progress, and hence the upward adjustment in long-dated yields that has occurred is overdue. As long as higher long-term real yields are driven by quality growth and do so in a gradual fashion, financial markets can adjust to that without major downward dislocations in either equity or real estate markets.

The environment for fundamental theme and sector selection is improving and is more critical than ever before. This is in the context of our expectations that equity volatility will increase as governments seek to unwind their support to markets over the next few years, combined with tighter regulations being implemented in China to prevent the disorderly expansion of capital.

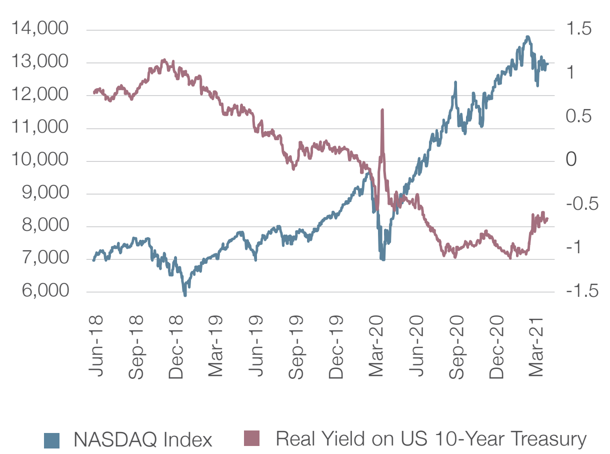
To that end, we expect a meaningful level of productive opportunity to be available for those that can be selective and have the capacity to allocate capital to fundamentally driven ideas that are differentiated to the broader equity markets:

1. **Structural themes** that have large, yet still developing addressable markets, and therefore have notable further potential for growth over the next few years despite having performed well to date. Opportunities here include areas such as cloud adoption and cybersecurity, which we have established our conviction in for a few years now.

Performance of equity market indices since 2016



NASDAQ Index and US 10-Year Real Yields



Source: Bloomberg and Private Wealth. Past performance is not a reliable indicator of future performance. Performance of equity markets indices rebased to 100.

2. **Investment opportunities** that are fundamentally robust, however have been overlooked and underappreciated by investors for various reasons. As a result they offer undemanding valuations compared to their growth potential. This includes various themes and sectors (some of which are covered earlier in this publication) such as US financials, global and US industrials, 5G network equipment providers, beneficiaries of infrastructure spending and US housing evolution, equipment providers to the global semiconductor sector, and offshore revenue-oriented companies in Australia. Many of these businesses have defensive characteristics while manifesting an increasingly attractive earnings growth profile.

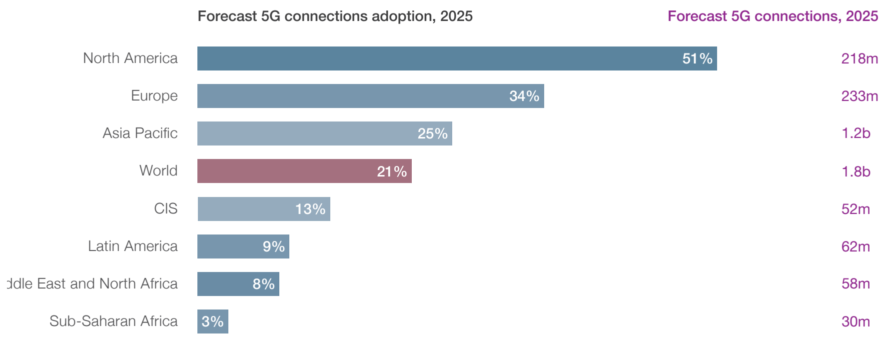
Overall, the importance of taking a medium-term fundamental view has never been as important as it is today. In addition, we believe the balance of opportunity has shifted from opportunity on the long side to opportunity on both the long and short side.

We are increasingly constructive on the long-term opportunity empowered by the development of a global 5G standard across the world. As we consider the forward context into 2022 and 2023, we see clear evidence of 5G deployment gaining pace globally combined with accelerating 5G hardware and software innovation. Meanwhile, China and the US strategically lead the world with their 5G network deployment, committing vast amounts of capital to become nationwide 5G-ready.

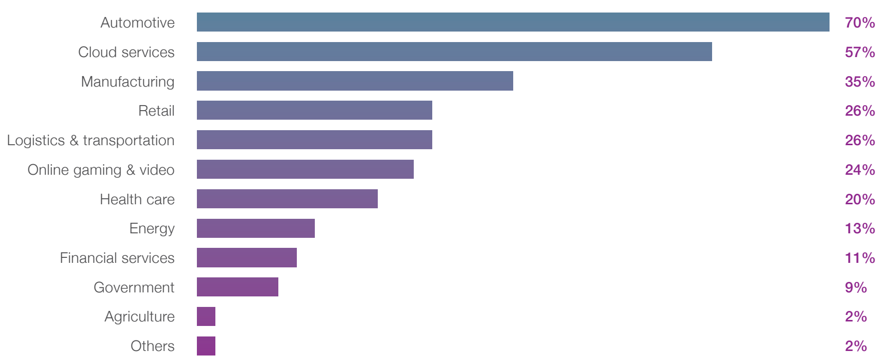
Our fundamental vision is unchanged, reflecting that the faster development of the 5G infrastructure will transform industries and enhance people's quality of life through the deployment of advanced technologies, remotely activated business services, smarter phones, and smarter cities.

In terms of its impact on industries, given that 5G reduces latency times while preserving energy, this will positively impact time-critical applications such as connected health, cloud services and advanced manufacturing.

5G connections and adoption



Industries expected to be impacted the most



Source: Business Performance Innovation Network (BPI). Past performance is not a reliable indicator of future performance.

Cybersecurity – the new cold war frontier for the 21st century

A world that is increasingly connected through 5G, served by public clouds, and defined by the internet of things and rising geopolitical tensions, is a world that is becoming increasingly complex in terms of security needs.

We believe that the overall challenge, which is under-appreciated, is the scope at which the cybersecurity opportunity set is growing and the increasing impact it is having on multiple areas of security.

Last year, several large-scale US government agencies were hacked, while this year, about 60,000 SMEs were hacked as Microsoft's widely used business email software was compromised. Sadly, cybercriminals capitalised on the tragic year 2020 was by attempting to breach a record number of enterprise systems in e-commerce, financial services, healthcare, and many other industries.

In addition, **the US-China relations will define the geopolitics of this decade, adding to a world divided by ideologies.** As a result, we believe cyber-warfare will emerge as the single most dangerous activity for the period ahead. **This is already starting to become evident as state-run or state-sanctioned cyber-warfare is on the rise**, such as the recent Russian-backed hacking group, which was boldly attacking a range of targets, from American corporations to Eastern European energy grids. This extends to the recent weak long idling of US Eastern border gas pipeline infrastructure.

Cloud-first, cloud-only and cloud sector leadership

The philosophical challenge that we all must contend with is the importance of not just trust but maintaining trust, even though our cyber experts may be outsmarted at times. Just when 2020 exposed the potential to test the breaking points of the global healthcare system, the shortage of cyber talent and expertise will emerge as one of the most acute challenges for the next five years.

In the December 2020 quarter (Q4), global cloud infrastructure service revenues reached US$37 billion, bringing the total for the calendar year 2020 to US$129 billion, (source: Gartner). This is an industry that did not exist 15 years ago and will be one that will be a priority and considered critical infrastructure to the world economy by 2025. During 2020, leading cloud providers experienced two years of growth in almost three months, reflecting the significant acceleration in demand for cloud services during the pandemic.

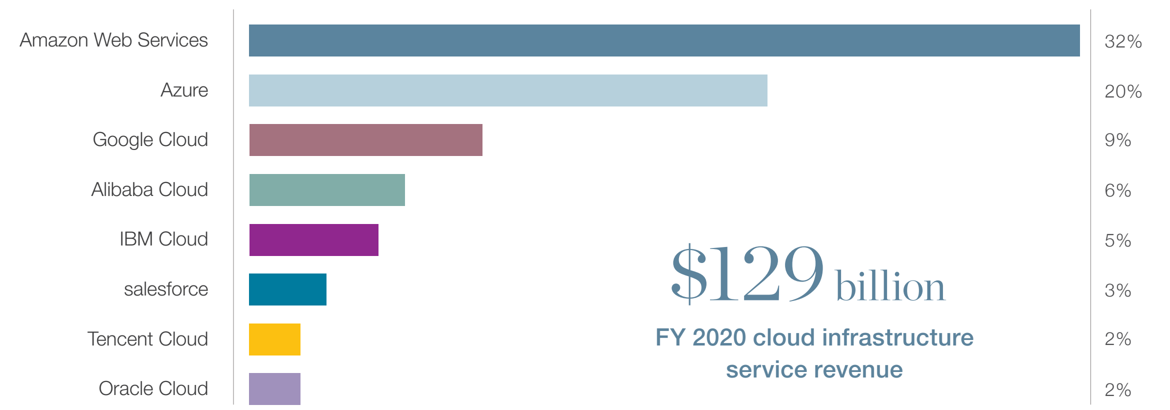
What we expect to emerge is three key trends:

(a) the critical benefits of cloud adoption to be best exemplified by the increasing number of businesses going cloud-first or cloud-only;

(b) the total size of the addressable market to maintain its double-digit growth as digital transformation trends grow further; and

(c) the leaders in this ecosystem to get stronger while smaller or later entrants struggle to achieve critical and

Worldwide market share of leading cloud infrastructure service provides in Q4 2020*



* Includes Platform as a Service (PaaS) and Infrastructure as a Service (IaaS) as well as hosted private cloud services. Source: Gartner, HIS, Strategy Analytics, Mckinsey, Private Wealth. Past performance is not a reliable indicator of future performance.

profitable scale. While the structural growth trends will, in our opinion, persist for years to come, we expect productive investment opportunities will exist by identifying the longer-term winners and losers, expressed through stock selection skills on both the long and short side.

We believe that one of the most underappreciated features of the global corporate community is their determination to digitise their key business functions to serve changing customer preferences better, address operational challenges, and enhance operational efficiency.

The global digital transformation market size is expected to grow from circa US$469.8 billion in 2020 to US$1 trillion by 2025 (source: IDC, Accenture and McKinsey), where its major growth drivers are the increasing penetration of mobile devices and applications as well as the increasing adoption of cloud services.

Recognising where pricing power and resilience emerge

We believe some of the factors that will drive productive investment opportunity going forward is the ability to (a) differentiate between the aspects of industries that are likely to be exposed to competition, and those that are likely to experience a recurring and stable set of growth drivers over time; and (b) identify innovation-led or structural changes in business models that lead to resilient earnings.

In relation to the former, a case in point is the global semiconductor sector, which has gone from excess capacity in 2019 to supply shortage in 2021 due to sharp global economic recovery. With the volatile nature of the semiconductor sector, the structural end-market drivers are strong, driven by 5G, Artificial Intelligence and high-performance computing. As the global giants (such as Samsung, TSMC, Intel) commit significant amounts of capital to increase production over the next two years, supply and demand will ultimately normalise as will pricing power and operating margins.

Attractive Growth Opportunities in the Digital Transformation Market

469.8 USD BILLION 2020 (ESTIMATE)

1009.8 USD BILLION 2025 (PROJECTION)

CAGR of 16.5%

The global digital transformation market size is projected to reach **USD1009.8 billion** by 2025, growing at a CAGR of 16.5% during the forecast period.

Source: IDC, Accenture and McKinsey. Past performance is not a reliable indicator of future performance.

However, we believe the more resilient growth-oriented businesses in the semiconductor supply chain are those that engage in the design automation and the supply of equipment makers and components to major chipmakers. These companies can leverage their dominant and oligopolistic position in the market, which is underpinned by multi-year structural growth drivers and without being exposed to volatile and fast-changing end-product demand and supply dynamics.

To that end, with the US being home to the largest submarket in equipment and design automation, we believe that this sector, along with some specific leaders in Europe, are multi-year beneficiaries of this trend.

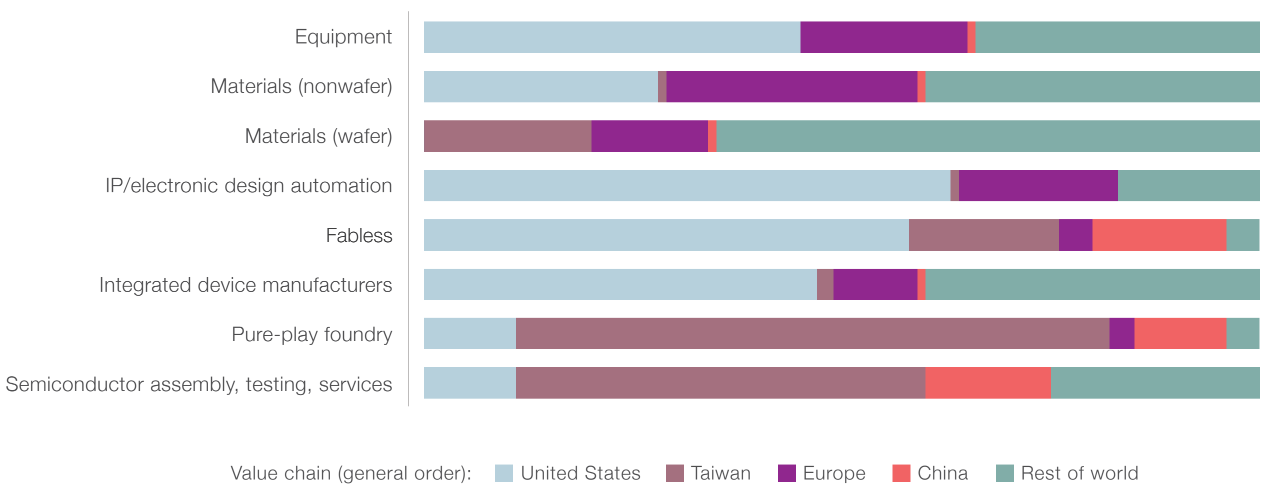
For the latter, an example would be businesses that are evolving from cyclical to less cyclical. As business models evolve, select companies will become less cyclical in their overall activities and operating performance. This includes industrial companies in Australia and overseas, whose innovation-led product range is increasingly used in existing and new market segments, thus reducing the dependency on one specific activity.

Similarly, the innovation in recycling within the waste management industry in Australia (and globally) has the potential to produce robust and sustainable earnings and cash flow outcomes as the needs of our country become more dependent on the services provided by the local industry that is going through a consolidation phase, in part driven by China's decision to cease importing waste from other countries. With Australia generating approximately 67 million tonnes of recyclable waste per year, waste management is a huge industry that will increase with population growth, however has high barriers to entry in particular segments of the waste sector, such as municipal collections and commercial waste.

Lastly, one of the most overlooked attributes in equity markets we are highly constructive on is an increasing number of small and mid-size businesses, especially in Australia that are becoming more global at a younger phase of their development and in some instances at a very early stage. Put simply, we see an increasing number of smaller businesses with more immediate global ambitions. As such, we expect the market to reward demonstrable innovation more going forward, in both private and public markets.

To that end, we expect an attractive opportunity set through the underappreciated pace of innovation from smaller businesses with a good focus on scalability and the ability to withstand economic shocks, factors which were less considered in a world prior to COVID-19. This is also occurring in defensive sectors such as healthcare, where such targeted innovation is hard to replicate.

End-to-end capabilities for semiconductor design and manufacturing by region



Source: Gartner, HIS, Strategy Analytics, Mckinsey, Private Wealth. Past performance is not a reliable indicator of future performance.

Rising sector-based volatility sets a backdrop for productive opportunities, especially in Asia.

We believe the combination of fundamental discipline, active management and overall macro awareness will be the prism for opportunity extraction in equity markets at this stage of the global equity market cycle.

We expect a higher degree of stock price volatility over the next two years for several reasons, including changing geopolitical landscape, current levels of valuations, faster degree of competition in sectors such as healthcare and electric vehicles, localisation of supply chains creating winners and losers globally, and most crucially the lack of equity markets' ability or patience to extend their horizon beyond the short-term to truly appreciate the operating strength of leading innovative business.

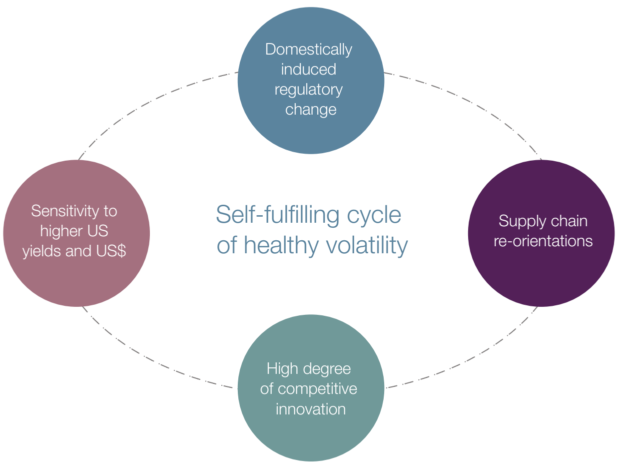
Meanwhile, structurally challenged businesses and those that cannot sustain the same level of growth experienced during the COVID-19 pandemic period are likely to be exposed. Combined with rising sector and stock-based volatility, we believe the balance of opportunity has shifted from opportunity on the long side to opportunity on both the long and short side.

For us, Asia is at a unique intersection. On the one hand, the medium to long-term thematic drivers of the opportunity continue to positively evolve across financial inclusion, evolving consumption, healthcare, and the progressive rise of South Asia's manufacturing supremacy. However, on the other hand, it is the region with the potential to offer outsized two-way volatility and hence Asia offers a rich set of resultant opportunity for the experienced investors that have an active management mindset.

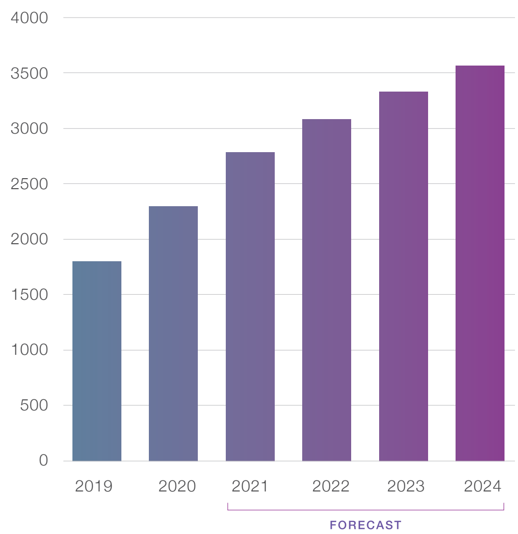
Across Asia, we see an improved opportunity set in credit and equity markets due to an increasing level of fierce business competition across a large number of sectors, resulting in both productive long and short investment opportunities, as product cycles get shorter and pricing power gets harder to retain.

On the short side, we see a rising breadth of opportunities in consumer related businesses (whose valuations have extended beyond justified long-term growth trajectories), the highly competitive nature of a commoditised life

Fundamental sources of volatility in Asia going forward



Retail e-commerce sales in China forecast to almost double by 2024 (in US$ billions)



Source: Private Wealth, eMarketer. Past performance is not a reliable indicator of future performance.

insurance market in China with global insurers entering the market, and traditional appliance companies and smartphone camera makers that are suffering from declining operating margins.

On the long side, we are constructive about the developments at an industry level across a number of verticals, ranging from; global leadership in the development of electric vehicle batteries, design apparel manufacturers benefiting from ESG and industry consolidation, shipbuilding being exposed to the first large scale upcycle in containerships in more than a decade, further progress in the area of financial inclusion, increased pace of innovation in and adoption of healthcare services, and finally the continued rise of advanced manufacturing in south east Asia. We also believe that the future of advanced manufacturing across Asia is evolving fast with the displacement effect being impactful within and across countries.

Underlying this is a unique generational attribute specific to Asia where younger members of the Asian population are highly aspirational in their desire to undertake breakthrough innovation and incredibly empowered by the innovators of the last ten years to undertake further evolution.

Balancing innovation and regulation

In addition to the above, specific to China, we expect volatility-induced opportunity to be also driven by its antitrust and financial authorities instigating a historic level of regulation on market-leading technology and e-commerce platform businesses as well as the banking industry, whilst reducing moral hazard in its credit markets. It is so critical to appreciate that this phase of regulation and market developments are not only significant in terms of their implications but are a state of play that will be with us for sometime, hence understanding the emerging opportunity and challenges has never been as important.

To that end, China's antitrust authorities have signalled their resolve to end a decade of unfettered expansion by its technology giants, combating behaviours such as data monopoly, market dominance, expansions without approval for years-old acquisitions and investments, and most importantly, online lending.

The context is important here. The banking sector in China has always been regarded as far too important to be left to the private sector. President Xi Jinping made clear in 2017 that financial stability was so critical that it should be regarded as an aspect of national security. With a large part of personal borrowing in China these days coming from online platforms, it is increasingly a central piece of market oversight.

After a peer-to-peer (P2P) lending boom that spiralled out of control in 2016, Beijing launched a crackdown that reduced the number of surviving P2P lenders from 6,000 to 29. P2P lenders still owe their depositors some US$115 billion, and Beijing is still trying to recover the funds. Beijing is resolute in its determination to control this segment of the market. In addition, we expect China's financial regulators to impose additional capital requirements on the nation's systemically important banks as part of its determination to ensure the stability of its US$49 trillion banking industry and its ability to recover from a crisis. This extends to a rising level of credit defaults in China, especially by state owned enterprises that have implicit government guarantees, where we expect Beijing to allow such defaults to reduce moral hazard and cultivate a mature credit market.

As a result, we believe the credit impulse in China will gradually ease over time, given China's focus on quality rather than quantity of growth. This is part of China's focus on domestic demand stability as well as scientific and technological independence and self-reliance – key pillars in its current five-year plan and a special 15-year strategy called "Vision 2035" that will see the country through "the long-term goal of in principle achieving socialist modernisation by 2035."

Leading companies in technology, logistics, digital payments, online services and overall e-commerce have to adapt, and those that proactively embrace the regulatory drive are likely to benefit from the fast-changing landscape, which we believe will lead to a change in market leadership. Those that don't will see their historical rates of strong revenue growth ease quickly, with implications to enterprise valuations.

This is at a time when online purchases are expected to surpass 50% of the country's total retail sales in the next few years, crossing this milestone as the first major economy globally (source: eMarketer), with user penetration expected to reach 83.5% by 2025.

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Starting his career at Bankers Trust Australia, George joined Westpac Private Bank in 2011. Before joining Private Wealth, George spent 11 years at Macquarie, initially working within the Treasury & Commodities Group. George then became a Division Director at Macquarie's Equity Markets Group and Macquarie Funds Group.

While there, he developed the investment selection and due diligence framework to support the investment management function for alternatives, hedge fund incubation opportunities as well as the delivery of structuring solutions.

As Chief Investment Officer for Private Wealth, Westpac Group, George identifies themes in global markets that are empowered by structural drivers, thereby seeking to uncover the investment opportunities and beneficiaries of those themes before they become widely recognised.

He also leads a team of six investment analysts who together form the Private Wealth Investment Team. The overall team is responsible for identifying and selecting investment opportunities for Private Wealth's Global Investment Service (GIS).

GIS is a service designed for self-directed wholesale investors that filters, selects and monitors investment opportunities for clients across global asset classes and currencies.

Whether addressing domestic or global economic developments, George is a regular thought leader and frequently shares his views to help clients allocate capital and navigate changing investment landscapes.