NEWTON ROSS

PRIVATE WEALTH MANAGEMENT

19th April 2021

March 2021 Quarterly Report

This time last year we were grappling with the prospect of a steep recession amid the global pandemonium of Covid-19. Whoever could have predicted that there would now be 18 vaccine candidates in testing or in use today and with more candidates to come? Knowledgeable commentators at the time were saying an effective vaccine may never be developed or at best would be years away.

While 2020 was about getting the recovery started after the deepest recession since the Second World War, 2021 is all about speed of vaccination and ending the lockdowns as quickly as possible. Freeing up economies will accelerate growth through the year while additional government spending and continued low interest rate settings will assist. All this economic stimulus is likely to be further supported by households around the world that saved trillions during various lockdowns. The IMF has recently revised their global growth prospects up to +6% this year – a rate of growth not seen since the early 1970s.

With a very strong economic outlook for the rest of 2021, we expect growth assets in investment portfolios to be well supported by recovering business earnings and rising demand for property, commodities, and infrastructure assets while safer income assets such as bonds and term deposits are not likely to produce high returns but will still be needed to provide some portfolio protection.

The risks to this positive outlook include the divergent nature of the vaccination programmes putting developing countries at a significant economic disadvantage, the potential emergence of a nasty virus variant and global supply chain disruption as rampant demand overwhelms producers and suppliers.

There are also significant overvaluations for some assets, sectors, and markets. We expect the recent rotation of investor funds into more undervalued sectors (such as travel, financials, retail, accommodation, and hospitality) will continue as a post covid future gets closer.

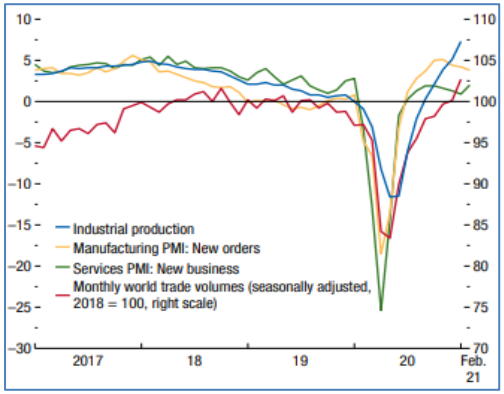
Kind regards,

Wayne Ross
Director Investments

T 09 377 5777 | PO Box 2683 | Shortland Street | Auckland 1140 |www.newtonross.co.nz

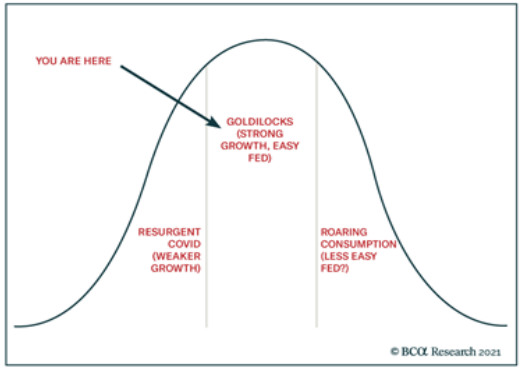
ECONOMIC AND MARKET SUMMARY

We saw the beginnings of a very sharp economic recovery in the September quarter last year which then dipped in the December quarter on a 3rd wave of virus lockdown measures around the world. This weakness continued into the early part of 2021 before growth took off again as vaccination programs provided optimism for an earlier than expected re-opening of the US and UK economies. The recent April IMF world economic outlook revises their expectations for global growth this year up to +6% and +4.2% for 2022. Following massive stimulus, the US may even grow around +7% and China +8.5%. The chart below shows global industrial, and manufacturing is back up to pre-Covid levels while services have nearly fully recovered too.



This activity reflects the supplier response to pent up demand accumulated during the lockdowns. With all the additional fiscal and monetary stimulus this year and the expected spend of trillions of dollars of household savings, the prospects for growth look well underpinned. There are of course risks to this rosy outlook including some potential virus disaster, significant geopolitical stress, or a global supply chain meltdown (where strain is already showing). There is also the more likely risk that the uneven nature of vaccination rates across the world will disproportionally impact emerging economies. This will hinder their recovery while potentially being an ongoing source of new mutant virus forms while they remain unvaccinated. Present estimates put global developed economy vaccination by the end of September and major developing economies (China, Brazil, India) by the end of 2021 while many emerging economies may not see vaccination until the end of 2022 at best.

The stylized economic cycle graph from BCA Research below shows the global economy has entered a "Goldilocks" period of strong economic growth while central bank interest rates remain easy (low). Investment markets are pricing in a strong recovery this year with growth assets continuing to perform well over the quarter. In local currency terms Global shares were up +6.1%, US shares +6.3%, China +4.2%, Japan +7%, Europe +10.8 % and Australia +6.2%. The NZ share market was -4.1% underperforming other markets. We also saw a rotation of interest in share markets away from strongly performing (and expensive) technology, communications and consumer discretionary sectors to commodities, financials sector and Covid impacted travel and tourism related companies. We expect this rotation of interest to accelerate as investors look for better value - although the general trend for outperforming technology and healthcare sectors will also continue.



Fixed interest (bond) markets had another difficult quarter. With strong economic growth prospects, fixed interest markets are caught between the forces of central banks keeping interest rates artificially suppressed while potential inflationary pressures loom closer. Ten-year government bond yields rose from historical lows in mid-2020 of around 0.5% back to 1.8% and are nearly back to pre-Covid levels. As bond yields rise the market value of bonds held decreases, especially for longer dated maturities. Subsequently, bond markets were lower again this quarter at -2.9%. We have been maintaining shorter dated bonds and deposits in client portfolios to mitigate the impact of rising yields on the value of client bond investments. Whether bond yields rise further will depend on the shape of economic growth to come. If growth can be achieved without sharply rising structural inflation, then investment markets will continue to have a positive outlook. Should inflation become more embedded, markets will become cautious and more volatile. With the very low yields currently available from fixed interest investments and their weak return prospects, we are increasingly being asked by investors why such assets are held. The answer of course is risk management. While bonds at such low yields provide significantly less volatility protection, high quality bonds still provide absolute loss protection for portfolios and active management can add value by reinvesting in good quality, higher yielding bonds as interest rates rise over the next few years.

We continue to counsel investors about taking on higher risk fixed interest assets or allocating more of their portfolio to growth assets without clearly understanding the additional risk they are taking on by doing so.

The table below shows the gross returns (before tax) from the benchmark index for each asset class.

Market Returns	Mar. Qtr.	1yr p.a.	3yr p.a.	5yr p.a.
$NZ v TWI	**-1.6**	7.4	-0.2	0.2
$NZ v $US	**-2.7**	18.2	-1.1	0.2
$NZ v $AUD	**-1.8**	-5.3	-0.8	0.4
NZ Cash	**0.1**	0.3	1.3	1.6
NZ Fixed Interest	**-3.4**	-1.6	3.6	3.3
Intl Fixed Interest 100% hedged to $NZ	**-3.0**	-1.1	3.9	3.3
Australasian Equities 50/50 Indexes	**1.0**	36.7	12.8	11.7
NZ Listed Property	**-4.2**	25.6	14.5	9.7
Intl Equities 50% hedged to $NZ	**7.3**	43.3	13.0	13.3
Commodities $NZ	**9.9**	14.3	0.8	2.1

SECURITIES RETURNS FOR THE QUARTER

The following tables show the returns from the securities recommended by NZ DIMS. Depending on your investment strategy you may hold all or only a portion of these securities and the returns for the securities held may also differ slightly depending upon cash flows and transactions in your portfolio over the quarter.

AUSTRALASIAN EQUITIES

Company	Sector	Quarterly Performance In NZ$ terms
New Zealand Equities		
Auckland Airport	Ports	3.4%
Contact Energy	Energy	-19.4%
F&P Healthcare	Healthcare	-2.6%
Fletcher Building	Building	22.0%
Freightways	Transportation	14.5%
Meridian Energy	Energy	-26.3%
Port of Tauranga	Ports	5.3%
Spark NZ	Telecommunications	-1.0%
Stride Property	Property	-2.0%
Australian Equities		
BHP Group	Resources & Energy	11.9%
Brambles	Professional Services	3.0%
CSL	Healthcare	-4.4%
IAG	Financials	3.2%
Macquarie Group	Financials	12.4%
Goodman Group	Property	-2.4%
Ramsay Healthcare	Healthcare	10.8%

- Macquarie Group was presented with a US$210m windfall profit due to the record low temperatures seen in Texas which led to massive price increases in wholesale gas and electricity prices. The record cold snap froze oil and gas wells, leading to millions of homes being without power and gas suppliers like Macquarie having to ship supplies into the state. Macquarie expanded its US commodities business in 2017 by purchasing a US power and gas business and is currently the 2nd largest US gas supplier behind BP PLC.
- BHP lifted its profit outlook for the year ahead, citing better commodity prices and stronger global growth in the near term as vaccine rollout's gather pace. The company increased its dividend to $1.01 from $0.65 cents per share last year and will pay out a record A$5.1b. In the medium-to-long term, commodity prices are being helped by the mega trends in global population growth, electrification, and energy transition. Iron ore futures surged 70% last year and this key steel-making ingredient accounts for about 70% of company earnings. Demand for copper and nickel is expected to quadruple by 2050 as faster rollout of electric cars, solar panels and wind farms increase demand for these key commodities. For example, electric vehicles use 4 times as much copper as a petrol-based car and require additional infrastructure to connect to charging stations, while renewable power systems are 5 times more copper intensive than conventional power. BHP, a partner with Rio Tinto in the world's largest copper mine, is seeking to lift its exposure to this essential resource as copper prices surge to their highest in a decade.
- CSL announced a 45% increase in profits for the first half of the year, supported by a large jump in sales of higher margin products. This was a strong result considering Covid related concerns reducing blood collection and fewer elective surgeries being undertaken.
- The share prices for Contact Energy and Meridian Energy have been impacted significantly over the last year by record fund flows to and from the Blackrock

Sonic Healthcare	Healthcare	12.3%
Westpac	Financials	28.3%
Woodside Petroleum	Energy	8.2%
Woolworths	Consumer Staples	7.8%

- Goodman Group announced a profit of A$615m which was 16% higher than last year. The company is experiencing strong demand from their property clients who have seen massive increases in online sales and therefore need support with logistics and warehousing. Demand for high quality properties in top locations is high, with 98% occupancy rate across the portfolio. Goodman is focused on development activity which reflects the structural change in consumer behaviour towards the digital economy. In total A$8.4billion of development projects are underway across 56 sites in 12 countries, this includes new builds and redevelopments of existing sites to better utilise scarce land and contribute towards being net zero/carbon neutral by 2025.
- Ramsay Healthcare delivered a better-than-expected result as earnings from government Covid related contracts offset weaker income from delays to normal business caused by lockdowns. In countries which are quickly rolling out vaccination programs there are encouraging signs of an improvement in surgical admissions and the backlog of surgery and care in every jurisdiction is expected to provide a multi-year volume tailwind for RHC.

iShares Clean Energy exchange traded fund (ETF). The ETF follows a S&P index which tracks just 30 companies globally and increased investor demand and trading activity has led to a jump in share price volatility. To reduce concentration and liquidity risk the index provider has decided to increase the number of holdings to 100. CEN and MEL currently make up over 8% of the total index and the change will lead to a significant reduction in the allocation within the ETF. However, it does not change the long-term characteristics of these companies which remain attractive investment options.

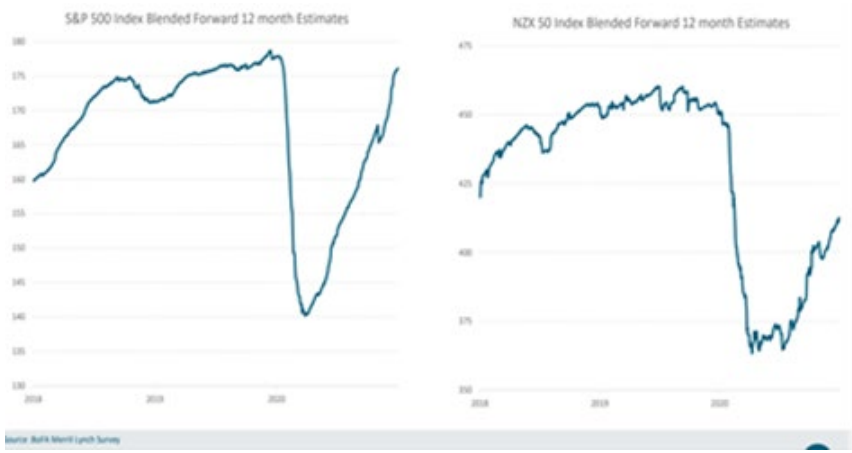
- Meridian is to begin construction of its latest wind farm, a 3yr $395m development in Hawkes Bay. The Harapaki Wind Farm will be NZ's 2nd largest with 41 turbines generating sufficient energy to power 70,000 households. MEL has also revised the construction process to lower the amount of concrete and steel needed and therefore reduce the carbon footprint of the project by over 30%. The company is zero net carbon across all NZ operations and has committed to halving gross emissions by 2030.
- Westpac announced that it is assessing the appropriate structure for its NZ business and whether a demerger would be in the best interests of shareholders. Key factors cited by Westpac are the requirement of the Reserve Bank of NZ to structurally separate the Bank's NZ operations from the Australian parent and for all NZ banks to hold more Tier 1 capital from July. Options for Westpac include an outright sale or alternatively listing the NZ business on the local share market.

AUSTRALASIAN EQUITIES

The Australian market which is dominated by energy, mining and financial stocks had a very strong quarter up +4.3%. Reflecting the clear shift from growth to cyclical growth sectors. Technology stocks were down -10% while banks were up +15%. Several Australian companies posted strong results with the market having its best earnings reporting season in over 20 years. On average, 2021 earnings were revised higher by +6% with results exceeding analyst expectations with a further growth forecast of +15% this year. Despite the outperformance over the quarter, the Australian market remains better value than NZ, trading at 19 times 12 month forecast earnings while NZ is at 29 times.

The NZ market index is dominated by growth companies and fell -4.1% over the quarter after hitting a record high early in the new year. Company earnings results were generally positive (23 companies beat expectations with only 4 missing), although results remain significantly distorted by Covid related activity. Adding to the weakness in growth companies was increased volatility in the electricity generation stocks due to adverse price movements and fund flows associated with exchange traded funds.

s&P500 & NZX50 12month Forward Earnings Forecasts
(Souce: Harbour Asset Management)



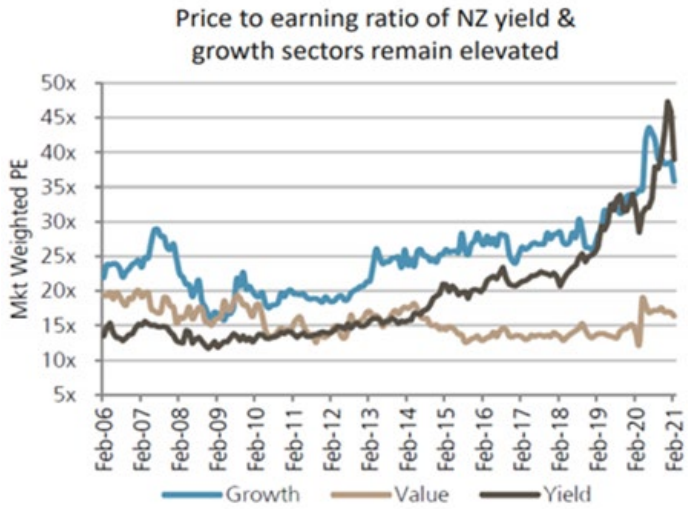
Fund	Quarterly Performance In NZ$ terms	Commentary
Devon Trans-Tasman Fund	3.2%	The fund outperformed the market benchmark over the quarter. Key contributors were Aristocrat Leisure, Fletcher Building and Vista Group as cinema re-openings gathered pace. AMC Theatres, the largest US cinema operator has 98% of its sites open and the UK market is set to reopen in May. The manager took profits on Virgin Money after a period of strong performance and Fortescue Minerals was sold due to concerns about capital allocation with approximately 20% of net profit now being allocated to areas outside their core iron ore business. Rio Tinto was added to after recent share price weakness. The manager has a positive outlook for equities over the coming year as companies rapidly accelerate earnings from 2020 lows and enjoy the benefits of various cost-out strategies that were implemented during the height of the pandemic. With the risk of rising bond yields the investment focus is on finding investment opportunities with strong fundamental valuation support and without excessive balance sheet gearing.
Harbour Australasian Equity Focus Fund	-2.7%	The fund underperformed the market benchmark over the quarter. Key detractors to performance were a2 Milk (mixed infant formula sales), Fortescue (lower iron ore prices) and My Food Bag which listed poorly in a weak market much to the disappointment of retail investors. Growth companies Pacific Edge and Nuix were negatively impacted by higher bond yields despite hitting business milestones and lifting revenue forecasts. Positive contributions came from financials (NAB and Macquarie), Vista Group and travel software company Serko which commenced rolling out its platform to Booking.Com business customers. Despite recent NZ economic data pointing to a dip in activity, stronger household spending is expected

		this year which will benefit sectors such as technology, banks, retail, and materials companies. The portfolio remains tilted in favour of the healthcare, biotech and retirement/aged care sectors which are expected to benefit from long term structural growth drivers including technology change, demographics, and sustainability.

INTERNATIONAL EQUITIES

International equity markets had another strong quarter with riskier assets benefiting from central banks continued liquidity support and massive government spending programmes. Bank of America has estimated that globally, central banks have purchased more than US$1billion of assets every hour since March 2020. At the same time governments have rolled out substantial fiscal spending programs which range from handing out cash to voters for immediate spending to long term (and well overdue) investment in ailing infrastructure. The US government has spent the equivalent of 25% of total GDP to address what amounted to a -10% decline in the economy at the height of the pandemic. Despite further lockdowns occurring in most countries, the global vaccination program gathered pace (at least among developed nations) with almost 700 million doses administered - 150 million of these in the United States. Perhaps it was no surprise then that the US earnings season was very strong for the quarter with 77% of companies either in-line or beating earnings. Forward earnings expectations are probably over cautious for most markets likely leaving room for positive surprises.

Stronger earnings outcomes will support the presently high market valuation levels while the rotation from investment in 'growth' style companies (that are expected to grow at an above-average rate to market) to out of favour and therefore cheaper 'value' companies (trading less than their book value) which started last year is expected to be an ongoing theme. The NZX PE ratio chart opposite shows growth and yield sectors (bond proxies) are very expensive compared with much lower priced value companies (banks, energy, mining, pharmaceuticals, insurance, etc).



This style rotation is occurring in all global share markets and finally rewarding value investing after many years of poor returns relative to growth investments. While there is the potential for rising interest rates this is far from certain in the short to medium term and growth companies, in particular the mega-cap tech stocks will still perform well should interest rates remain low. It is just this sort of uncertainty which supports our strategy of investing in a diversified range of passive and active investment management styles and fund managers.

Fund	Quarterly Performance In NZ$ terms	Commentary
Active Fund Managers		
Platinum International Fund	10.9%	The fund was up +8.9% in AU$ terms for the quarter, benefiting from the global rotation to value stocks and in particular cyclical growth companies (industrials, materials, energy, real estate, financials, and consumer discretionary), that will benefit from changes in government policy and more fiscal spending. Key themes across the portfolio include semi-conductors, growth industrials, travel, Chinese consumer, healthcare, internet related (though much reduced) and metals. During the quarter key positive contributors were resource stocks such as Glencore and semiconductors (Samsung, Micro and Microchip). Relative to asset values, cyclical stocks still look cheaper than their long-term averages and investor demand is expected to continue building. Against this positive outlook is the risk of a rise in interest rates and the impact this will have on defensive stocks (healthcare, utilities, consumer staples) which have been bid up in the search for higher yield. The pressure on some areas of the market is evident with recent hedge fund collapses which are potentially the canary in the coal mine as opposed to one-off company issues. The manager has increased the allocation to short sales as portfolio insurance and potential value add.
Monks Investment Trust	3.9%	The fund was up +1.2% in GBP terms for the quarter and up +66% for the year. The manager continues to focus on companies that can thrive in a fast-changing world where data and artificial intelligence is a pre-requisite to create business efficiencies and target customers or risk losing out to the latest fin-tech disruptor. Over 90% of all the data in the world has been created in just the last few years and while industries such as communications, entertainment and retail are well along the path of transformation; many others such as healthcare, education, real estate, and energy are only just beginning. The Chinese Government moves to rein in dominate online heavyweights and the emergence of self-policing social platforms also suggests that we are entering a period of increased regulatory oversight and awareness of societal value. This will challenge the profitability of incumbents and provide opportunities to companies who offer an ethical and environmental approach as an integral part of a great product at a competitive price. Finally, the great energy transition from fossil fuels to renewable sources is underway and as marginal costs are driven ever lower (potentially to zero) what will this mean for energy intensive industries and how will this reshape global geopolitics.
Magellan High Conviction Fund	6.1%	The fund was up +4.2% in AU$ terms for the quarter. The manager remains cautious that markets are not fully factoring in 2 key risks, firstly the possibility for mutation of the virus and the inability of vaccines to work; and secondly the risk of inflation becoming a real threat and forcing central banks to aggressively raise interest rates sooner than planned. Despite these risks the portfolio is close to fully invested rather than holding high levels of cash as the manager believes any such issues will be transitory at best. In the medium to longer term there are great opportunities by investing in companies which will benefit from the current global monetary and fiscal stimulus. Particularly Chinese and Western companies that are exposed to the domestic reorientation of the Chinese economy and the increasingly wealthy middle class i.e., Starbucks. While there are political risks investing in this area (as seen with the recent ANT IPO debacle) these risks are known and in many ways decisions are easier. While Alibaba may lose out due to new government rules and may ultimately end up owning a smaller share of the

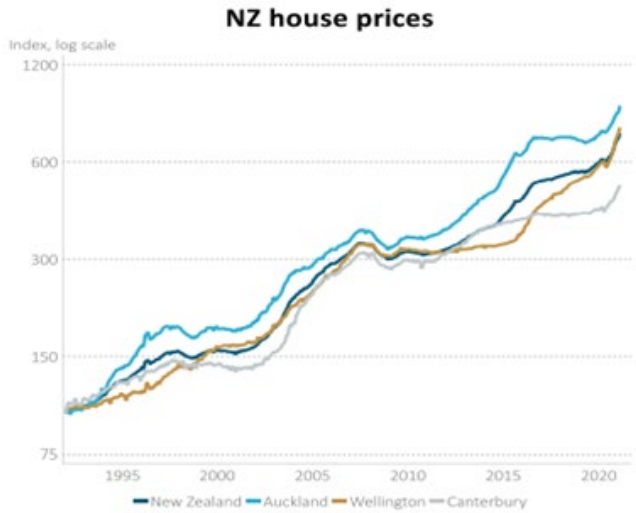
		domestic consumption pie, that pie is expanding overall so the company will continue to grow and remains a preferred investment option.
Passive/Index Funds		
Vanguard Intl Shares Select Exclusions Index Fund Hedged to NZD	5.9%	This fund provides passive exposure to all major developed share markets and is hedged back to the NZ dollar, so returns are not influenced by movements in the currency. Over the quarter returns were strongly positive with value stocks outperforming growth stocks. The US market was up +6.3%, UK +5%, China +4.2%, Europe +10.8% and Japan +7%.
iShares Russell 2000 Index Fund	16.3%	These funds provide passive exposure to smaller companies in the USA and around the world and are valued in USD. Over the quarter the -2.7% fall in the NZ dollar against the US$ increased returns for NZ investors. The March quarter was another strong period with the US small companies having risen almost 95% in the past 12 months, the second-best result for the index in a 40-year history as it rebounded from weakness in 2020. Small Cap companies in the cyclical financial, industrial and consumer discretionary did well this quarter and should continue to be supported by government spending, low interest rates, strong consumer balance sheets and the wealth effect of rising house prices.
Vanguard FTSE All-World ex US Small Cap Index Fund	8.1%	
Vanguard Emerging Market Index Fund	6.7%	The fund provides passive exposure to companies listed in emerging markets and is valued in USD. Emerging markets grew strongly over the quarter despite lagging developed markets. The Middle East, Africa and Europe gained the most primarily due to higher oil prices. Asia produced a small gain while Latin America fell due to continued Covid outbreaks and a lack of vaccine supplies. In line with global interest rate moves, central banks in Brazil, Russia and Turkey all lifted policy rates to get ahead of inflation risks. Historically, emerging markets do well in a period of slowly rising interest rates if these rates reflect better global growth. Vaccination rates over the next 12-18 months will be critical with emerging markets struggling to acquire supply.

COMMODITIES

Commodities surged again through the quarter with energy, food, and metal prices all up sharply and back to levels not seen since 2014. China continues to take an increasing portion of our exports as their economy sucks in more than 55% of total global commodity production. The ANZ World Commodity Price Index lifted +6.1% m/m in March to reach a record high. Oil prices rose above US$60 per barrel which is a gain of over $20 since November. Dairy prices rose to their highest level in 7 years, up +43% over the year and log prices also jumped +25% leading to a shortage in timber materials for the local building industry. A bumper growth year for horticulture has ended disappointingly due to the lack of foreign pickers allowed in the country due to Covid (and unmotivated Kiwi workers) while the global shortage in shipping is making it challenging for growers and foresters to get produce to market.

PROPERTY

After rising +20% over the year to February, the Government unveiled a package of policies to try and stem the near hysterical "FOMO" driven buying frenzy that was seeing properties sell in some cases for more than 60% of their CV. Targeting 'speculators', the removal of tax deductibility for interest costs (a perceived "loop-hole") and extending the selling bright line test out to 10 years looks like panic politics with no cost benefit analysis or modelling of the decisions being undertaken. More practical was a $3.8bn allocation for housing related infrastructure spending and enhancements to first home loans and grants.



The tax changes will certainly dampen demand in the short term and residential prices could well fall with some bank commentators predicting as much as -20% - though we have seen these forecasts before. Tighter bank lending and the prospects of higher interest rates will temper demand. The Housing Acceleration Fund is a better idea to try and address the real supply side problem of the market.

Source: Jones Lang LaSalle.

With lower net migration numbers over the last year and low numbers expected again this year, the present frantic construction rates might also make a difference at the margin but until cheaper land can be accessed, red-tape legislation addressed, and councils appropriately incentivised, then our residential property market will remain a basket case. Elsewhere farm prices also rose strongly, up +25% from February 2020.

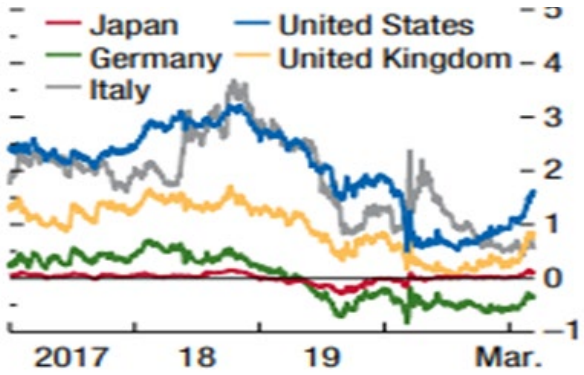
Commercial properties, particularly office and retail were hard-hit last year with vacancy rates rising towards the end of the year and again in this quarter.

Industrial property has been more robust during Covid and remains well positioned as business activity builds in growth areas such as logistics.

FIXED INTEREST

Volatility in global bond markets continued to rise during the quarter as investors began to focus on the first signs of a meaningful lift in inflation. The massive monetary and fiscal policy stimulus and rapid vaccine rollouts in key markets is successfully driving a global economic recovery. While central banks can effectively anchor short term interest rates at these very low levels, longer term rates ultimately reflect future expectations and bond prices fell due to concerns about inflation and the ability of governments to pay back what they are currently spending. With the US now running large twin deficits and with more fiscal stimulus promised, the USD (after lifting post elections), is likely to drift lower over the year as other economies also accelerate, particularly against the Yen, Euro and GBP.

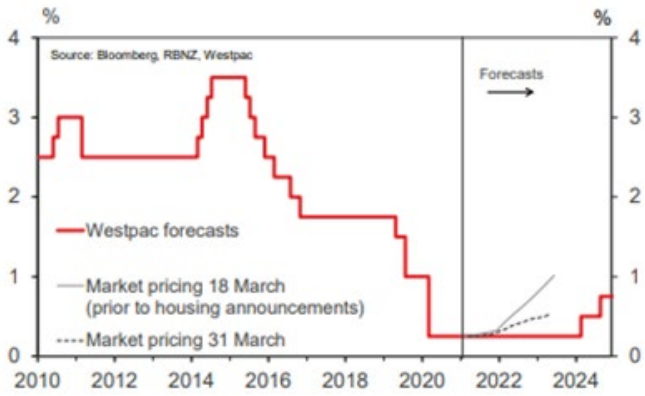
10- year Government Bond Yields Rising



Bond markets continued to sell off over the quarter with global markets falling -3.1% and the NZ market down -3.4%. Central banks have worked hard during the period to convince the markets they are not ready to tighten conditions anytime soon though there is an expectation QE programs will be progressively wound back.

10-year nominal bond yields have risen sharply in the quarter with the US rate lifting to 1.75% and NZ rate to 1.85% primarily driven by higher inflation expectations. Yields are back up to pre Covid-19 levels and may have further to rise although any large spikes are likely to be met by central bank intervention. We continue to maintain a shorter duration of bond maturities for our investors to help mitigate the risk of rising yields and we delivered a better than market return once more during the quarter.

NZ Official Cash Rate Forecast (Westpac)



New Zealand's economic strength, coupled with a stronger global economic picture, has led to a marked change in interest rate expectations. Markets have gone from pricing in negative OCR rates late last year to now expecting an OCR hike in the middle of 2022. However, a recent twist has been the Government tax policy change for the treatment of investment properties which may see property prices and domestic demand fall. If this eventuates the RBNZ will keep the OCR lower for longer and Westpac is forecasting no rate rises until 2024. Complicating matters even further is the new Government remit to the RBNZ to consider the impact its monetary policy and financial policy decisions will have on house prices. The remit stops short of imposing a new monetary policy objective but does ramp up the pressure on the RBNZ who will need to regularly explain how it has considered political objectives to improve affordability for first home buyers. Given capacity constraint issues in some parts of the economy, inflation may well lift to the upper band of the RBNZ's target range by year end though this is presently not a limiting factor.

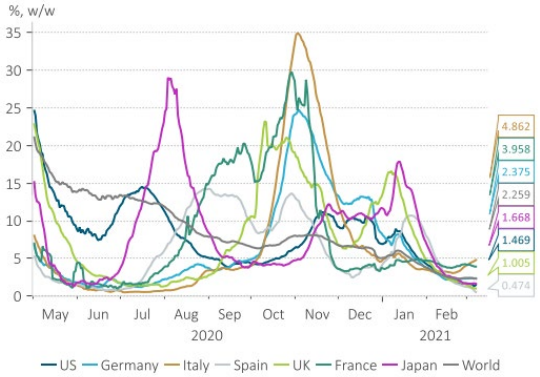
Security	Quarterly Performance In NZ$ terms	Commentary
AMP Capital NZ Fixed Interest Fund	-2.8%	The manager had expected a lift in long term interest rates and outperformed the benchmark over the quarter. Market volatility increased dramatically in February with 10-year yields almost doubling, rising 0.8% to 1.8%. Short term yields are expected to remain anchored at low levels with changes to housing policy meaning the RBNZ will sit on the side-lines for longer despite meeting its dual inflation and employment mandates. Longer term yields are expected to follow global rates higher, so the manager has retained a slightly shorter than index portfolio duration and is positioned for a steeper yield curve. High quality, liquid corporate bonds are favoured to boost yield and underweight government bonds as the RBNZ continues to taper and Government issuance is reduced.
AMP Capital NZ Short Duration Fund	-0.3%	
Harbour Wholesale NZ Core Fixed Interest Fund	-2.4%	The manager has positioned the fixed interest portfolio to protect it from what they see as the key risk at present - a rise in inflation which is more persistent than central banks are currently forecasting, resulting in interest rates being hiked quicker and more aggressively than forecast. The portfolio holds fewer longer dated bonds (which suffer the most when yields rise) and has an allocation to inflation indexed bonds which do relatively well when inflation rises. The manager has also started to book gains and reduce exposure to some corporate bonds. The search for yield has seen corporate bonds trade at very low margins and when interest rates start to rise debt serviceability starts to become an issue, especially for lower rated bond issuers which can also suffer from a lack of liquidity in the thin NZ market. With short term rates barely above zero it is important to take advantage of any active investment opportunities that arise to add value. The governments surprise announcement on housing provided the manager with an opportunity to add duration to the cash portfolio and then take profits when the market subsequently rallied.
Harbour Enhanced Cash Fund	0.2%	

OVERVIEW

2021 is all about vaccination speed and country immunity. Nothing else matters until Covid-19 is under control and politicians can set about focusing on repairing the economic, health and social damage done over the last year. While advanced economies are well positioned to rollout vaccine programmes this year, poorer countries will be left behind - potentially for years, creating significant long-term health and economic damage. They also remain a potential ground zero for mutations to globally re-circulate. Interestingly, those countries worst affected are also the most motivated to get their populations protected while those countries least impacted (China, Japan, Australia & NZ) are taking a more measured approach and may struggle to motivate people to inoculate (patients now get a free basket of eggs for every shot in China). Economic growth rates will therefore be divergent across the world this year though the IMF recently revised upwards their outlook to +6% for 2021 which is the highest since the early 1970s.

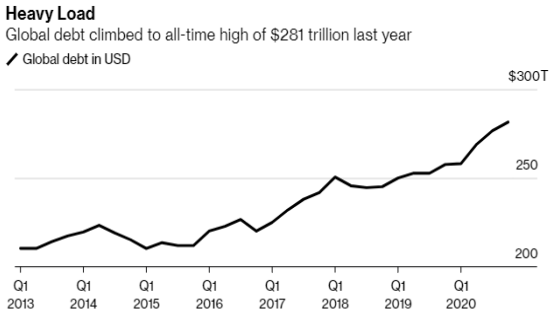
The cost of the pandemic and recovery will be felt for generations as governments borrow heavily to firstly protect their economic foundations (jobs) and then again to stimulate growth to pre-Covid 19 trend levels. Global debt has risen to $281trn which is about 320% of global GDP. Given the already significant debt levels going into the pandemic how this debt will be managed is key - particularly if interest rates rise from historically low levels. There are only 4 ways to reduce the debt, raise taxes, cut spending, grow the economy faster than debt growth or cancel the debt. As we exit from the pandemic governments will be trying combinations of all the above. The most politically acceptable is the Keynesian approach to spend money to try to grow the economy faster than the debt pile. A growing economy also grows the tax base. In practice this approach has had limited success or is too difficult to measure its effectiveness over time. Implementing austerity measures has been more effective - though painful on standards of living and not populist. Raising taxes sounds counterintuitive but doing it to redistribute wealth from the ultra-high net rich to repay public debt will be an attractive political option. Already we are seeing rising corporate tax rates in the US and UK and personal tax rates in New Zealand. This will extend to nationalization of assets (China), anti-trust actions and cross border taxation recovery (Yellen led OECD initiative underway). As the global economy accelerates this year the debt pile will also grow but the ratio of debt will likely be the same or lower this time next year. Should the world grow a further +4.4% in 2022, the ratio will fall further to less than 300% and so on. Continued low interest rates will be critical to affordability while letting inflation run a little hot will also assist. Government and central bank policies are now deeply intertwined. Finally, debt restructuring including debt forgiveness will play an important role. The IMF and word bank will be working hard to assist pandemic afflicted low-income countries who will be crushed by their inability to repay foreign denominated debt. Default rates will sharply rise over the next few years adding to the geo-political instability.

Covid-19 Cases



Source: WHO, Macrobond

Global Debt at Record $281trilllion

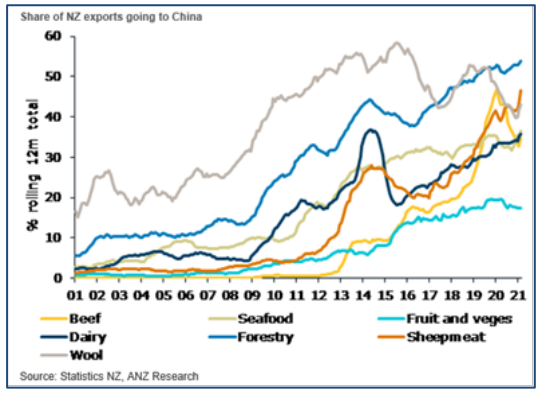


Source: Institute of International Finance

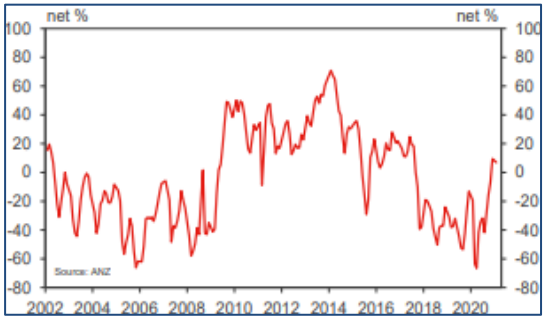
New Zealand

Our domestic economy delivered an admirable performance last year as Kiwis did their best to get on with things despite the lockdown restrictions. Stronger than expected employment, rising home prices and low borrowing costs all assisted domestic activity which is now back to pre-Covid levels while our exports continued to perform well. We have entered 2021 in a better position with business confidence much higher. The economy has been recently softer (-1% GDP Q4) largely explained by the loss of overseas tourists this summer. On the positive side, our exports are doing well on strong Chinese demand and as other trading partners come out of lockdown. The recently announced Australian 'travel bubble' provides some hope for our embattled international tourism operators. Australians make up 40% of our normal tourist arrivals and spend more here than we do in Australia so they will be very welcome. On the negative side, we are hitting capacity constraints with employment fuller than expected and severe shortages for skilled labor and materials in several areas but particularly in construction. Add in global supply chain problems, rising minimum wages and a record 52.9% of recent business survey respondents expecting to raise prices; and the BNZ sees inflation moving to the top of the RBNZ's range by year end. Presuming a steady vaccine roll-out and the economy remaining on course, it is unlikely the RBNZ will cut cash rates further, especially now given rampant house prices. After a 20% surge over the year to February, housing unaffordability is now (after Covid) the key political focus and putting pressure on the Government to introduce desperate (on the fly and unmodelled) demand side policies which may reduce demand at the margin in the short term, but likely to lead to higher rents and less turnover of housing stock. With net migration at zero last year and expected to be only about +5,000 this year, housing supply is starting to improve though will only provide limited relief until radical changes to land availability and infrastructure fast-tracking is undertaken. Home ownership has fallen to 1950 levels with Auckland now the fourth least affordable city in the world (Source: Demographia).

Share of NZ Exports to China



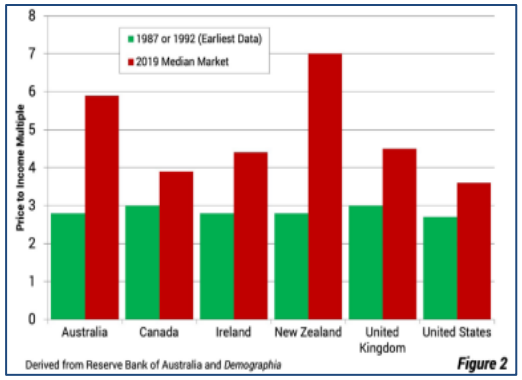
NZ Business Confidence Recovered



Australia

Along with most of the world, Australia has been involved in increasing diplomatic skirmishes with China resulting in several Australian exports being banned by China. Iron ore is not one of these. Australia contributes approximately 60% to all China's ore imports and they cannot substitute it. China's remarkable growth in 2020 and their demand for Australian materials exports, ensured Australia performed well last year and it has entered 2021 on a very good footing. In addition to record exports, surging house prices, strong domestic consumption, lower unemployment levels (5.8%) and booming construction activity have all delivered a very promising environment for growth. During the quarter, business confidence also (finally) surged and rise to an 11-year high. Faster import growth through the period also signals stronger domestic activity. Like NZ, Australia is also running up against capacity constraints, particularly in construction which may see some enticement for Kiwis to cross the ditch.

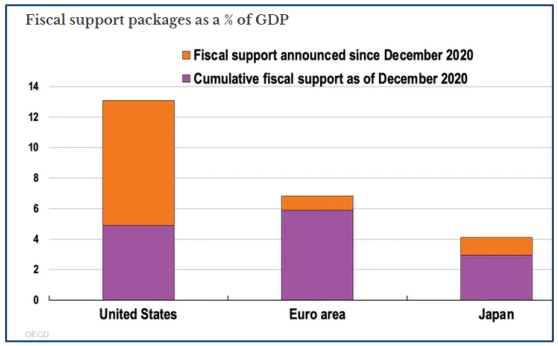
International House Price to Incomes Ratios



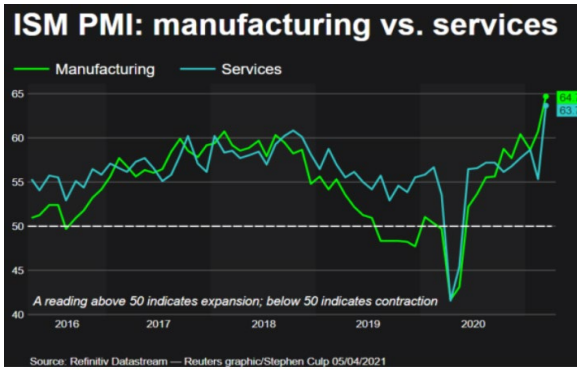
US

The Financial Times commented that President Biden's opening spell has been the most accident-free of any US president in recent memory. Possibly not a great compliment but it certainly reflects the much steadier approach and personality at the helm. After the frenzied internecine politics that culminated with the debacle of the Capitol Hill riots, Biden has worked hard to keep things calmer with less rhetoric and more doing. Regardless of your political persuasion, America is exhausted and needs to find new common ground to move forward and rebuild both economy and society. At their present rates of immunisation, the US should attain herd immunity levels well ahead of schedule by the end of May. The rapid opening up of their economy will trigger a jump in domestic activity supported by record fiscal stimulus, continued low interest rate settings and the unleashing of an estimated $1.4trn of additional lockdown related household savings. To the end of 2020 the US had spent about 5% of their GDP on fiscal stimulus ($1trn) and Biden has since released the $1.9trn American Rescue Plan. The Plan is primarily for social support while providing some grants to businesses and a further $2.25trn American Jobs and American Family plan is in the works, intended to be spent over the next 8 years. Funds are to be directed towards, infrastructure, clean energy, EV support and retrofitting federal buildings. Total fiscal stimulus could end up near 27% of GDP which is war time spending levels. Corporate tax rate rises, capital gains tax increases and capturing taxes on US company global earnings will be implemented to fund the spending. The US is therefore likely to growth by as much as +7% this year. Data in the 1st quarter shows much stronger and broad-based employment growth, 14-year high housing starts while manufacturing reached its highest level since 1983 and services activity also hit a record high. America is also re-engaging with the world having re-joined the Paris climate agreement and is back in indirect discussions on the Iranian nuclear agreement. The Biden administration's early actions suggest the US will remain hawkish on China and strategic tensions high.

US Stimulus to Date



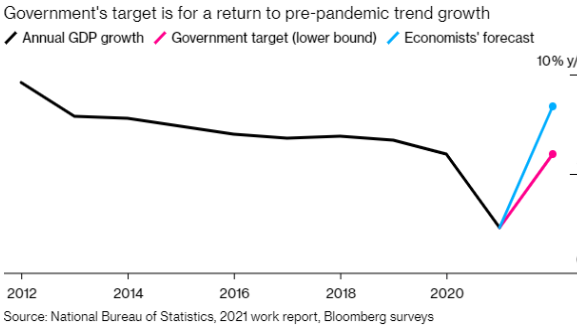
US Purchasing Managers Indexes



China

After dealing with the pandemic better than any other economy, China started 2021 well positioned to unwind stimulus and to reduce the budget deficits used to stimulate their economy through Covid. Very strong domestic growth could see China grow at +10% this year putting the size of their economy closer to that of the US and poised to overtake it withing the next 7 years. China's government however, recently set a more conservative economic growth target of +6% and instead is using its momentum to shift focus to longer-term structural challenges such as reducing excess leverage, pollution, and better health management. They also continue to pivot to high value add industries with a particular desire to reduce any dependence on US technology. China continues to push hard its regional and global power aspirations, further cementing control in Hong Kong and worryingly, showing a renewed focus on Taiwan. Those states questioning Chinese internal matters (Uyghurs, Hong Kong, cyber hacking or true Covid origins) have felt the full force of China's unsubtle tactics - although China has successfully completed regional trade agreements in both east Asia and with Europe. At the time of writing, the UK High Commissioner Laura Clarke gave a speech in Auckland about the UK's ambition to re-focus on the east. "We will work closely together with other like-minded countries in responding to the systemic

China to Moderate Growth



challenge that China poses to our security, prosperity and values, while also co-operating on shared priorities such as trade and climate change," she said. HMS Queen Elizabeth (aircraft carrier) will deploy to the region later in 2021, and British offshore patrol vessels will stay on to contribute to the Five Power Defense Arrangement – an agreement that includes New Zealand, Australia, Malaysia, and Singapore.

Europe & UK

With less economic stimulus, a third wave of Covid lockdowns and a slow start to vaccinations; Europe's economy has not started 2021 as well as it could have. Services industries have been negatively impacted by social distancing measures, although they are showing better resilience to this recent lock-down. Manufacturing has conversely been very strong as the world's economy starts to generate new orders. German manufacturing grew at a record rate and France had its fastest growth since 2018. Business optimism rose to a 2-year high leading to robust hiring intentions by manufacturers though supply chain problems (Suez Canal, semi-conductors) are causing delays and raising input costs. As immunization levels increase, Europe should open through summer and release a surge of domestic demand. Following the -7% GDP fall in 2020, the Eurozone should bounce back +5% this year. Overall, no western country has managed Covid-19 worse than the UK. After stumbling their way through 2020 and having the highest per capita death rate of any developed country, a desperate early vaccination play means they are now leading the western world immunization and on track for a full opening this month. After GDP fell nearly -10% in 2020 (worst since the Great Frost of 1703), growth could be as high as 7% as domestic activity accelerates through summer. They will also begin once again to deal with post Brexit and potential union succession pressures.

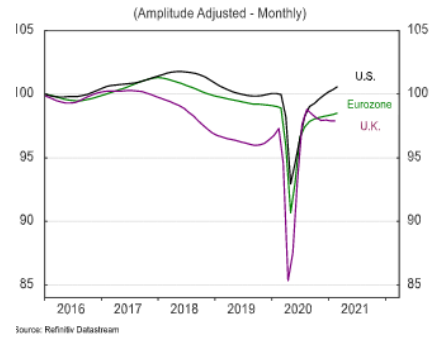
Japan

Japan has managed the virus relatively well but is also slow to approve any vaccine roll-out meaning their economy is likely to lag its potential recovery this year though growth will be above trend. Stronger factory orders should assist manufacturing and exports, despite a recent lockdown seeing manufacturing contract once again. Further lockdowns are a significant risk and may impact the Olympics which are scheduled to go ahead but without any overseas visitors.

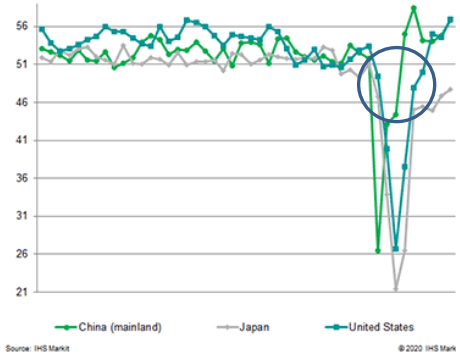
Emerging Economies

The Covid recovery will be divergent. Rich countries have quickly secured vaccine production and despite the best intentions of the UN sponsored Covax scheme, emerging countries may not achieve effective immunization until well into 2022 and possibly as far out as 2024. While the rest of the world accelerates this year, low income producing countries are forecast to grow at only 2% (IMF WEO April 2021).

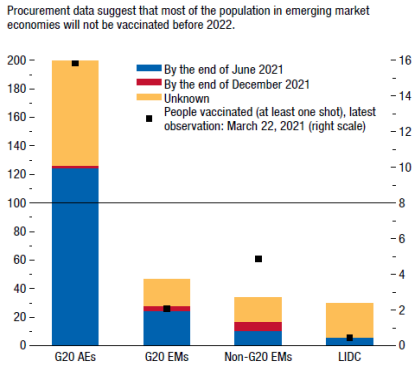
Europe and UK will lag the US. OECD Leading Indicators



Japan also lagging. PMI Services



Emerging Countries at Risk



NEWTON ROSS
PRIVATE WEALTH MANAGEMENT