NEWTON ROSS
PRIVATE WEALTH MANAGEMENT

19 April 2022

March 2022 Quarterly Report

After a strong finish to 2021, the first quarter has been a difficult environment for investment markets with negative returns from share, property and fixed interest (bond) markets.

Persistent inflation data, which in turn requires higher interest rate settings by central banks, has upset markets. While the prospect of higher interest rates can be challenging for valuing assets, markets can quickly recover if the outlook for rates rises are steady and reasonably predictable. At the present time investors are still pricing in substantial interest rate rises and are unsure of exact timing, assuming central banks need to catch-up with the reality of inflation pressures.

On top of inflation concerns, the Russian invasion of Ukraine and subsequent economic and trade sanctions saw markets fall further in early March then largely recover late in the month as investors assessed a more contained global economic impact from the invasion. Slowing Chinese economic activity is also weighing on markets as China continues to pursue a Covid elimination strategy through mass lockdowns. At the time of writing the mega city of Shanghai (25m) was in lockdown and slowing Chinese growth.

On a positive note, economies (aside from China) are continuing to open from Covid restrictions. Global growth is pulling back from very high 2021 levels though significant momentum remains and still above pre-Covid trend levels. This will be supportive for markets providing inflationary pressures begin to ease and interest rate prospects moderate.

As a normal part of market functioning, we expect further volatility over the coming quarter as markets assess inflation management policies, potential Russian escalation risks and the Covid lockdown on Chinese production. During these volatile periods, it is important to think as investors (not speculators) and stick to the long-term investment strategy. All our client portfolios are carefully constructed to specific risk limits and hold liquid, high quality and well diversified assets which helps to smooth out portfolio performance but the opportunity for higher returns over time requires accepting short term fluctuations. Volatility also creates opportunities for investing additional cash and rebalancing portfolio holdings by selling assets which have done well and buying more of those assets which have had a dip in value.

Kind regards,

Wayne Ross
Director Investments

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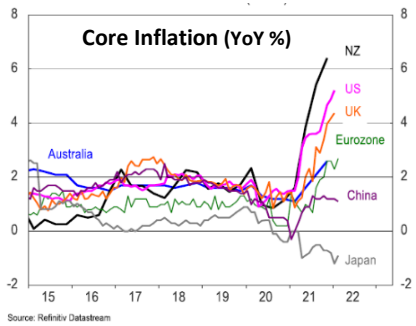
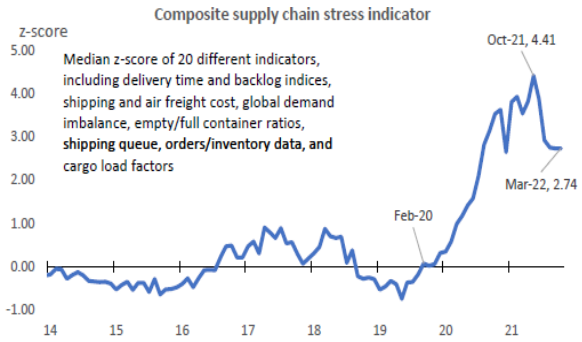
ECONOMIC AND MARKET SUMMARY

It was a difficult quarter for investments with share, property and bond markets all losing value. Global shares had their first negative quarter in 2 years down -6.1% while global bond markets had one of their worst starts to the year on record. The largest global bond index was down -5.6% for the period on sharply higher yields. Global property prices also retreated -5.3% while CoreLogic's analysis shows NZ property prices fell by an average of almost -8% in 154 suburbs across New Zealand in the four months to February. Commodity markets bucked the trend with record rises in energy, industrial metals and some agricultural products. The Bloomberg Commodity Index was +23.6% for the quarter; unsurprising given that Russia and Ukraine are important energy, agricultural and fertilizer suppliers.

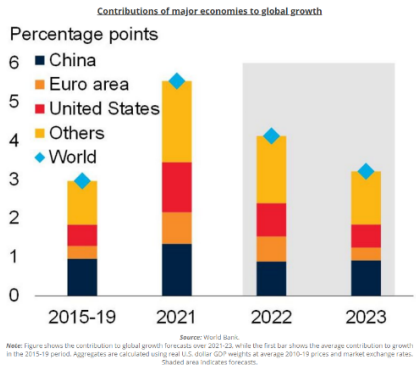


Despite the shocking invasion of Ukraine, inflation management concerns were the primary driver for the weaker market performances over the quarter. The chaotic mismatch last year of global supply production versus catch-up household demand continues into 2022, recently exacerbated by additional Chinese Covid lockdowns affecting their production activity and domestic demand. Inflation data continued to deteriorate. US inflation rose +6.4% year on year last month, a 40-year high. Closer to home, NZ inflation rose +5.9% year on year, the highest rate since 1990. This inflation persistency puts pressure on central banks to raise interest rates faster and further. Markets fell as they priced in the potential impact of higher rates slowing demand and economic activity. Central banks while indicating rate rises ahead, remain cautious to overcooking things and the risk of pushing economies into unwanted recession. They tread a fine line between subduing demand when the inflationary culprit is tighter supply restrictions.

Governments have begun winding back their spending after engaging in record non-war stimulus during last year's renewed Covid lockdowns. The removal of this stimulus will reduce aggregate demand, liquidity and can also be disinflationary. More recently there are signs supply problems are improving. The following graph is a global supply chain stress indicator suggesting conditions such as transport, delivery times, backlogs and inventory are better.



Commentators remain divided on whether core inflationary pressures will persist and becoming more imbedded. Certainly, record low unemployment levels in many economies mean labour markets are very tight though wage pressures have so far been contained and improving worker travel mobility may help. Commodity prices are also expected to recede from recent record levels. Inflation is also not being felt evenly across the globe being far more of a problem for western economies. Despite this tricky inflation outlook, global growth (see World Bank graph next) is forecast to remain above pre-Covid trend levels this year and into 2023 driven by Covid opening momentum. After a tearaway 2021, both US and Chinese economies are expected to moderate though for distinct reasons.
With the pull back in markets and despite the prospects for higher interest rates, investors found better value in the



extremely hard hit or sold off "growth" company sectors where some prices had fallen more than 35%. Companies such as Amazon, Tesla, Apple, Google moved sharply higher at the end of March and recovered their quarter losses. Solid global growth momentum will be positive for company earnings. This should support share markets that have already priced in slower trading conditions and higher interest rate prospects. If inflation data weakens, we expect share and bond markets to perform. Conversely, if inflation remains sticky, it may necessitate more aggressive rate rises which may place further pressure on both share and bond markets in the shorter term.

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	**2.1**	1.2	0.4	-0.3
$NZ v $US	**2.0**	-0.7	0.6	-0.1
$NZ v $AUD	**-1.5**	0.7	-1.1	0.2
NZ Cash	**0.2**	0.5	0.6	1.1
NZ Fixed Interest	**-4.3**	-7.1	-1.3	1.6
Intl Fixed Interest 100% hedged to $NZ	**-4.7**	-3.7	1.1	2.3
Australasian Equities 50/50 Indexes	**-1.7**	5.0	9.7	10.1
NZ Listed Property	**-6.2**	0.8	6.8	10.1
Intl Equities 50% hedged to $NZ	**-6.1**	7.5	13.3	11.6
Commodities $NZ	**23.6**	50.3	15.4	9.1

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	1.7%
Contact Energy	Energy	2.8%
F&P Healthcare	Healthcare	-25.7%
Fletcher Building	Building	-9.6%
Freightways	Transportation	-1.9%
Meridian Energy	Energy	5.7%
Port of Tauranga	Ports	-6.0%
Spark NZ	Telecommunications	5.2%
Stride Property	Property	-4.2%
Australian Equities		
BHP Group	Resources & Energy	34.0%
CSL	Healthcare	-6.3%
IAG	Financials	5.8%
James Hardie	Building	-25.5%
Macquarie Group	Financials	0.2%

- BHP benefited from the surge in energy prices as commodity supplies were impacted by the Russian invasion of Ukraine. The share price was also influenced by an increase in its ASX200 index weight (ending its UK listing), the spin off of petroleum assets to Woodside and the announcement of a significant return of capital to shareholders. The company has committed to cutting the company's direct greenhouse gas emissions by 30% by the end of the decade and reach net-zero by 2050. As part of this commitment, the company took delivery of its first LNG fuelled bulk carrier ship which will transport iron ore. LNG ships eliminate nitrogen oxide and sulphur oxide emissions and reduce carbon dioxide by 30% compared to bunker fuel.
- Higher mortgage rates and a sharp drop in building approvals - particularly in Australia - saw building materials companies such Fletcher Building (despite a strong profit result) and James Hardie sold down. However much of the decline in activity can be attributed to delays caused by Omicron induced staff shortages across Council workers, private certifiers, and industry staff. Short- and medium-term construction demand remains robust despite rising interest rates potentially slowing housing activity. JHX has seen strong growth in fibre cement sales in the US (as an alternative to vinyl or wood), but margins have softened due to higher input costs and marketing expenses as the company looks to build a direct retail brand to attract consumers looking to repair and remodel their homes.
- Improved global aluminium prices have enhanced the likelihood of the Tiwai smelter remaining open for longer and benefiting electricity producers, Meridian Energy and Contact Energy. CEN posted a strong earnings result with strong hydro production and their Tauhara geothermal project is expected to take the company to over 90% renewable production. Both companies will benefit from the long-term electricity use upside from any green hydrogen development in Southland, further electric vehicle penetration and conversion of less efficient industrial boilers to electricity.

Goodman Group	Property	-12.2%
Ramsay Healthcare	Healthcare	-6.5%
Sonic Healthcare	Healthcare	-21.9%
Westpac	Financials	15.3%
Wesfarmers	Diversified Industrial	-11.7%
Woolworths	Consumer Staples	1.0%

- Goodman Group share price fell despite a strong result and guidance of 20% earnings growth in FY22. Listed property companies in general are negatively impacted by rising interest rates which impact property values. GMG, however, is heavily biased towards industrial property, which as a sector is benefiting from the transition to on-line/ecommerce and supply chain efficiency. The company currently has A$70b of assets under management (generating fees) and a strong development pipeline is expected to grow this to A$100m over the next 4-5 years.
- CSL is reviewing its wage and employment structure to attract and retain staff as labour market competition heats up across the healthcare sector globally. Staff safety, career advancement and other non-wage benefits are all being considered as the company focuses on rebuilding is core human plasma collection business post Covid disruptions.
- Spark has successfully grown its mobile revenue and improved margins; however, the broadband business remains extremely competitive. Growth in Cloud IT services was disrupted by Covid, but demand remains solid for new capacity at the Takanini Datacentre. The company announced it will segment off its mobile tower assets into a subsidiary company and explore introducing third party capital while retaining a shareholding in the new company.
- Wesfarmers (who own Bunnings, Target and K-Mart) posted a softer profit result largely due to supply chain disruptions, elevated transport costs and labour constraints as staff were forced to stay home due to Omicron. These pressures are expected to continue for at least the rest of the year.
- Healthcare sector stocks were markedly down as Covid related government spending starts to change focus and winddown. In Australia, the recent budget highlighted a 70% drop in funding for PCR tests (pathology provided by Sonic Healthcare and Ramsay Healthcare) in favour of Rapid Antigen Testing (assuming of course no new variant). At the same time the budget also allocated new funds for preventative health (testing and screening of cancers) and mental health reforms (an area of focus for RHC).
- Fisher & Paykel Healthcare (FPH) was sold down aggressively after revising FY22 revenue guidance slightly lower to $1.69b. This is 14% below the 2021 peak and is largely due to a decline in hardware sales - a sign that hospitals have enough to deal with respiratory cases including Covid. The largest contributor to revenue is still consumables (masks and tubing) and this is also expected to soften with fewer patients in hospitals due to Omicron and a mild flu season. Post this short-term adjustment however, the positive news for the company is that their devices are now in considerably more hospitals worldwide and their respiratory products have a universal application in general practise.
- Westpac posted a good result which shows it is making progress on reducing costs (-22% qoq), primarily by reducing headcount (mainly contractors) and announcing an executive restructure. This intended to reduce the size of their corporate area by 20% as the company focuses on core business and client self-help technology. Banking stocks such as Westpac rose over the quarter amid expectations that the worst of business margin compression was behind them due to rising interest rates allowing banks to increase their margins. In NZ, the first half of 2022 will see a significant re-set of fixed rate mortgages which were taken out by borrowers in 2020/21. The increase in mortgage rates is expected to reduce household discretionary income by $4.1bn this year, rising to $7.5bn in 2024.
- Auckland Airport benefited from an easing in travel restrictions, reinvestment of investor capital released from the take-over of Sydney Airport and the announcement that their largest customer Air NZ is undertaking a recapitalisation which reduces risk around future growth potential.

AUSTRALASIAN EQUITIES

The Australian market was one of the best performing markets over the quarter, rising +2.2% largely due to its strength in the commodity and energy stocks. These sectors have benefited from supply constraints related to Covid and the Russia-Ukraine war. The recent moves by Chinese authorities to support domestic growth by boosting residential housing construction may also assist commodity prices in the medium term. The Australian government released the 2022 budget which included new measures targeting the cost of living, lower taxes, housing affordability and increased defense spending.

In contrast, the NZ market which has a larger number of interest rate sensitive companies fell -7%. Companies which have benefited from the cyclical uplift in activity now face a potential earnings crunch as they contend with rising costs, scarce labour supply and much weaker business and consumer confidence. Consumer confidence is at the lowest level since the 2008 global financial crisis as households face reduced cashflow due to negative real wage growth, high inflation and a sharp rise in residential mortgage rates with more strain still to come as fixed rate mortgages taken out to buy properties in 2020/2021 are re-set at much higher rates.

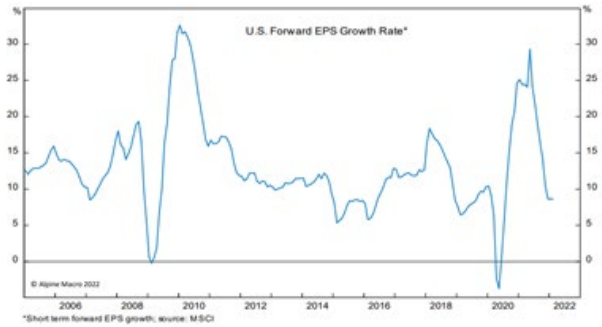
On a more positive note, while equity markets in general tend to struggle during periods of high and rising inflation, companies with pricing power are better placed to protect margins. Research from Schroders suggests that energy, real estate, utilities and healthcare sectors can offer some protection. These are all sectors that are well represented in a diversified Australasian portfolio.

Fund	Quarterly Performance In NZ$ terms	Commentary
Devon Trans-Tasman Fund	1.4%	The fund outperformed the market benchmark over the quarter. The portfolio has an overweight allocation to resource companies such as South32 who have exposure to aluminium (40% of earnings), copper, nickel, silver and metallurgical coal; and Santos who posted a 34% increase in revenue, benefiting from a strong oil price and increased gas sales from their Darwin LNG asset. Metcash also performed strongly and is the manager's favoured exposure to retail consumer demand through its home improvement chains (Mitre 10, Total Tools, Home Hardware) and IGA supermarkets. Retailers with solid market share such as many of the independent Metcash brands have some pricing power and more of an ability to pass on rising input costs rather than reduce margins.
Harbour Australasian Equity Focus Fund	-9.9%	The fund underperformed the market benchmark over the quarter. The fund has significant exposure to growth technology stocks which were negatively impacted by rising interest rates and a weaker revenue growth outlook as economic activity slows and costs increase. Detractors were Serko, Pacific Edge, Block, Xero and Summerset (retirement village and aged care operators face higher labour costs and slowing unit sales). Positive contributors included BHP and Macquarie Group which benefited from the increase in commodity prices while National Australia Bank looks to improve bank margins on rising rates. Looking forward, earnings growth in Australia is looking positive - especially for resource and commodity stocks. In addition to the current supply shortage lifting prices, these companies supply the critical metal inputs required for green alternative energy infrastructure which is so much of an investor focus. One such company is Iluka Resources (a new fund holding) who produce Zircon and various rare metals required in powerful magnets (such as those used in wind turbines). The transition to renewable energy has some way to go and Australia with greater exposure to key sectors is expected to continue to benefit, extending its recent outperformance of the NZ market.

INTERNATIONAL EQUITIES

International equity markets initially brushed off the steeper inflation data in the last quarter of 2021. Some inflation is potentially good for sharemarkets in the medium term as it signals economies are growing strongly and above trend. However, as inflation readings hit decade high levels; markets began falling on concerns that central banks were too slow to tighten rates and may be forced into more drastic action to quash demand (and potentially kill off economic growth).

Estimated US Forward Earnings Lower



Higher interest rates impact company valuations, particularly "growth" style companies that have high revenue growth but little earnings. A higher interest rate means a higher discount rate used to calculate the present value of these companies. The "growth" company laden Nasdaq index fell -9% over the quarter with companies such as Facebook down -34% and Netflix down -37%.

Several major markets moved into correction territory (worse than -10%) during the quarter but rallied in late March paring back losses. With inflation rising, top line revenues for companies will rise but higher input prices will impact earnings. US (S&P500) company earnings are expected to move back to a more trend like 9.3% (chart opposite), Australia to 9.2% and NZ to 5.5%. The fall in market prices has pulled valuations back to more reasonable levels even accounting for slower economic conditions and weaker earnings prospects.

Despite the resurgence in some mega-cap tech stocks last month, there has been a sharp reality check for many growth investors as interest rates have started to rise. For example, there were 59 new technology companies listed in the US over the 2021 year, most at sky high valuations. The median revenue multiple at time of listing of those 59 companies was 17x revenue. As at the end of March 2022 only one of those companies was still above its listing price, with the median stock price down -63% and companies trading at a more realistic 5x multiple.

Fund	Quarterly Performance In NZ$ terms	Commentary
Active Fund Managers		
Platinum International Fund	-6.3%	The fund was down -7.7% in AU$ terms for the quarter. The portfolio held a significant amount of cash (17%) and short stock positions (particularly in high flying technology stocks) at the start of the quarter which means it performed very strongly relative to markets. However, by the end of March uncertainty due to the Russia-Ukraine conflict and a general risk off market mood saw investors flock back to the assumed 'safety' of growth stocks. Commodity producers Glencore (mining) and Mosaic (fertiliser) were strong performers for the fund and profits were taken. The manager increased exposure to energy (Shell, Suncor Energy) and European travel (Wizz Air). Detractors from performance included Chinese stocks (covid and political/regulatory issues and concerns about China's relationship with Russia), industrials (supply constraints) and banks with European exposure (although the manager bought more at lower prices). The fund continues to be conservatively invested (62% net market exposure including cash and short positions) reflecting ongoing concern about inflation, interest rate rises and a deteriorating geopolitical environment.

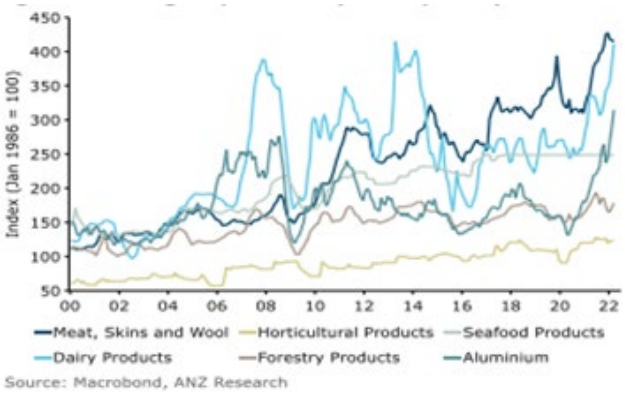
Monks Investment Trust	-22.8%	The fund was down -18.9% in GBP terms for the quarter however this included a -4.5% impact from a reduction in the share price premium. The share price of listed funds like Monks often trade at a premium or discount to the actual value of the underlying net assets (NAV) in the fund. These differences average themselves out over time as the value of the underlying assets is realised. The manager invests in a range of companies including several smaller growth stocks outside of the more recognised large mega-cap tech stocks. Investment in these rapid-growth companies is a key driver of long-term growth for the manager (they make up approx. 50% of fund holdings) however it is also the reason for the recent underperformance relative to the market. Current growth holdings provide exposure to a range of investment themes and disruptive tech such as the shift to electric cars, combating dementia, improving education, and growing consumer demand for a plant-based diet. These are different industries and different companies with totally different challenges and business models; however, they all offer the potential for rapid growth over time while diversification across many, varied opportunities that helps reduce portfolio risk. The other half of the portfolio is invested in more established companies with proven, profitable businesses and those able to reallocate capital to make the most of business cycle opportunities. During 2021 the fund sold EOG Resources which means it has no gas or oil company holdings for the first time in 90 years.
Magellan High Conviction Fund	-13.8%	The fund was down -15.3% in AU$ terms for the quarter. The largest detractors were Starbucks, Netflix (slower subscriber growth and narrower profit margins) and Meta Platforms (impacted by Apple privacy measures and loss of some young users). The biggest contributors were Visa (improve payments volume) and Amazon (above forecast sales and raising the price of its Prime membership scheme). Magellan has been in the news following the announcement that co-founder and CIO Hamish Douglas has stepped down from his role in the firm for personal health reasons. Hamish is a very well-respected fund manager, and the firm has seen good fund performance and spectacular business growth under his leadership so the announcement raised questions of how this might impact the company and investors. While the group's global funds have seen outflows from some institutional and retail investors, Magellan remains a significant business and the High Conviction fund has to date retained the support of investors. Hamish was a co-manager of the fund along with Chris Wheldon (since 2018) and his replacement is Chris Mackay, also a co-founder of Magellan and a highly respected and successful fund manager in his own right. We have placed the fund on watch but remain comfortable that Magellan have a strong investment team and process in place. The portfolio is a highly concentrated selection of the managers best stock picks, and it performs an important role in the overall exposure to international equities.

Passive/Index Funds		
Vanguard Ethically Conscious International Shares Index Fund Hedged to NZD	-7.2%	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. Of all the major markets, the UK was the only region to post a positive return (up +2.9%) while the US was down -4.6%, Japan -2.5% and Europe fell -8.9%. This fund tracks a FTSE index which recently announced a change in the methodology of how they determine which companies are screened for exclusion. Greater investor focus is leading index providers to provide greater transparency and consistency of approach and methodology for determining the extent to which a business may have either zero, minimal or low exposure to revenue generated by a particular business, and whether they are involved as a primary activity (such as producing and manufacturing) or a secondary activity (retailer, distributor, supplier).

iShares Russell 2000 Index Fund	-9.4%	These funds provide passive exposure to smaller companies in the USA and around the world and are valued in USD. The NZ dollar was lower against the US dollar over the quarter which assisted returns. Small company stocks have lagged large company stocks over the past year and the sharp rise in interest rates (which led to a reduction in valuation metrics), saw the Russell 2000 officially enter a bear market in late January down -20% from its previous high in August 2021. Interestingly small caps recovered somewhat over the rest of the quarter despite the Russian invasion, albeit with considerable volatility with a greater than +1% daily move in the index on 71% of trading days, more than twice the long-term average.
Vanguard FTSE All-World ex US Small Cap Index Fund	-7.5%	
Vanguard FTSE Emerging Market Index Fund	-7.4%	The fund provides passive exposure to companies listed in emerging markets and is valued in USD. Following the invasion of Ukraine, Russia was removed from the underlying market index in early March effectively at a value of zero. This fund tracks the index and will exit any remaining holdings if/when possible - although previously Russia made up less than 1% of the fund allocation so any performance impact is insignificant. More important negative factors for emerging markets were the renewed focus on global geopolitical tensions, a strong US dollar and further lockdowns in China which makes up 34% of the index. Conversely those countries who are net commodity producers posted sizeable gains and were helped by support from investors looking for value outside the large mega cap stocks.

COMMODITIES

World Prices for our Agricultural Produce

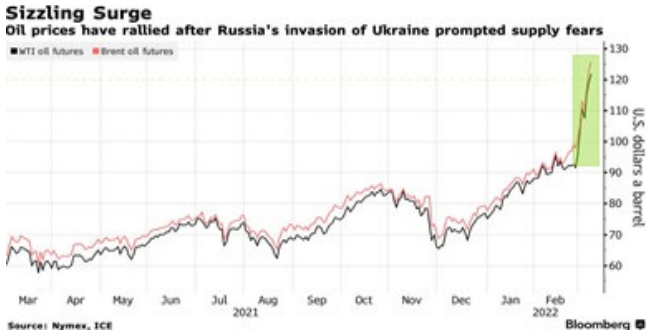


Commodities prices soared during the quarter as the Ukraine war impacted further on short global energy supply. Since the Russian invasion in February, oil has surged +30%, thermal coal +77% and natural gas +400% in the European market. Food prices also jumped with wheat up +35%. Ukraine is one of the world's largest wheat producers, while Russia - one of the world's largest energy producers. Industrial metals were also higher.

Closer to home the ANZ Commodity Price Index hit another high up +3.9% in March and lifting our terms of trade to record levels. Dairy prices were +7.6% for the month and Aluminum + 8.4% (Russia is a large producer).

ANZ noted that the restriction in port throughput in China under Covid lockdowns, is once again affecting shipping times and costs which again may negatively impact on our exporters once this coming quarter.

Higher Oil Prices $125bbl



PROPERTY

Global property markets also had a tough quarter with the global property index down -5.3% while our listed NZ property market was down -6.2%. Higher interest rates negatively impact property valuations as they do shares. The NZ residential market is finally succumbing to the multitude of pressures; higher mortgage costs, longer bright-line tests, loss of interest deductibility, tighter bank lending and an improvement of new housing supply at the margin. Over one third of all outstanding mortgages will be reset at a higher rate this year.

REINZ House Price Index

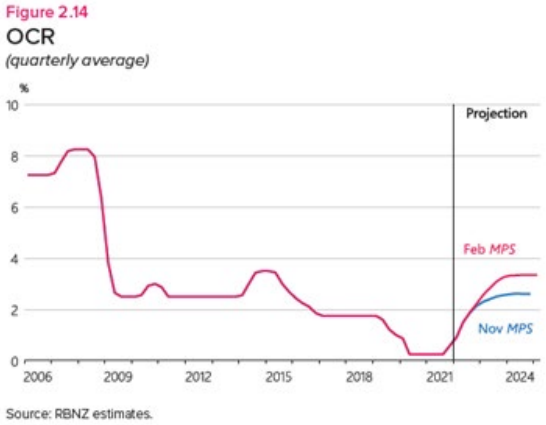
The REINZ residential property index was down -4.3% for the quarter. CoreLogic's latest mapping analysis revealed NZ residential property prices fell by an average of almost -8% in 154 suburbs across New Zealand in the four months to February, with all suburbs with a price decrease of more than -5% being in Auckland.

The next test will be net migration rates and whether we see potential home buyers leaving or arriving. Non-residential property is faring better with industrial property steady while both commercial and retail sectors are showing some sign of life as Covid restrictions lift.

FIXED INTEREST

Central banks blinked sharply this quarter as persistent inflation data became too hard to ignore politically, exacerbated by sharp energy and food price increases following the Ukraine invasion. A previously patient US Federal Reserve is now moving to catch up and signaling at least six rate rises this year: with markets pricing in an 88% chance of a rate hike at the next FOMC meeting in May. This puts the US cash rate on track to reach 2.25% to 2.5% by the end of the year and creates space for other central bankers to follow suit more easily. The previously reluctant RBA is now likely to bring forward a rate rise this year (previously it was 2023) with some commentators picking a move in June. The BOE increased the UK rate to 0.75% in March and may move again this quarter.

RBNZ OCR Projection



In New Zealand the RBNZ surprised markets and raised our rates to 1% in Feb and by a further 0.5% to 1.5% in April, at the same time signaling a much higher cash rate trajectory to peak at 3.6% in 2024.

Despite the rapid hawkish nature of policy development, the major central banks still remain wary of tightening conditions too far should components of the present inflationary pressures prove transitory. Headline inflation (despite hitting record levels) is likely to abate as energy and agricultural markets compensate and settle from the Ukraine war and from slower Chinese growth rates. Oil is now back under $100bl. Labour markets are generally tight everywhere but greater post-covid mobility may relieve some of that pressure as the year progresses.

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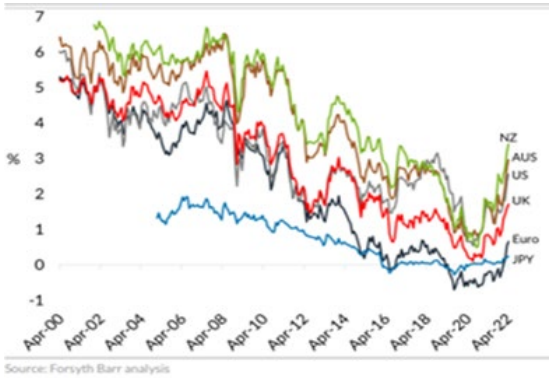
Global 10yr Bond Yields



The major shift in monetary policy in the first quarter saw a massive sell off in global bond markets sending yields and swap rates sharply higher. The global bond index had one of its worst starts to the year and was down -5.6%.

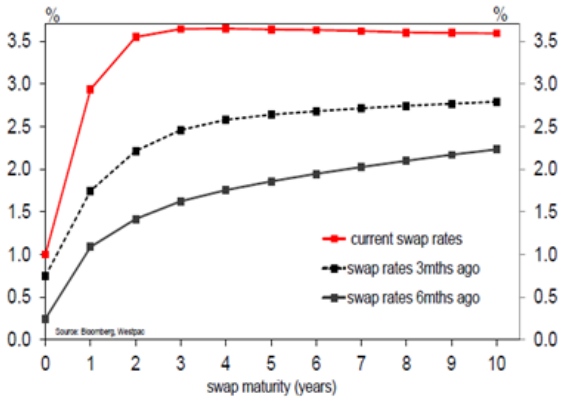
Interest rate curves flattened dangerously close to inversion during the quarter with US 2-year yields briefly rising above 10-year yields which historically has signaled recession. However, this seems unlikely without the key condition of also having high unemployment. Credit spreads also moved higher in the period as investors determine the risk of quality issuers especially given the potential fallout risks from the Ukraine war.

In addition, the Fed indicated it will commence selling down its $9trn of bond holdings at $95bn per month. Regardless of the inflation outlook, this level of bond supply onto the market will continue to put upward pressure on yields and further tighten financial conditions. Both the BOE and RBA may also commence selling their bond holdings this year while the ECB will be more patient given their war issues. There is increasing commentary suggesting yield rises may now be overdone and that as both growth and in turn inflation subside to more normalized trends, some unwinding of yield rises may occur.

The NZ market index was down -4.3%. This performance was on top of an already poor year where the NZ bond market index fell -7.1%. The NZ interest rate swap curve opposite shows how far and fast the curve has risen over the last 3 months (dotted line) and 6 months (solid line) to today (red line). Current 10-year NZ govt bond yields are at 3.5% and US 10-year at 2.7% (and a long way from 0.6% in 2020).

Over the last year we have continued to weight client portfolios towards the shorter end of the yield curve to reduce the chance for large capital losses that can occur as bond yields rise. The longer the maturity of a bond the more its value is impacted by a rise in yields. This active management has substantially protected client portfolios from the brunt of bond value losses over the period. It is unusual for bond values to fall at the same time as share markets and property prices have also fallen which has made it a particularly tough period for investor portfolios.

NZ Interest Rate Swap Curve Lifts



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Security	Quarterly Performance In NZ$ terms	Commentary
Macquarie NZ Fixed Interest Fund	-3.5%	AMP Capital Investors (NZ) Ltd has been renamed Macquarie Asset Management (NZ) Ltd following the sale of the global equity and fixed income business. The fund managers and key management team for the funds we invest into remain in place and no changes are planned in the short term. We will continue to review any changes with the fund manager and monitor performance. The manager outperformed over the quarter due to holding shorter duration bonds believing the US Fed, ECB and RBA have some way to go in raising rates to contain rampant inflation. In NZ, where the RBNZ has moved quicker, the manager now believes short term rates have almost reached a peak with markets pricing in a terminal OCR of 3.25% and they have therefore started to position for the RBNZ to have to adjust to a rapidly cooling housing market. Credit exposure has been reduced slightly at expensive valuations and widening credit spreads, especially for financials as term deposit rates rise and banks increase bond issuance.
Macquarie NZ Short Duration Fund	-1.4%	
Harbour Wholesale NZ Core Fixed Interest Fund	-3.6%	The manager outperformed over the quarter. Following hawkish statements by the RBNZ in February, and the subsequent sharp move higher in yields, the manager considered the market had moved further than warranted and started extending the duration of the portfolio. With yields moving higher still in March, largely driven by offshore moves, this strategy proved premature but remains in place. The manager believes the RBNZ will be forced to stop and consider the impact on growth well before they get to the aggressive monetary conditions currently priced into markets. Supporting this view is the expectation that NZ rates will again start to attract international investors, particularly once NZ joins the widely used WGBI global bond index in November when index investors will need to buy government bonds.
Harbour Enhanced Cash Fund	-0.3%	

OVERVIEW

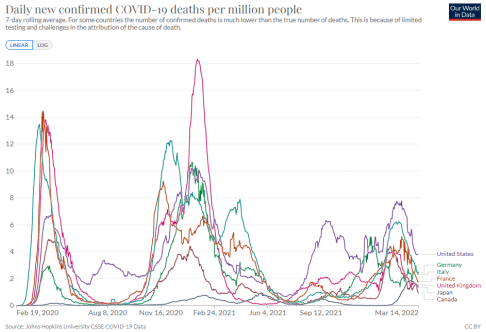
Investment markets are focused on three concerns this year. Covid-19, record inflation management and the Russian/Ukraine war with all its knock-on effects.

After first being detected in Wuhan 2.5 years ago, global Covid deaths are again reducing (graph right) as the less deadly Omicron dominates infections and as vaccination rates and natural immunity levels rise. China is the only country pursuing elimination strategy through aggressive lockdowns. China's vaccination rates are high at 87% but concerns remain over the efficacy of their vaccines and healthcare system capacity to deal with high infection rates. China recently locked down large parts of Shanghai. This policy response is slowing their economy (5.5% in 2022 from 8.1% in 2021) and their contribution (18%) to global GDP. Lockdowns will contribute to global supply chain problems but also reduce energy demands. New mutations or recombinants of the virus are also appearing nearly monthly around the world and although none to date are as deadly as Delta or Alpha, world health officials are on high alert. The latest Omicron XE variant is 10% more transmissible though not as deadly. Covid-19 remains a key threat to global economic activity. For now, while China contracts, most countries continue to open (labour mobility, services, travel) adding to the economic momentum that started in late 2020.

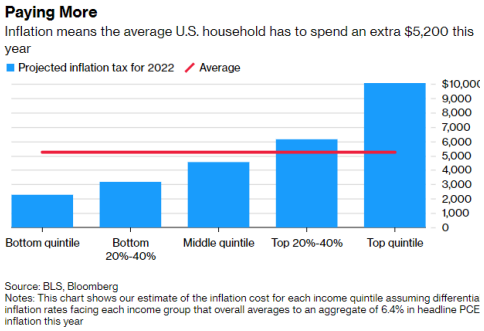
Investment markets remain on tenterhooks while watching global inflation data and trying to interpret potential central bank policy responses. The debate around the nature and risk of the surge in inflation continues daily. Is it structural and embedded or transitional and passing? Recent indicators suggest the global supply chain chaos is starting to ease with some commentators wondering if there will be a "bull-whip" effect from a sudden drop in demand because of higher prices and improved supply. An example of this closer to home includes GIB board for construction where a multi-pronged supply response may end up oversupplying the market. Elevated levels of inflation also naturally reduce demand as household disposable income falls and spending focuses on key goods including food, petrol, transport and potentially meeting higher mortgage payments. At the same time high inflation means real wages are falling. In this environment setting interest rate policies becomes a fraught process. Letting natural price rises reduce demand or increasing interest rates to forcibly reduce demand while most inflationary pressures are supply side issues is not solved by higher interest rates. At present, markets are worried that central banks may trigger a recession by tightening monetary conditions too aggressively. At the same time central banks are under immense political pressure to force inflation down. Getting it right is looking increasingly difficult with bank governors trying to buy time for better supply side inflation clarity.

The fall-out risks from the Russian Ukraine invasion continue to rise. It is not going well for Russia who is now a global pariah. The sanction response from the west is starting to crush the Russian economy (estimates range from -18% to -25% to date). Troop and war material losses are stalling their invasion with increasing supplies of western sophisticated weaponry to Ukraine to continue. The WSJ reports up to 40,000 Russian troops killed, wounded, taken prisoner, or missing. Backed into a corner, Putin may declare 'war' and order a general mobilization of his forces to crush Ukraine. Such an escalation would not be in China's interests who now seem the only party capable now of influencing Putin back from the edge.

Covid Deaths Falling



Inflation Costing US Households $5,200



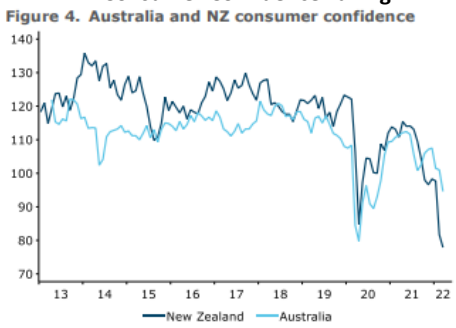
Russia Withdraws to Refocus Attacks

NEWTON ROSS
PRIVATE WEALTH MANAGEMENT

New Zealand

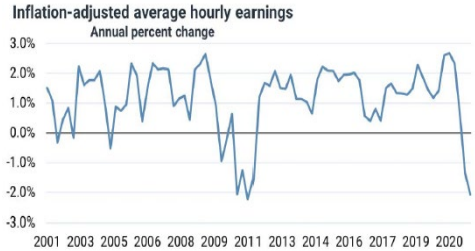
NZ came out of 2021 in decent shape with recent data showing a 3% annualized rise in GDP in the last quarter of the year (above forecasts) and recovering most of the Covid lockdown related drop of -3.6% in the previous quarter. Manufacturing, construction, mining, retail and professional services were all strongly higher. Detractors included ongoing lockdown affected education, travel, tourism and hospitality sectors. Government spending in the March quarter was the highest on record. During the quarter inflation surges saw energy, food prices rise, and mortgage rates lift. This negatively impacted consumer confidence while businesses continue to cope with tight labour conditions and other rising operating costs - construction services are particularly feeling the pinch. The ANZ – Roy Morgan consumer confidence index fell to a record low in March while the ANZ Business Outlook improved slightly after sinking in February. The ANZBO survey showed 96% of respondents expected higher input costs although wage pressures are low at present and mostly being felt in the construction sector. In response to rising inflation concerns (and under political polling pressure), the government reduced excise duty and road user charges by 25c and halved public transport fees for 3 months which will have a temporary and minor impact on inflation while they then borrow more money to fund the cut. Business pricing intentions are rising, particularly in manufacturing which may help offset rising margin pressures. Meanwhile consumer demand (and confidence) may continue to dip as household disposable incomes fall while house listings, sales, auction clearances and now prices point to a softer residential market which will additionally impact on confidence. On the 1st of April the government increased the minimum wage by $1.20 to $21.20 per hour while record low unemployment of 3.2% shows a very tight labour market and certain future wage pressures. As our borders open more fully this quarter net migration numbers will be carefully watched for signs of a brain drain or gain and its impact on the demand for housing. Despite obvious challenges, GDP forecasts for 2022 (Westpac) are still positive at 3.4%.

NZ Consumer Confidence Falling



Source: Roy Morgan, Statistics NZ, Macrobond, ANZ Research

NZ Inflation Adjusted Hourly Earnings



Source: Statistics NZ, Refinitiv, Jarden

Australia

The Australian economy also finished 2021 strongly after bouncing out of Covid lockdowns in several states. Westpac is forecasting the economy to grow at a similar or better rate in 2022 as it did in 2021. Consumer spending accelerated in the quarter as households continued to unleash some of the estimated $265bn in lockdown savings, while unemployment fell to 4% and is on track to go lower and reach levels not seen since the early 1970s. Surging commodity prices are expected to lift their terms of trade another 11% this year while rising wages, planned tax cuts and low to middle income fiscal support will additionally support household spending. Inflation is also rising more sharply than expected; and given that the US Fed Reserve is tightening faster, provides room for the RBA (from a currency perspective) to move its planned hikes back from 2023 into 2022. Some commentators predict a rate rise as early as June. With such strong economic momentum, higher tax earnings enabled a generous recent Australian budget (election lead-up); reducing taxes but also supporting national infrastructure projects, technology investment including cyber protection, house affordability schemes and (like NZ) a cut to fuel excise duties. The lucky country has benefited from near perfect growing conditions and soaring agricultural prices which will help farmers produce a record forecast $81bn in agricultural production this year and $3bn + more than expected (Source: AFR). Projections for falling house prices may not materialize with strong inbound net migration now expected as Australian states more fully open their borders.

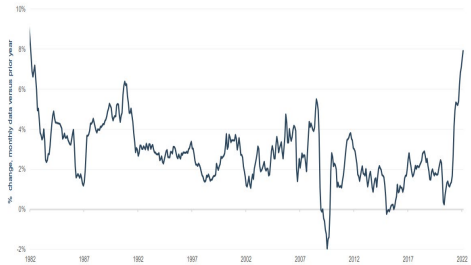
Australian Wages Indicator
(annual % change)

Source: CBA

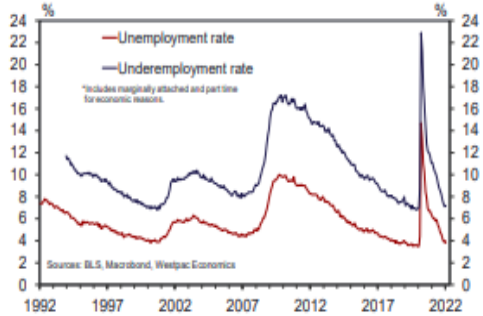
US

The US economy continued its strong 2021 momentum into the first quarter with an extremely tight labour market pushing unemployment levels down to 3.6% and jobless claims are at a 52-year low. US household net worth jumped 14% in 2021 to a record US $150.3 trillion. The recent ISM Manufacturing Index reading of 58.6 is consistent with a strong economic outlook and reflects the 21st month of expansion since pandemic started. After a booming 5.7% growth rate in 2021, current consensus forecasts are for 3.6% real GDP growth this year versus the 20-year average of 1.9%. US productivity has also been impressive at +6.6% year on year. The strong pace of activity combined with chronic supply shortages and sharply higher energy and food prices drove US inflation levels to a 40-year high with CPI coming in at 7.9% in February. On the flipside the US ISM services index fell for the third consecutive month (Omicron driven). The Federal Reserve increased its target rate to 0.5% in the quarter - the first hike since 2018. They recently signaled they will also start reducing their massive bond holdings ($9trn) by selling up to $95bn of bonds into the market each month. These bonds were largely issued by Treasury to fund pandemic fiscal response programs. Investors have now priced in a far more aggressive Fed response to inflation and expecting at least 8 x 0.25% rate hikes in 2022 while the Fed has signaled six hikes, with a 0.50% hike expected in May. While demand is running hot, much of the inflationary pressure is coming from supply side issues outside the US economy. At the same time there has been a significant improvement in shipments indexes. There is a clear risk that the Fed may overtighten financial conditions and potentially put the economy into recession. The bond yield curve's recent inversion (short rates higher then longer rates) highlights this risk though with such full employment a recession is still very unlikely, particularly in the short term.

US Inflation: 40yr Highs



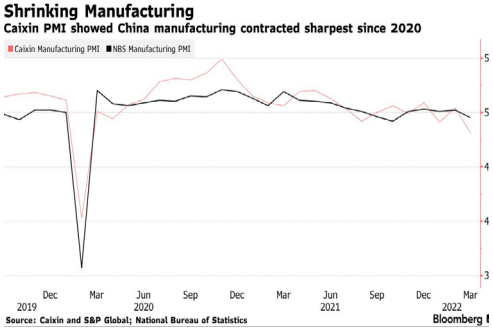
US Full Employment?



China

China's lockdown response to surging Omicron cases is having a significant impact on their economy with manufacturing contracting over the quarter (Caixin PMI) though exports remained strong. With Shanghai's 25 million residents presently in some form of lockdown Chinese authorities are prepared to accept slower activity rather than risk overloading a vulnerable health system. Premier Li Keqiang expressed confidence in the economic outlook, signaling a target growth rate for 2022 of 5.5%. It is clear the government wants to build a more robust economy relying on improvements to productivity, wage growth and social reforms. This includes restructuring their property sector to increase low-cost housing, education reform and investment in job creation schemes in targeted sectors. It also includes a focus on greater capital markets stability which had been under pressure following the high-profile financial collapse of some of their largest property developers. Westpac points out that Chinese consumers are also showing an increasing preference for domestic brands as the government activity promotes buying local. Xi Jinping who is seeking re-election this year will want to keep the economy on target and is likely to introduce additional stimulus measures if required. Apart from Covid, China's presently tacit support for Russia becomes a greater economic threat. With the world increasingly shocked at Russia's ever more bloody campaign, key trading partners may introduce new trade tariffs or sanctions.

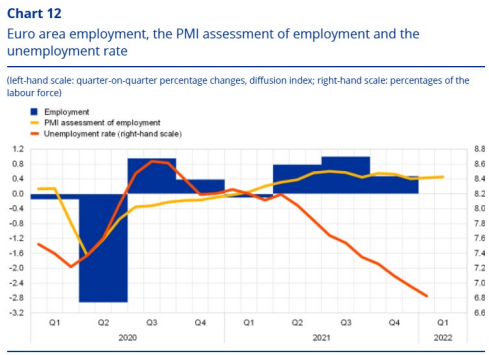
China Slows on Lockdowns Manufacturing Dips



Europe

Just as it was emerging strongly from the impact of Covid, the Russian invasion of Ukraine has put European economic growth prospects in doubt. In contrast, the ECB is still forecasting 2022 growth at 3.7% after the strong recovery in 2021 (5.3%). However, this growth rate looks challenging - Goldman Sachs forecasts a more modest 2.5% - given Europe was already experiencing an energy crisis before Russia invaded Ukraine. Consequently, the EU is frantically looking at ways to wean itself from Russia's energy supply, given Russia provides 45% of Europe's gas and 25% of its oil supply. Record energy prices and continued global supply chain problems are also impacting European industrial production. With annual inflation running at 5.8% and unemployment levels back to 6.8% (Germany 5.0%) the ECB, with its still positive growth projections, has indicated they will start tightening financial conditions by reducing their bond buying program - although interest rate rises are not yet on the horizon.

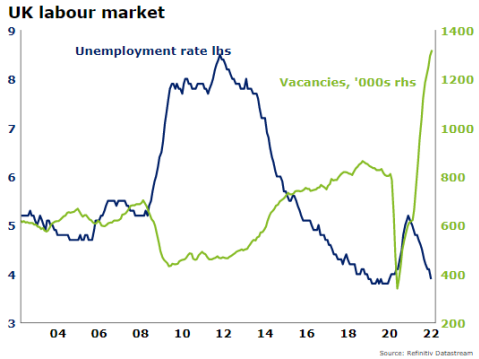
Eurozone Falling Unemployment



UK

After the strongest G7 recovery in 2021 (7.2% GDP growth rate) the UK economy has bounced back to its pre-pandemic size. With Covid restrictions lifted, their services PMI Index rose sharply in the quarter and to its second strongest level since May 1997. The unemployment rate fell to 3.9% while job vacancies soared to record levels. UK inflation is running around 5.5%, driven by higher energy and food prices. GDP growth is still forecast at 3.6% this year although consumer spending will slow as inflation cuts into household disposable incomes. With Europe its biggest trading partner, UK growth prospects are also linked to the progress of the war in Ukraine. The UK has banned all investment in Russia, has recently frozen the UK based assets of Russia's largest bank, Sberbank and will end all imports of Russian coal and oil by the end of the year.

UK Record Employment Growth



Japan

Following pandemic induced contractions Japanese economic growth finished at 1.7% for 2021 driven by pent up domestic demand and fiscal support packages. Spending on durable goods, semidurable goods, and services were all notably strong. The IMF however recently slashed their outlook for Japan's growth this year to 2.4% (down from 3.3%) on higher energy and materials input costs and further potential supply chain disruptions exacerbated by the Ukraine war fallout. CBA are forecasting only 1.6% growth. Japan also introduced trade sanctions on Russia while Japanese businesses are either exiting or significantly reducing activities in Russia. Critical trade with China may also be impacted if the Chinese maintain their Russian support.

Emerging Economies

Energy and commodity exporting developing nations are positioned to benefit from the record surge in commodity prices though prices are expected to ease through 2022. The UN's global food index rose 12.6% in March and is up more than 50% since mid-2020 while oil, gas and coal prices have hit decade highs. Energy and food importing nations will be hamstrung by the higher commodity prices, including Middle Eastern & North African countries that are particularly reliant on Ukrainian and Russian wheat and India on Russian energy supply. Sharply rising interest rates and tighter global liquidity will further hinder indebted nations finances and mean more restrictive investment. On a more positive note, the lifting of Covid restrictions should assist with travel for tourism focused countries. Overall, Schroders see emerging market growth slowing from a high of 6.5% in 2021 to around 4.5% in 2022 which is around long-term trend levels.

IMF Emerging Market GDP Outlook