

BT Index Defensive Fund

Monthly report – 31 July 2022

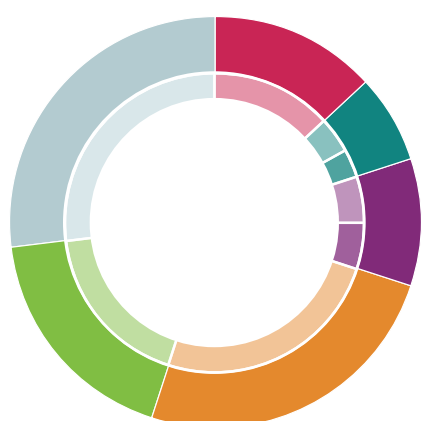
Fund overview

Inception date	1 August 2016
APIR code	WFS0588AU
Fund size (AUD millions)	\$243.64
Investment objective	To provide investors with predominantly income and some growth returns, with a low probability of loss over the short term which tracks the overall return of a diversified portfolio of underlying investments.
Recommended investment timeframe	3 years
Minimum initial investment	\$500,000
Distribution frequency	Quarterly
Management costs (%) pa¹	0.34
Buy/sell spread (%)	0.06 / 0.06

Performance review²

Period ending 31 July 2022	1 month	3 months	1 year	3 years	5 years	Since inception
	%	%	%	% pa	% pa	% pa
Total return	3.48	(1.10)	(4.78)	1.10	3.31	3.05
Growth return	3.48	(3.78)	(7.92)	(2.34)	(0.11)	(0.43)
Distribution return	0.00	2.68	3.14	3.44	3.43	3.48

Actual asset allocation %³



- **Equity – Australian Listed – 13.12%**
 - BT Australian Shares Index Fund – 13.12%
- **Equity – International Listed – 6.90%**
 - BT International Shares Index Fund (Unhedged) – 3.90%
 - Blackrock Index Hedged International Equity Fund – 3.01%
- **Property – International and Australian Listed – 10.12%**
 - BT Property Securities Index Fund – 5.18%
 - Blackrock iShares Global Listed Property Index Fund – 4.95%
- **Fixed Income – Australian – 25.12%**
 - BT Australian Fixed Interest Index Fund – 25.12%
- **Fixed Income – International – 17.92%**
 - BT International Fixed Interest Index Fund – 17.92%
- **Cash – 26.81%**
 - Advance Cash Multi-Blend Fund – 26.81%

Market update

After a benign June month for the world's share markets, July saw a bounce back driven by easing fears of central banks' over-tightening of monetary policy, stronger consensus on peak inflation and a solid Q2 reporting season out of the US, which all helped shape a good month for markets in the face of still evolving geopolitical tensions.

Australia

July saw the Westpac Melbourne Institute Index of Consumer Sentiment fall 3.0% to 83.8 from 86.4 in June, marking the seventh consecutive monthly fall. The survey, covering 1200 respondents, was conducted over the four days from July 4th to July 7th. Last month we noted the Index was already around levels that, since the beginning of the survey in 1974, had only been seen during periods of major disruption in the Australian economy, including the COVID pandemic, the Global Financial Crisis, the recession in the early 1990s, the slowdown in the mid-1980s, and the recession of the early 1980s. This fall in July means that the pace of the sentiment deterioration is now also in line with these infamous periods. The Index has now fallen 19.7% since December 2021, a precipitous tumble comparable to the two-month plunge during COVID (-20.8%), the six-month declines seen heading into the Global Financial Crisis (-29.7%), the early 1990s recession (-20.5%), the mid-1980s downturn (-23.8%), and early 1980s recession (-18.8%).

As the RBA takes the Australian cash rate higher, discussion and risks around a recession in Australia will also rise. In recent weeks, references to the 'R word' have had a workout in the media. It is not the BT Economics Team's core view that Australia will enter a recession, though we do think that the cash rate will peak at a higher level than previously expected, resulting in a sharper economic slowdown.

Indeed, the fresh information on the jobs market and remarks from both the Governor and Deputy Governor suggest the cash rate could now peak with a '3' handle. Our Group's house view on the peak cash rate has been upgraded, from 2.60% previously to 3.35%. The timing of the peak remains unchanged at February 2023, but there are risks the peak could occur sooner.

To get to this peak, we believe the profile will consist of a 50bp hike in August (which has occurred at time of writing), followed by another of this size in September, and then 25bp hikes at each Board meeting from October through to, and including, February. The RBA does not meet in January.

Our view somewhat echoes that of interest-rate markets. Markets expect the cash rate in Australia to peak near 3.65% within the next 12 months, with rate cuts beginning in the second half of next year. We also anticipate that the RBA will turn to rate cuts, though with our anticipated timing being early 2024.

As for the growth outlook, with the RBA hiking the cash rate, the pace of consumer spending will ease, flowing on to slower economic growth. Pent-up demand and elevated savings are still helping to underpin growth at this stage, but momentum will dissipate as the year goes on.

Indeed, as we move through 2023 with a much higher cash rate, economic growth is likely to be sluggish. We anticipate GDP growth of 4-4.5% this year, followed by only 1% next year (well below the long-run average) as the weight of much tighter monetary policy takes hold.

Note that Australia's exceptionally low unemployment rate will help moderate stresses to the aggregate household sector amid these tighter monetary policy conditions. Various labour market indicators suggest to us that the unemployment rate could fall to 3.0% or lower by the end of this year. But given the sharper slowdown in economic growth that we now envision for 2023, we are likely to see unemployment move higher over next year to finish 2023 between 4 and 4.5% – closer to the natural rate.

July saw reporting that Australian dwelling prices are losing altitude quickly. The CoreLogic home value index, covering the eight major capital cities, fell 1.4% in July, following on from a 0.8% decline in June and a 0.3% dip in May. July's fall is the largest monthly decline since 1983. That said, prices are still up 5.4% year-on-year, with the retracement to date only taking prices back to the level they were at in October 2021. The detail in the CoreLogic index showed the price correction being worse in Sydney and Melbourne, with Brisbane, Hobart, Canberra, and most regions also recording material declines. Turnover continues to decline as well, with sales on a rolling 3-month basis down 15.6%yr nationally (Westpac estimates of seasonally adjusted sales). Sydney and Melbourne are leading the way here too, although it should be noted that sales in these markets were coming off a much higher starting point due to post-COVID catch-up activity. Sales are now running well below new listings in these markets.

The price correction is likely to continue deepening and broadening as the RBA delivers more rate hikes in coming months. Conditions will only improve once policymakers are convinced that the inflation threat has passed.

The S&P/ASX300 Accumulation Index clawed back some previous losses by posting a 5.95% gain in July, bringing the 1-year rolling return to -2.31%.

United States

GDP fell in the US over the June quarter, which means that by some measures the US is arguably in a technical recession following the March quarter's fall. Reports stated that June's decline was driven by a fall in domestic demand resulting from higher petrol and general transportation prices, which are key factors in the upward pressure the US is encountering on the inflation front.

The Fed lifted rates by 75bp at its meeting on July 26th-27th, taking the fed funds rate to 2.25-2.50%. This is the second Fed meeting in a row that ended in a 75bp rate hike, with further rate increases remaining firmly on the agenda. Fed Chair Powell noted that, having indicated they would move 'expeditiously' back to neutral, this has now been achieved. He also stated that "As the stance of monetary policy tightens further, it likely will become appropriate to slow the pace of increases while we assess how our cumulative policy adjustments are affecting the

economy and inflation". He also stated that there has been "some progress on supply and demand getting back into alignment".

The US unemployment rate was unchanged at 3.6% in June (in line with market expectations), remaining the lowest since February 2020. The number of unemployed people decreased by 38'000 to 5.912 million, while employment fell by 315'000 to 158.111 million. Meanwhile, the labour force participation rate edged down to 62.2% in June from 62.3% in May.

The S&P500, the NASDAQ, and the Dow Jones Industrials Average all posted impressive gains in July. They closed the month up 9.22%, 12.39%, and 6.82% respectively. Annual returns are, however, still in red territory at -4.64%, -14.95% and -4.14%.

Asia

A Reuters report released at the end of July provided insights into the Chinese economy that covered a number of key measures and observations, including the results of a private poll by Caixin that showed manufacturing activity grew more slowly than expected over the month, after surging in June once widespread COVID lockdowns were lifted. Also, a poll by China Index Academy, one of the country's largest independent real estate research firms, showed property sales by floor area in 17 tracked cities slumped 33.4% month-on-month in July versus the 88.9% post-lockdown jump in June, as buyers shunned a market increasingly filled with desperate sellers.

Second-quarter GDP in China grew just 0.4% on-year, but authorities have so far refrained from massive stimulus despite fears of a global recession, uncertainties from the Ukraine war, and the prospect of recurring COVID lockdowns at home.

Retail sales improved in June, up 3.1% for the year after lockdowns were lifted in some cities, including China's financial hub and most populous city Shanghai. The jobless rate also eased to 5.5% from 5.9% in May, but consumer sentiment remained fragile due to widespread uncertainty over jobs. In the Caixin survey, an index for factory jobs dived to the lowest in 27 months. Companies attributed the staff shedding to cost-cutting, subdued sales, and the non-replacement of voluntary leavers.

Japan's economy rebounded in the June quarter from contraction in the previous quarter, thanks to solid consumer spending in face-to-face services no longer hindered by coronavirus curbs. However, analysts are concerned about risks for the current quarter, including the possibility of a global economic slowdown and a resurgence of COVID-19 cases in Japan.

The world's third-largest economy grew at an annualised 2.5% in April-June, rebounding from a 0.5% contraction in the first quarter, according to economic consensus. Second-quarter expansion was driven largely by a projected 1.3% rise in private consumption, which accounts for more than half of Japan's GDP.

Capital expenditure expanded 0.9%, according to the poll, which also suggested external demand had added 0.1% to GDP growth.

During July Japan's current account reported a shift to a deficit of JPY 132.4 billion in June 2022 from a surplus of JPY 739.6 billion in the same month of the previous year.

This was the first current account gap since January, with the goods account reversing to a shortfall of JPY 1,114 billion from a surplus of JPY 633.6 billion as exports rose by 20.4 percent while imports jumped 49.2 percent.

Asian markets painted a more mixed picture, with the Korean KOSPI ending July up 5.10% and the Japanese Nikkei 225 up 5.35%. The Chinese Shanghai Composite and Hong Kong's Hang Seng reversed June's gains, ending July down 4.28% and 7.79% respectively, and are still under pressure for the year with their 1-year rolling returns at -4.24% and -22.36% respectively.

Europe

Private-sector activity in the Euro area unexpectedly shrank for the first time since the pandemic lockdowns of early 2021, adding to signs that a recession might be on the horizon.

A survey of purchasing managers by S&P Global dropped to a 17-month low in July, dipping beneath the level that signals contraction. The downturn was driven by worsening output among manufacturers and a near-stalling of service-sector growth. Economists had expected a mild expansion.

"A steep loss of new orders, falling backlogs of work and gloomier business expectations all point to the rate of decline gathering further momentum," said Chris Williamson, an economist at S&P Global. "Of greatest concern is the plight of manufacturing, where producers are reporting that weaker-than-expected sales have led to an unprecedented rise in unsold stock."

The data underscores the vulnerability of the Eurozone economy that is now facing abrupt stimulus withdrawal after the ECB's half-point interest-rate increase in late July, the first hike in more than a decade.

"We understand that these decisions are expected to mean slower economic growth due to more expensive loans and, unfortunately, uncreated and sometimes lost jobs," ECB Governing Council member Madis Muller said in a recent blog post. "But the consequences of persistently too-fast price increases would be even worse."

Signs of slowing growth will reinforce the growing chorus of economists predicting a recession in the 19-member currency bloc later this year. Energy supplies are a major worry as Russia reduces natural gas flows in response to Western sanctions over its invasion of Ukraine.

An index earlier showed German activity unexpectedly shrinking, while a French report also signalled concerns of an economic slump.

European bonds rallied over July, with short-dated German debt leading the gains. The two-year yield fell 22bps, set for the biggest slide in the month. Traders have since priced in 110bps of ECB hikes by year-end, and also pared bets for a hike in September.

ECB President Christine Lagarde stated over the month that it's important to prevent expectations of higher prices from becoming entrenched, though she conceded that the economy is weakening.

Forecasters surveyed by the ECB earlier in July cut their outlook for growth next year to 1.5% from 2.3%, where they also raised their longer-term inflation estimate to 2.2%.

Over to the UK, after a strong post-pandemic recovery, the economy is facing slower growth with rising inflation and labour shortages, exacerbated by Russia's war of aggression against Ukraine.

The Bank of England (BOE) raised its main rate by 50bps to 1.75% during its August 2022 meeting, the sixth consecutive rate hike, pushing borrowing costs to their highest levels since 2009. It is the biggest rate increase since 1995, though was largely anticipated by market consensus.

A near doubling of wholesale gas prices since May fed through to retail energy prices and will exacerbate the fall in real incomes for UK households by further increasing UK CPI inflation in the near term, the central bank said. According to new BOE projections, CPI is expected to rise to 13.3% in October and will remain at very elevated levels throughout much of 2023, before falling to the 2% target within two years.

The S&P Global/CIPS UK Composite PMI was revised lower to 52.1 in July from a preliminary reading of 52.8, down from 53.7 in June. The latest reading signalled the slowest rate of expansion since February 2021.

New orders increased only marginally in July, reflecting subdued demand in both domestic and overseas markets. Latest data signalled a renewed decline in export sales, largely reflecting a reduction in new work from abroad across the manufacturing sector. UK private sector firms signalled another steep rise in their average cost burdens during July. Softer input price pressures and subdued customer demand contributed to the least marked rise in average prices charged since February.

As for growth, the UK is now projected to enter a recession in 2022's fourth quarter, which is expected to last for five quarters.

European markets shared the same sentiment through July. The Europe 600 STOXX ended the month up 7.64%, the German DAX up 5.48%, and the UK's FTSE100 closing at 3.54%. The French CAC 40 almost perfectly reversed June's 8.44% fall to finish July up 8.87%.

Footnotes

- 1 The Management Costs included in this fact sheet are inclusive of the Management Fee and any Performance Fees and includes the effect of GST (net of RITC). They do not include other indirect costs. Refer to the Product Disclosure Statement and online disclosures for further information.
- 2 Past performance is not a reliable indicator of future performance. Performance returns are calculated net of management fees and costs. Growth and distribution returns may not equal the total net return due to rounding.
- 3 Allocations may not equal 100% due to rounding.

For more information

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