

BT Index Defensive Fund

Monthly report – 31 August 2022

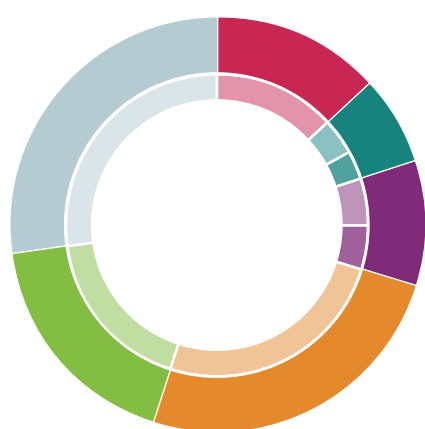
Fund overview

Inception date	1 August 2016
APIR code	WFS0588AU
Fund size (AUD millions)	\$239.32
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 August 2022	1 month	3 months	1 year	3 years	5 years	Since inception
	%	%	%	% pa	% pa	% pa
Total return	(1.58)	(1.37)	(7.11)	0.34	2.90	2.74
Growth return	(1.58)	(4.04)	(10.17)	(3.07)	(0.51)	(0.68)
Distribution return	0.00	2.67	3.07	3.41	3.41	3.42

Actual asset allocation %³



- Equity – Australian Listed – 13.21%**
 - BT Australian Shares Index Fund – 13.21%
- Equity – International Listed – 6.90%**
 - BT International Shares Index Fund (Unhedged) – 3.91%
 - Blackrock Index Hedged International Equity Fund – 2.99%
- Property – International and Australian Listed – 9.83%**
 - BT Property Securities Index Fund – 5.06%
 - Blackrock iShares Global Listed Property Index Fund – 4.77%
- Fixed Income – Australian – 25.12%**
 - BT Australian Fixed Interest Index Fund – 25.12%
- Fixed Income – International – 17.97%**
 - BT International Fixed Interest Index Fund – 17.97%
- Cash – 26.97%**
 - Advance Cash Multi-Blend Fund – 26.97%

Market update

The bullish sentiment in July that saw a strong market recovery was tempered over August as a more hawkish tone from Central Banks pushed most markets into negative territory. While the argument over whether we have hit 'peak inflation' continues, we saw US inflation moderate, however the Eurozone's continues to rise. Political uncertainty continued in the UK, where looking ahead, a fourth Prime Minister in six years was elected. This is in the face of an economy that has now slipped behind India in the World Bank's latest global GDP rankings.

Australia

Over August, wage pressures across the economy have been growing steadily. Survey measures suggest that total labour costs (including employment growth) are increasing at the fastest rate on record. Reports of oversized wage increases are common, particularly in industries with strong labour demand and labour supply issues. This includes IT, professional services, construction, and parts of the services sector that previously had a heavy reliance on international students and migrants.

These wage pressures are expected to flow through into the Wage Price Index (WPI) over time. Growth in the WPI had only returned to around pre-pandemic levels in the March quarter. For the June quarter, we predict that wages grew by 0.9%, to be 2.9% higher over the year. If our forecasts prove to be correct, this will result in the strongest quarterly wages growth since mid-2012 and the strongest annual growth since mid-2013.

In late August, data showed the Australian unemployment rate dropped 0.1 percentage points over July to a fresh 48-year low of 3.4%. Employment unexpectedly eased, but there were several unique factors at play. It's unlikely that the fall in July is the start of a new trend of jobs losses. There is now more than one job vacancy for every unemployed person and a further decline in the unemployment rate is likely.

The growth in wages is weaker than that of prices, contributing to a record contraction in real wages. The evidence from business surveys and customer liaison suggests wage pressures will build further and the wage price index is not fully capturing conditions in the economy. This is because non-wage payments and bonus payments are increasingly used to attract and retain staff and these forms of compensation are not captured in the headline wage price index.

The decline in real wages is likely to mean more workers are asking for wage increases as they face a weakening in their real purchasing power. As the RBA continues to raise rates, demand will be impacted and momentum in economic activity will fade. This combination means businesses could face weaker demand for their products and narrower margins, which could lead to weaker employment growth and a rise in the unemployment rate next year, although this is likely to be gradual and has yet to begin materialising.

August also saw reporting released showing activity in the construction sector continuing to fall after growing strongly in 2021 on the back of record low interest rates and an unprecedented level of housing stimulus.

Following a soft outcome in the March quarter, the market was expecting a bounce-back in the June quarter as constraints from the floods and omicron-related isolation were thought to have been largely resolved.

Construction work completed was down 3.8% over the June quarter, following a more modest fall of 1.3% in the March quarter. It is the biggest quarterly fall in 4½ years. In annual terms, activity fell by 4.3% in the June quarter – the largest fall in 2½ years.

Private sector residential building work fell by 6.9% in the June quarter 2022, the largest fall in nearly 22 years. Within this category, new private sector house construction fell by 13.9%, renovation activity fell by 1.9%, while other residential construction (e.g. apartments and townhouses) surprised on the upside and grew by 3.1%.

Australian equity markets continued their rally over August, although at a slower pace than July, with the ASX300 Accumulation Index posting a 1.18% rise.

United States

With recession talk abound following consecutive quarters of negative GDP growth, there are equal forces at play opposing this view with August data showing that the US added 528,000 jobs in July, at a time when unemployment is at 3.5% – its lowest rate since 1969.

However, this employment data is an inflation and growth red flag, with the tight job market fuelling upward wage pressures which can only add to the current year-on-year inflation number of 6.8% – the highest 12-month increase since 1982.

The S&P Global US Services PMI was revised lower to 43.7 in August of 2022 from a preliminary reading of 44.1, extending the decline from 47.3 in the prior month and pointing to the sharpest contraction in the US services sector since May 2020.

Output was seen sharply lower amid weak domestic and foreign demand, while new orders fell at the steepest rate in over two years. Simultaneously, employment grew at the slowest pace since January, as backlogs of work fell further.

On the price front, both input-price and output-charge inflation eased to the lowest in 16 months, aided by a slight decrease in material costs and efforts to drive sales. While business confidence rose to a three-month high, it remained well below the series average as low demand weighed on expectations.

Housing starts in the United States tumbled 9.6% month-over-month to an annualized rate of 1.446 million units in July of 2022, the lowest since February of 2021 and well below market expectations of 1.54 million. The housing sector has been cooling down amid soaring prices of materials and rising mortgage rates.

Single-family housing starts sank 10.1% to 916 thousand, the lowest level since June 2020; and starts for units in buildings with five units or more slipped 10% to 514 thousand.

Consumer sentiment continues to hold in positive territory following the University of Michigan consumer sentiment data release for the US that was revised higher to 58.2 in August of 2022 from a preliminary expectation of 55.1.

Inflation expectations for the year ahead moderated to 4.8% from 5.2% in the previous month, its lowest in eight months and below preliminary figures of 5%. Meanwhile, the 5-year outlook was unchanged at 2.9%, compared with 3% in advanced figures.

The S&P500, the NASDAQ, and the Dow Jones Industrials Average all posted negative results for August. They closed the month down -4.08%, -4.53%, and -3.72% respectively. This drags their one-year rolling returns even deeper into red territory at -11.23%, -21.99% and -9.07%

Asia

Reports of China's exports weakening over August because of global inflation on the demand side, including the continuation of the government's zero-COVID policy and heatwaves felt across most regions, further elevated again the risks ahead for the Chinese economy.

The International Monetary Fund (IMF) in July, cut its forecast for China's 2022 GDP growth to 3.3%. That would be the slowest pace in growth in four decades – excluding 2020's COVID crisis dip – and below the government's 5.5% target.

The relative monthly YoY increase in exports fell in August (7.1% gain YoY relative to an 18.0% YoY gain in July), missed analysts' expectations for a 12.8% increase. Outbound shipments outperformed other economic drivers in 2022 but now face growing challenges as external demand wanes.

China's slower growth is in part due to strong exports last year, COVID restrictions as infections spiked, and heatwaves having disrupted factory outputs in southwestern areas.

Imports were again tepid compared to prior months, rising only 0.3% in August from 2.3% in the month prior, (as detailed in the customs data) and well below a forecast for a 1.1% rise.

Weakening domestic demand dampened by the worst heatwaves in decades, a property crisis, sluggish consumption, and crippled imports have all added to China's economic risks.

Over to Japan, the gauge for their service sector sentiment rose by 1.7 points to 45.5 in August 2022 from 43.8 in July, which was the lowest reading in five months, the Economy Watchers' Survey showed. The improvement came as domestic COVID infections were under control, with the government already lifting all pandemic curbs following a steady drop in virus cases.

The index for household consumption trends gained, largely due to rises in eating and drinking-related items. Further, the data measure for corporate trends strengthened, primarily linked to an increase in non-manufacturing, while the index for employment also rose.

Meanwhile, the economic outlook index jumped 6.6 points to 49.4 in August from 42.8 in July amid growing hopes of economic recovery, despite lingering concerns over intense inflationary pressures.

The Korean KOSPI ending August up 0.84% and the Japanese Nikkei 225 up 1.1%. The KOSPI's one-year rolling return is -22.73%. The Chinese Shanghai Composite and Hong Kong's Hang Seng continued to fall, closing the month down -1.57% and -1.0% respectively, and are both still under strain for the year with their 1-year rolling returns at -9.64% and -22.89% respectively.

Europe

Big news over August was the annual inflation rate in the Euro Area that accelerated to 9.1% in August of 2022 from 8.9% in July, above market forecasts of 9%, preliminary estimates showed.

The inflation rate broke a new record high, as energy costs remains elevated (38.3% vs 39.6%) and food prices continue to accelerate (10.6% vs 9.8%). Prices also rose faster for services (3.8% vs 3.7%) and non-energy industrial goods (5% vs 4.5%).

Excluding energy, inflation increased to 5.8% (vs 5.4% in July) and excluding energy, food, alcohol and tobacco, inflation also increased to 4.3% (vs 4%). Compared to the previous month, the CPI went up 0.5%.

The S&P Global Composite PMI for the Eurozone was revised lower to 48.9 in August of 2022 from a preliminary 49.2, still pointing to the largest fall in private sector activity since February of 2021.

Both services (49.8) and manufacturing (49.6) shrank, with the decline particularly marked in Germany. Weakness in activity generally reflected falling demand, with new orders also down at a faster pace midway through the third quarter. Employment continued to rise, but the rate of job creation softened amid lower workloads and muted business confidence.

While remaining elevated, rates of inflation of both input costs and output prices continued to soften, providing some respite for firms. Meanwhile, business expectations remained historically muted despite a slight improvement in sentiment since July.

On the Jobs front, the unemployment rate in the Euro Area edged down to a record low of 6.6% in July of 2022 from an upwardly revised 6.7% in the previous month, in line with market expectations. A year earlier, the jobless rate was much higher at 7.7%.

There were 10.983 million unemployed persons in the Eurozone, down by 77,000 from June. Youth unemployment also declined by 35,000 to 2.208 million, pushing the rate down to 14.2% from 14.4% in June.

Among the biggest economies in the Eurozone, declines in the jobless rate were seen in France (7.5% vs 7.6%) and Italy (7.9% vs 8%) while the jobless rate was steady at 2.9% in Germany.

In the UK, August saw a raft of negative news and sentiment from the now 7th largest economy in the world (recently surpassed by India). The S&P Global/CIPS UK Manufacturing PMI was revised higher to 47.3 in August of 2022 from a preliminary 46, but still pointed to the first contraction in factory activity since May of 2020, namely consumer, intermediate and investment goods sectors

Output, new business, and new export orders contracted sharply, leading to a near stalling of jobs growth and a drop in business optimism. Meanwhile, input inflation slowed to the weakest point since November of 2020, but remained elevated on rising costs for commodities, containers, electronics, energy, packaging, raw materials, and transportation.

The British pound came under more pressure in August and is now at its the lowest level since 1985, pressured by a challenging economy outlook, high energy bills and soaring inflation which squeeze households' purchasing power.

With bond yields rising, the next UK Prime Minister (Liz Truss) is signalling a possible unfunded fiscal expansion to address the UK's economic woes, which includes large tax cuts and proposed measures to stimulate the economy.

The UK's central bank (the Bank of England) at the same time warned of the risk of inflation peaking at 13.3% in October '22, and projects the country to enter a recession in Q4 lasting for five quarters.

The Europe 600 STOXX ended the month down -5.29%, the German DAX down -4.81%, and the UK's FTSE100 closing at -1.88%. The French CAC 40 lost much of July's 8.87% gain to finish August down -5.02%.

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.

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