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MLC's scenario insights & portfolio positioning

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MLC's investment and super portfolios

- *MLC Inflation Plus, MLC Horizon and MLC Index Plus portfolios*

MLC's Managed Account Strategies

- *MLC Premium and Value model portfolios*

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Update for the quarter ending 31 March 2021.

Important information

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Continued at end of update.

Quarterly insights

Highlights

- **Financial conditions are the easiest they have been in measured history and central banks' forward guidance suggests cash rates won't move until 2024. This is cast against an environment where economic growth is rebounding strongly as vaccines open economies and governments continue with record stimulus.**
- **We're about to enter a period where reported inflation will rise meaningfully above 2% targets and central bankers will ask us to trust that it's only transient, a result of base effects and temporary supply constraints. The lack of price discovery in bond markets leaves them unstable and susceptible to an 'accident' if central bankers turn out to be wrong.**
- **Our research suggests elevated Price-to-Earnings (PE) multiples are also at risk if inflation rises. We may enter an environment where companies deliver on earnings expectations and yet stock prices go nowhere or perversely even fall.**

MLC'S ACTIVE INVESTMENT APPROACH

- Key to MLC's market-leading investment approach is our unique Investment Futures Framework.
- In an unpredictable world, the Framework helps us comprehensively assess what the future might hold. By taking into account the many scenarios that could unfold – positive and negative – we gain continuing insight into return potential, future risks, and opportunities for diversification.
- The information from the Framework gives us a deep understanding of how risks and return opportunities change over time for both individual assets and total portfolios.
- We can then determine the asset allocations that will help achieve our portfolios' objectives with the required level of risk control, and adjust the portfolio if necessary. We'll generally reduce exposure to assets if we believe risk is too high. We prefer exposures with limited downside risk compared to upside potential.
- More information about MLC's investment approach is available on our website and in Appendix 1.

Insights

Money is cheap. Any number of market indicators point to financial conditions heading into 2021 being the most accommodative in measured history. Chart 1 shows US jumbo mortgages at their lowest ever interest rates; the same would apply to Australian residential mortgages.

Central banks have committed to maintain this level of accommodation for the foreseeable future. The pandemic and associated rolling shutdowns caused significant loss of revenue and falling employment in certain sectors of the economy. They hope signalling a low cost of borrowing for a protracted period will encourage companies and individuals to borrow and invest. This central bank commitment is expressed in different ways.

In Australia, the Reserve Bank of Australia (RBA) has introduced Yield Curve Control (YCC) where they have committed to keeping the shorter maturity interest rates at 0.1% until April 2024. This aligns well with the typically shorter maturity cycle of corporate borrowing in Australia, as well as the floating rate nature of residential mortgages.

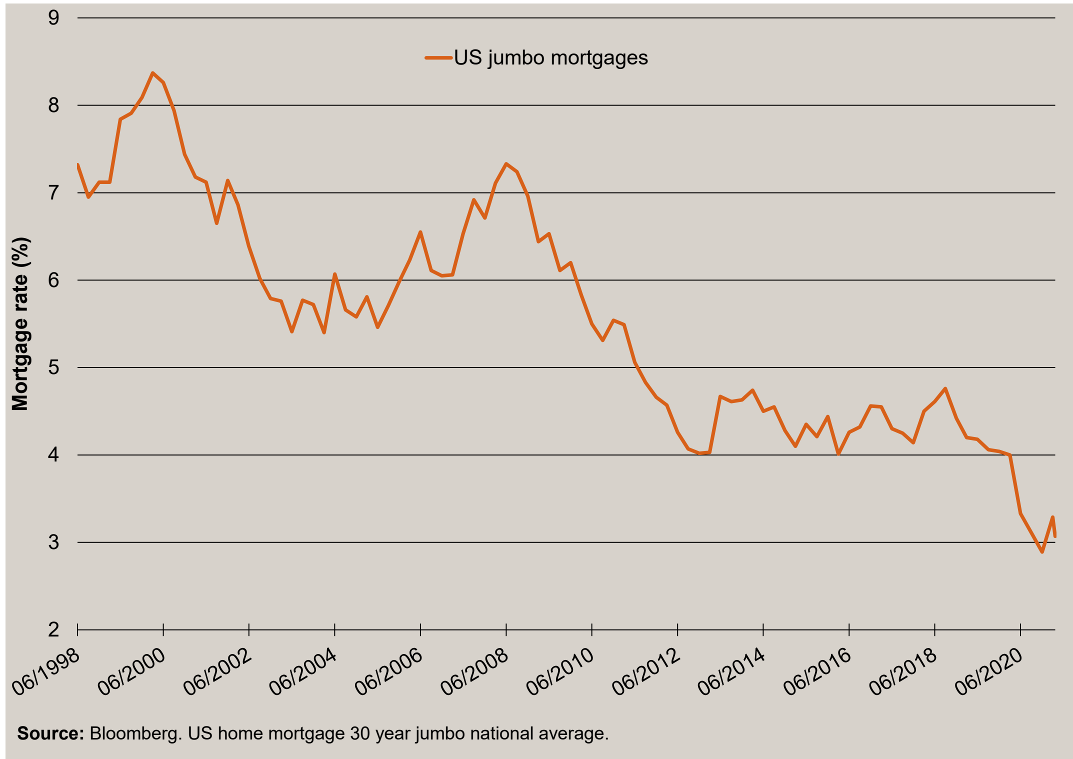
In the US, the Federal Reserve (Fed) has made a different commitment. The Fed uses forward guidance as their primary tool for setting market expectations. The guidance comes in the form of the 'dot plot' – a series of dots representing the Fed's members' expectations for the path of future interest rates. The dot plot from the March 2021 Fed meeting currently signals the majority of members expect no increase in cash rates in the US until 2024 (Chart 2).

We need to consider forward guidance as simply that – guidance. The dot plot is not a guarantee but instead a representation of the Fed's *current* thinking on how the path of interest rates could evolve given the *current* information. As the information changes, we should expect the guidance to do so as well. The US Fed Vice Chair Richard Clarida said as much in a comment in April this year. When talking about the Fed's forecast for inflation to rise above 2% and then fall back, he stated:

"We would expect those (increases) to be transitory and as the year progresses if they are not, we'll certainly have to take that into account"

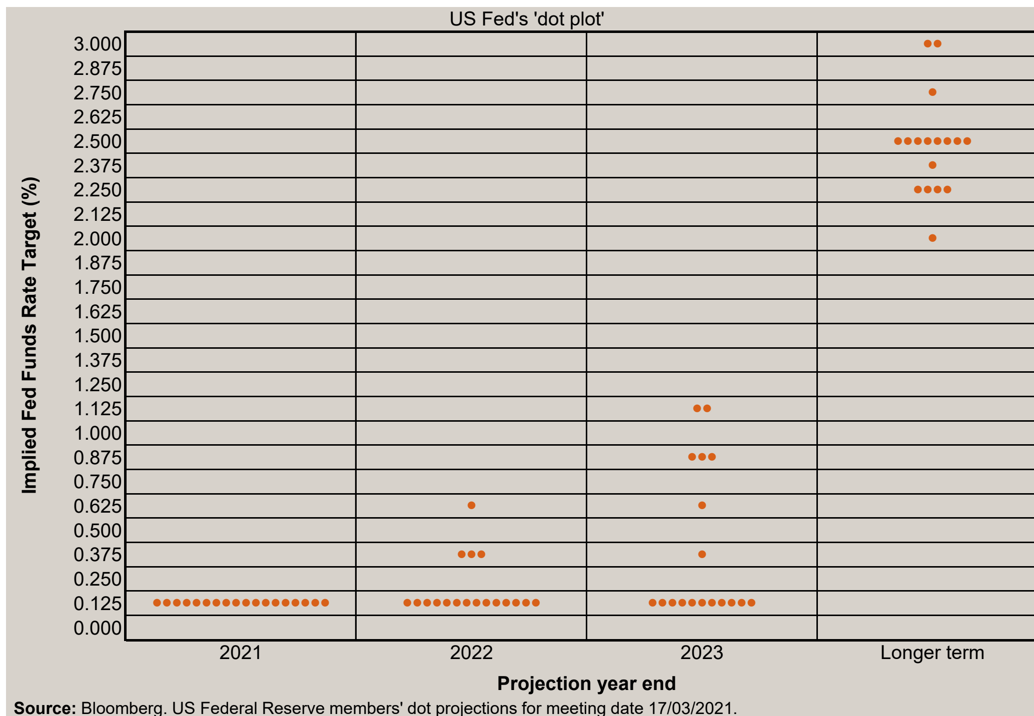
If the information changes, the Fed will change their mind. This is perfectly rationale in a normal market that functions on price discovery – as the information changes, the market will adjust. Unfortunately, the bond market has not been an arena for price discovery in quite some time. Instead, it has traded based on forward guidance and the constant intervention of central bank Quantitative Easing (QE). This lack of price discovery leaves the bond market unstable. Any unexpected change in forward guidance (or QE tapering) could have an outsized impact on bond prices as the market does not possess the underlying conviction on where the 'fair' price should be.

Chart 1: US 30 year home mortgage rates



Source: Bloomberg. US home mortgage 30 year jumbo national average.

Chart 2: US Fed Governors' interest rate expectations



Source: Bloomberg. US Federal Reserve members' dot projections for meeting date 17/03/2021.

Why is this important?

Interest rate markets are about to confront an abrupt increase in reported inflation, particularly the closely monitored measure of annual Consumer Price Index (CPI). Central banks tend to target a level of consumer prices (typically around 2%) in an effort to foster price stability. Annual CPI is about to blow through their 2% targets. The pandemic caused an abrupt decline in prices last year as activity came to a halt across the globe. This created a low base from which prices could accelerate as the vaccine and government stimulus allowed activity to recover. This base effect is now in full swing as last year's nadir has a maximum effect on annual CPI numbers. Table 1 shows the US CPI components and how they have changed over the last 12 months.

Table 1: US Consumer Price Index components

	Weights	Mar 20	Apr 20	Mar 21	Annual change Mar 20 to Mar 21
Total CPI	100%	258.1	256.4	264.9	2.5%
Food	14%	262.7	266.8	271.8	3.5%
Energy	6%	199.6	183.1	225.9	13.2%
Core CPI (ex Food & Energy)	80%	267.3	266.1	271.7	1.7%

Source: US Bureau of Labour Statistics.

As you can see, annual CPI has already breached 2% in March 2021. If prices do not increase from March to April 2021, the annual CPI for April 2021 will be 3.3%. This is the base effect in action.

These inflation increases aren't only attributable to base effects. Supply constraints arising from the pandemic have seen shortages in certain sectors, resulting in price increases. The media has focused on the microchip shortage affecting industries from autos to TV's, but there are a number of other production inputs experiencing shortages. Some of these supply constraints will be addressed over time as resources come back online, reflecting the potentially transient nature of the price increases. However, there will be certain companies that will seek to shorten their supply chains to avoid being caught out again and this will come at a cost. How much of this cost can be absorbed by the company in lower margins or passed on to customers as higher prices will take time to assess. But these effects will not be temporary.

Another contributor to inflationary pressures has been the level of fiscal stimulus, directing money straight into people's pockets and increasing disposable income. Pent up demand as economies open is chasing constrained supply in certain sectors, increasing prices. Again, these could be temporary but once a company has made the tough decision to put prices up, they tend to be reluctant to lower them again absent a shock to the system. Price rises tend to be sticky.

Inflation is bad for bond prices as the future fixed cash flows become less valuable in an environment where prices are going up. In a normal functioning market with price discovery, we would expect bond prices to adjust lower to reflect the inflationary pressures. But central banks are still providing guidance (as shown in the earlier dot plots) that interest rates won't move until 2024. In the intervention-heavy bond market, prices at shorter maturities barely move. The yield on the US 2 Year Treasury bond is only 0.17%. In Australia it is 0.10%.

Central bankers assure us this rise in inflation will be temporary – base effects and supply constraints will resolve themselves and inflation will return to the 2% target. Based on the current information, this may be a valid assessment. Although as Fed Governor Clarida said, if the information changes so will our view. Unfortunately, we won't know if this increase in inflation is temporary until the base effects roll off later in the year and we will get greater clarity on the 'stickiness' of the price increases. Until then the bond market is expected to take at face value the Fed's intention to keep rates unchanged whilst staring down a meaningful increase in inflation. Any unexpected adjustment in QE or guidance from the Fed has the potential to disrupt an unstable bond market.

This pending increase in reported inflation, whether temporary or not, also has important implications for shares. Recently, the main factor driving share markets higher has been an expansion of the multiple investors are willing to pay for the stream of equity earnings — the PE multiple. Earnings fell sharply last year as economies shut down and we're still only part way through recovering that loss of earnings. Share prices on the other hand, have more than recovered last year's losses and in places like the US have reached substantially new highs. The forward-looking nature of share prices means this can in part be attributed to an expected recovery in earnings, but to date the primary contribution has come through an expansion in the PE multiple.

For example, looking at Table 2 we can see how these three inputs have changed since the start of the pandemic last year. Using the S&P500 share index as a proxy for US stocks, index earnings are down around 9% since last year and yet prices are up 35% over the same period.

Table 2: S&P500 share index changes

	Index earnings	Index price	PE multiple
Feb 2020	$163	2954	18
Mar 2021	$147	3972	27
% change	-9.3	+34.5	-

Source: FactSet.

This has been achieved by the PE multiple expanding from 18 to 27 times. Granted part of these elevated price levels reflect an expected increase in earnings, although the level of optimism is high. If earnings recovered to the same $163 level seen in February 2020, a PE multiple of 24 times would be required to sustain current prices at around 4000 on the S&P500 Index.

This elevated multiple will be at risk if inflation increases. Our internal research suggests PE multiples are negatively impacted by rising inflation – any increase in inflation results in a decrease in PE multiples. The research is not saying inflation is bad for shares, but more specifically that it is bad for PE multiples.

This makes intuitive sense as increasing inflation is a potentially unrewarded risk factor for a stock. Some companies will have the pricing power to pass on increased input costs and others will have

to absorb them as reduced margins. The added risk of determining how each company will navigate this dynamic is reflected by investors paying lower multiples on the earnings to accommodate the uncertainty. We may enter an environment where companies still deliver on their expected earnings growth, but markets don't move or even perversely fall as the multiple paid for those earnings contracts.

Portfolio implications

Our response in the portfolios we manage to this increased risk to bond markets is to maintain limited exposure to nominal duration and prefer real duration in the form of inflation-linked bonds. We are also using a number of alternative methods other than nominal duration for defensive protection in the portfolios, instead turning to gold, foreign currency and volatility as mechanisms for limiting losses.

We continue to approach share investments in our multi-asset portfolios using a 'participate and protect' approach. The tailwinds for earnings are still present as vaccine driven openings and government largesse accelerate economic growth – strong reasons to participate in share markets. The spectre of rising inflation and its potentially deleterious effects on bonds and equity multiples lead us to invest in a protected manner, utilising volatility and other hedges to manage potential losses should the inflation risk come to bear.

The Investment Futures Framework: Scenarios, changes in return potential, and portfolio positioning

Scenarios

In managing MLC's multi-asset portfolios using our Investment Futures Framework, following are the short-term scenarios that we have assessed as currently providing the highest potential future risks and opportunities.

This remains a highly unusual time. Following on from last quarter, the near-term set of future scenarios that are important for financial markets continue to pivot around the evolution of the COVID-19 pandemic, and as such our three key scenarios remain more or less unchanged. Political change in the US and a shift in global geopolitics are also important and we continue to consider these in the context of the evolving pandemic situation.

Despite large parts of the northern hemisphere battling severe outbreaks of COVID-19, the rollout of several vaccines has buoyed sentiment towards risk assets. Continued vaccination as well as growing innate immunity should begin to reverse the worsening pandemic situation over the course of the coming months. Markets seem to be erring on the optimistic side with multiples paid for risk assets suggesting anticipation of strong growth over the ensuing quarters. Markets are also anticipating a return of reflation in response to widespread large government stimulus. Key breakeven inflation rates, a measure of expected inflation rates, have risen beyond pre-COVID levels.

We too have revised the likelihood of a strong reflationary outcome in the next year, but our expectations are likely more tempered than the overall market. Risks to successful reflation cannot be overlooked. The highly infective nature of COVID-19 means that emergence of a vaccine resistant strain will hang over the pandemic for quite some time. And while antigen diversity across the currently approved vaccine panel somewhat reduces the risk of rapid emergence, we could find ourselves quickly back near square one if the viral genome is more unstable than currently believed. We also maintain a degree of scepticism that consumer behaviour will quickly return to pre-COVID times. There is good reason to believe that precautionary behaviours might linger, leading to changes in consumption and lower overall growth. Our core short-term scenarios continue as:

- **Global pandemic: Immunity drives a return to growth**
  - Rollout of vaccines and innate immunity supress COVID-19 across the northern hemisphere winter and spring season.
  - Lockdowns end.
  - Government stimulus fades.
  - Consumer behaviour returns to near pre-COVID profile.
- **Global pandemic: Slow return to normality**
  - Vaccine rollout continues at a moderate pace.
  - Infection rates fall slowly.
  - Earnings suffer in both FY21 and FY22.
  - Consumers remain cautious.
- **Global pandemic: Emergence of vaccine resistance**
  - A severe vaccine-resistant strain of COVID-19 emerges. Full lockdowns are re-established.
  - Fiscal and monetary stimulus near the point of exhaustion.
  - Acceleration of populism.
  - High risk of global depression.

Changes in return potential for asset classes

The return potential for Australian and global shares fell slightly in the March 2021 quarter (Chart 3). Rising valuations offset the positive impact of an increase in expectations for earnings growth and assignment of a higher probability to economic recovery scenarios. The likelihood of economic recovery has increased due to the rollout of several vaccines against COVID-19. As such we have revised both sales and margin forecasts for shares and increased the probability of recovery-type scenarios in the short-term probability set.

The stronger Australian dollar (AUD) has helped increase the return potential of unhedged overseas shares compared to hedged but we remain cognisant of risks to the US dollar (USD). This is reflected in several scenarios including the 'weak USD' scenario introduced last year. Nominal bonds continue to offer poor reward for the risk taken, despite the recent increase in nominal yields, as the absolute level of yields only provides a reasonable return in a limited number of economic scenarios.

Portfolio positioning

The deterioration in return potential for global shares prompted a decision to reduce exposures to this asset class in the MLC Horizon portfolios in favour of increasing exposure to emerging market shares. The sectoral decomposition of the Emerging Markets Index, particularly with higher weights in Financials, Energy and Materials, has the potential to perform better in a reflationary environment. Valuations in emerging market shares are also relatively more attractive than their global developed market counterparts. There were no major changes to the Index Plus portfolios' positioning during the March quarter.

There was activity in the Inflation Plus portfolios, which MLC Horizon, Premium and Value portfolios inherit through investments in Inflation Plus, and MLC Index Plus portfolios through the real return strategy which is managed similarly to Inflation Plus.

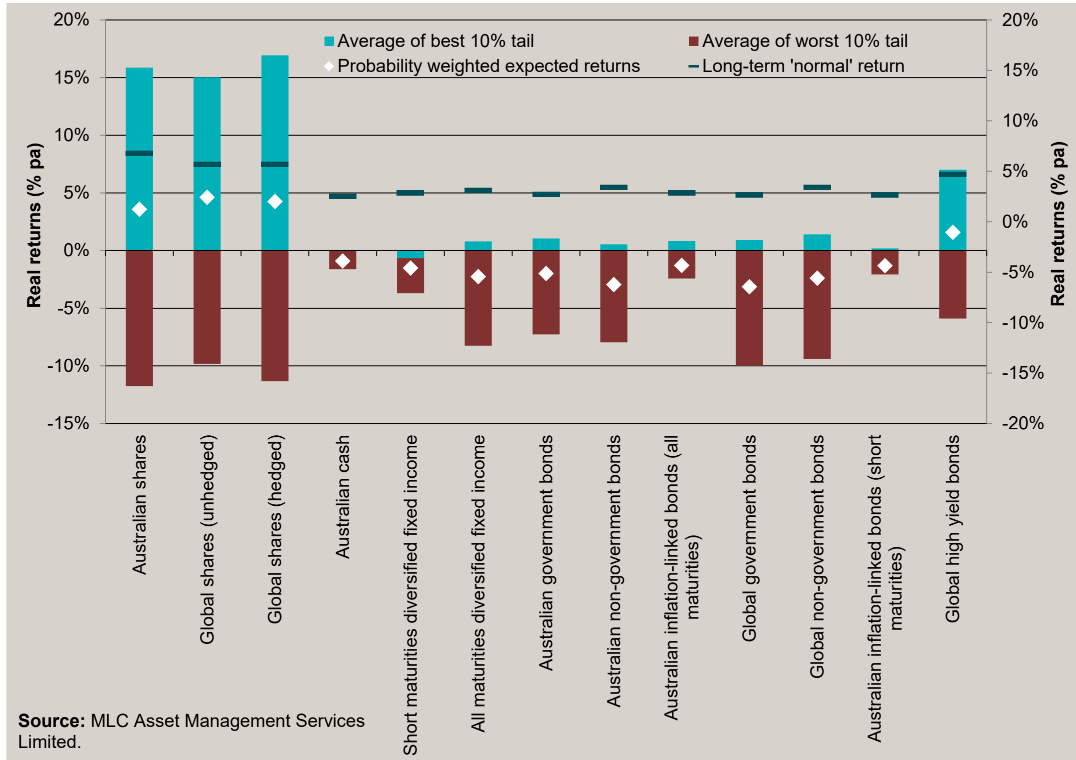
Consistent with our 'participate and protect' strategy, we introduced a protected equity exposure that utilised the skew in option volatility in the US market. The structure allows for cheap participation in US share market rallies while avoiding exposure to shallow losses. All three Inflation Plus portfolios and the real return strategy participate in this new structure.

While there were no changes to target allocations of the MLC Value and Premium portfolios (MLC Managed Account Strategies), during April we have taken the opportunity to rebalance growth allocations back toward targets as share markets rallied strongly. We believe this discipline will result in more consistent returns over the long term.

More information on portfolio positioning is in the sections: MLC Inflation Plus, Horizon, Index Plus, Premium, and Value portfolios.

The Investment Futures Framework: Scenarios, changes in return potential, and portfolio positioning

Chart 3: 40 scenario set (generic scenarios) potential real returns (March 2021) - 5 years, 0% tax with franking credits, pre-fees, pre-alpha



Source: MLC Asset Management Services Limited.

The potential real returns for each asset class are shown above. The probability-weighted real returns are shown as diamonds. For comparison we've included long-term 'normal' return expectations which are set by considering a stable fair value world – these are shown by the horizontal lines. Also, as an indicator of how uncertain these returns are, we've taken the bottom (and top) 10% of the scenario real returns and calculated the probability-weighted average in those 'tail' outcomes. These are shown in the bars. Asset classes with wider ranges could have more extreme return outcomes than those with narrow ranges.

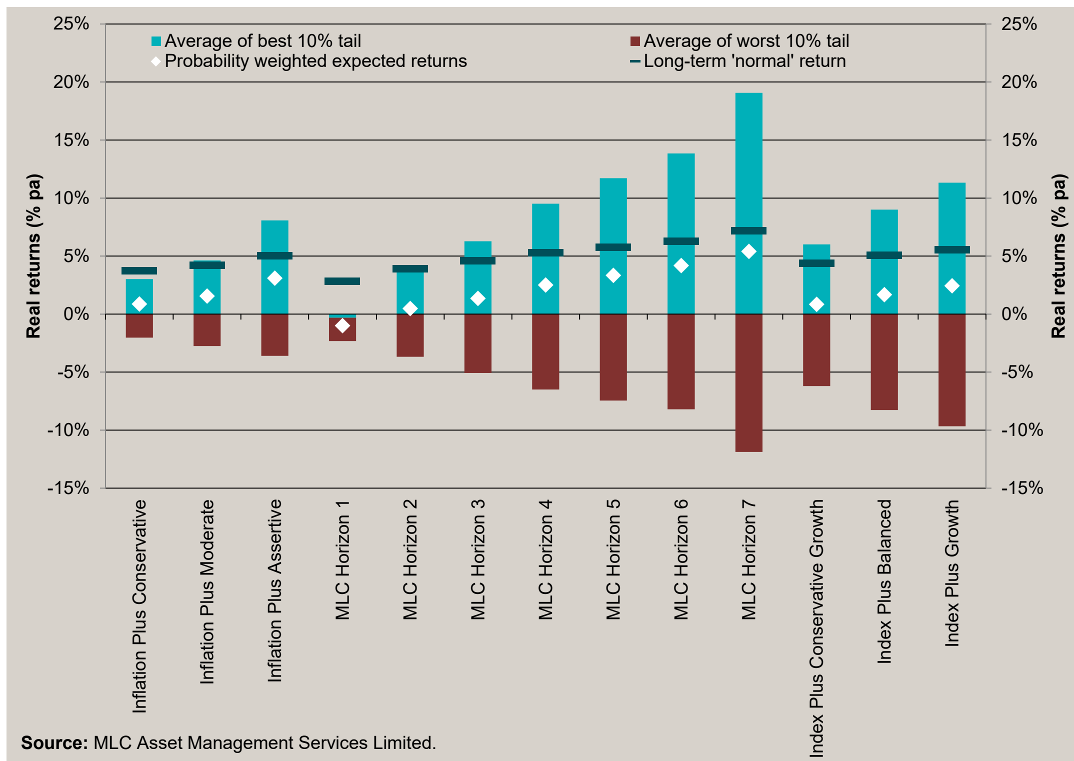
Return potential

Charts 4 and 5 show return potential for the MLC Horizon, Inflation Plus and Index Plus portfolios, and the Managed Account Strategies respectively, based on our generic (40) scenario set, looking forward from the end of March 2021.

Due to a slight decrease in the return potential for growth assets, the medium-term return potential of all the MLC multi-asset portfolios fell slightly during the March quarter.

The stronger risk focus of the Inflation Plus portfolios is evident (Chart 4). Consistent with their objectives, the Inflation Plus portfolios have responded to shrinking return potential and weakening risk diversifiers by reducing exposures to riskier assets. This reduces the return potential in strong scenarios but provides tight risk control in the event that an adverse environment occurs.

Chart 4: 40 scenario set (generic scenarios) potential real returns (March 2021) - 5 years, 0% tax with franking credits, pre-fees, pre-alpha



Source: MLC Asset Management Services Limited.

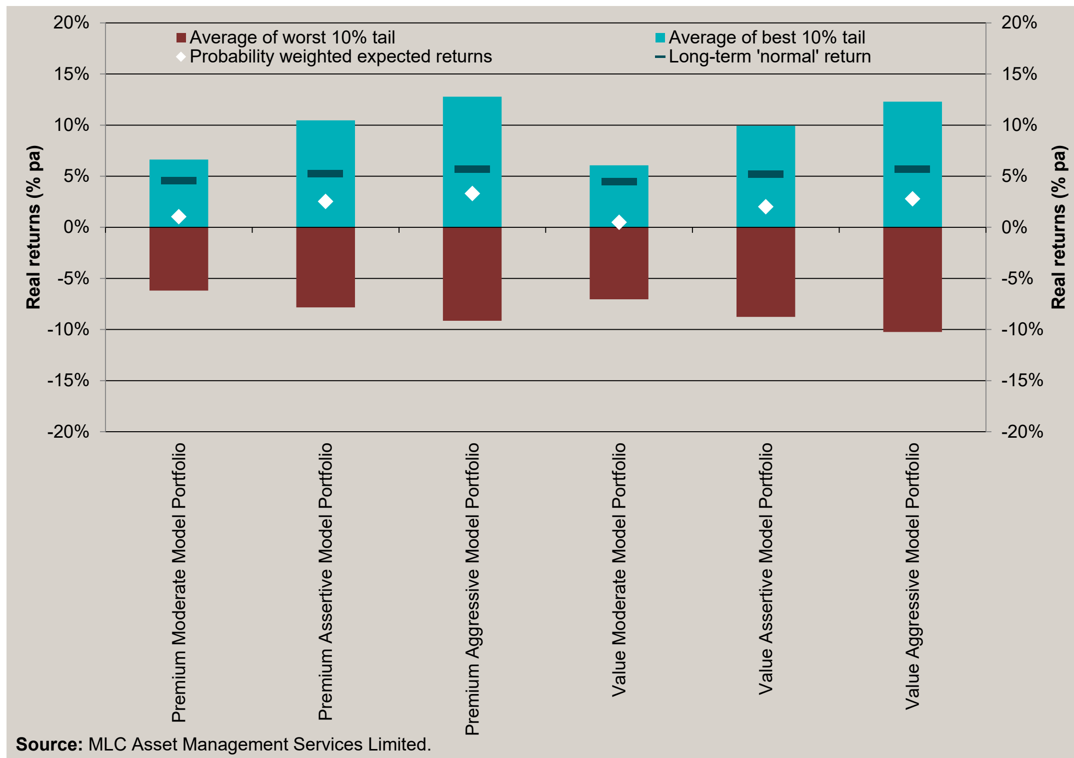
The probability-weighted real returns are shown above and below (diamonds). For comparison we've included long-term 'normal' return expectations which are set by considering a stable fair value world - these are shown by the horizontal lines. Also, as an indicator of how uncertain these returns are, we've taken the bottom (and top) 10% of the scenario real returns and calculated the probability-weighted average in those 'tail' outcomes. These are shown in the bars. Portfolios with wider ranges could have more extreme return outcomes than those with narrow ranges.

Return potential

The medium-term return potential of all the MLC Managed Account Strategies, like the other multi-asset portfolios, remain significantly below the returns similar asset allocations have produced in the past (Chart 5).

While both the Premium and Value Model Portfolios are expected to deliver similar returns, the additional levers afforded by the higher cost of the Premium Model Portfolios result in more positively skewed potential outcomes, with higher returns in the most positive scenarios and less negative returns in the worst.

Chart 5: MLC Managed Account Strategies - 40 scenario set (generic scenarios) potential real returns (March 2021) - 5 years, 0% tax with franking credits, pre-fees, pre-alpha



Source: MLC Asset Management Services Limited.

The probability-weighted real returns are shown above and below (diamonds). For comparison we've included long-term 'normal' return expectations which are set by considering a stable fair value world - these are shown by the horizontal lines. Also, as an indicator of how uncertain these returns are, we've taken the bottom (and top) 10% of the scenario real returns and calculated the probability-weighted average in those 'tail' outcomes. These are shown in the bars. Portfolios with wider ranges could have more extreme return outcomes than those with narrow ranges.

MLC Inflation Plus portfolios

Following on from adding risk in the December quarter in the form of listed infrastructure, key portfolio activities during the March 2021 quarter, including up until the time of writing, were:

- Rolling our protected emerging markets swap exposure for another three months. The previous structure delivered strong performance and we still believe emerging market shares will benefit in a reflationary environment.
- Introducing a US shares skew trade through an option structure that provides cheap participation in rallies without participation in shallow reversals. We are concerned at the elevated valuation levels of the US share market, but understand the level of financial stimulus and boost from vaccine led re-openings could continue to fuel earnings growth. The skew structure allows the portfolios to participate in any market rally through the purchase of a call option, while at the same time avoiding losses by not gaining any exposure to the market until it is 10% lower.

The MLC Inflation Plus portfolios have flexible asset allocations with few constraints which enable us to target tight control of risk over each portfolio's time horizon.

- Purchased a call option on USD/yen to protect against the adverse scenario of the Japanese yen depreciating at the same time as share markets fall. We hold the yen as a defensive currency that typically performs well when share markets do poorly and do not want to lose exposure to this protection. We have identified certain scenarios where rising interest rates may lead to the yen underperforming, and as such used the call option to mitigate losses in these scenarios.

Here is a summary of the changes to positioning of the MLC Inflation Plus portfolios over the recent quarter.

Asset class	**MLC Inflation Plus portfolios (in MLC MasterKey's super and pension products) change in target allocation over the 3 months ended 31 March 2021**		
	Conservative	**Moderate**	**Assertive**
Chinese government bonds (through derivative strategies)	Steady	Steady	Steady
China A-shares with downside limit of -20% (through derivative strategies)	Steady	Steady	Steady
Emerging market shares (through derivative strategies)	Steady	Steady	Steady
Defensive Australian shares	**Increased**	Steady	Steady
Global shares (through derivative strategies)	Steady	Steady	Steady
Listed infrastructure (through derivative strategies)	Steady	Steady	Steady
Global shares (unhedged)	Steady	Steady	Steady
Foreign currency exposure	Diversified basket maintained	Diversified basket maintained	Diversified basket maintained
Gold exposure (through derivative strategies via call options)	Steady	Steady	Steady
Low correlation strategy	**Reduced**	Steady	Steady
Real return strategy	Steady	Steady	Steady
Global private assets	Steady	Steady	Steady
Australian inflation-linked bonds	Steady	Steady	Steady
Insurance-related investments	Steady	Steady	Steady
Global high yield bonds and loans	Steady	Steady	Steady
Global non-government bonds (short-maturity)	Steady	Steady	Steady
Global non-government bonds (all-maturity)	Steady	Steady	Steady
Australian non-government bonds (short-maturity)	Steady	Steady	No allocation
Cash	Steady	Steady	Steady
Borrowings	Not permitted	Not permitted	No borrowings

MLC Horizon portfolios

Positioning of the MLC Horizon portfolios was adjusted to include an emerging market shares exposure in the March quarter. The deterioration in return potential for global shares prompted a decision to reduce exposures to this asset in favour of increasing exposure to emerging market shares. The sectoral decomposition of the Emerging Markets Index, particularly with higher weights in Financials, Energy and Materials, has the potential to perform better in a reflationary environment. Valuations in emerging market shares are also relatively more attractive than their global counterparts.

We also removed Morgan Stanley from MLC's global property securities strategy and replaced with BlackRock. While we believe Morgan Stanley has the potential to outperform in the long run, the volatility of their portfolio is too high for our strategy. BlackRock has demonstrated consistent outperformance in global property securities, has a highly experienced and well-resourced team, and quality and breadth of research. Their risk-controlled portfolio construction approach is well suited to our requirements. This change is expected to provide fund investors with a more consistent outperformance potential than the previous manager mix. This impacted the MLC Horizon 2 to 6 portfolios. Details are available at **mlc.com.au**

For the active management of the MLC Horizon portfolios, risk is primarily benchmark-related. Benchmarks have been designed to efficiently generate above-inflation outcomes on the basis of long-term investment assumptions and taking into account that over time a broad range of scenarios could play out.

Here is a summary of the positioning of the MLC Horizon 4 Balanced Portfolio.

Asset class	MLC Horizon 4 Balanced Portfolio (in MLC MasterKey's super and pension products) target asset allocation at 31 March 2021		
	Under	Strategic asset allocation	Over
Australian shares		•	
Global shares (unhedged)			•
Global shares (hedged)	•		
Global property securities		•	
Cash			•
Australian bonds - short maturities			•
Australian bonds - all maturities	•		
Australian inflation-linked bonds		•	
Global bonds - short maturities			•
Global bonds - all maturities	•		
Global non-investment grade bonds (high yield bonds and loans)		•	
Global private assets		•	
Real return strategies (including Inflation Plus)		•	
Low correlation strategy		•	

MLC Index Plus portfolios

Positioning of the MLC Index Plus portfolios was little changed in the March quarter. The portfolios achieved a relatively defensive orientation partly from exposures to the real return strategy which is managed similarly to Inflation Plus (explained earlier) and partly from exposure to foreign currency. Exposure to fixed income continues to offer some defensiveness, but lower yields mean that the scope for interest rates to protect the funds under adverse economic conditions remains challenged.

Risk is primarily benchmark-related for the Index Plus portfolios. Benchmarks have been designed to efficiently generate above-inflation outcomes on the basis of long-term investment assumptions and taking into account that over time a broad range of scenarios could play out.

Here is a summary of the positioning of the MLC Index Plus Balanced Portfolio.

Asset class	MLC Index Plus Balanced Portfolio target asset allocation at 31 March 2021		
	Under	Strategic asset allocation	Over
Australian shares		•	
Global shares (unhedged)			•
Global shares (hedged)	•		
Global property securities		•	
Cash	•		
Australian bonds – short maturities			•
Australian bonds – all maturities	•		
Australian inflation-linked bonds		•	
Global bonds - short maturities			•
Global bonds - all maturities	•		
Real return strategies		•	

MLC Managed Account Strategies

The MLC Managed Account Strategies were launched on 1 July 2020. No major changes have been made to the portfolio asset allocations since then. We've positioned the portfolios for diverse and resilient returns across asset classes in the following key ways:

- **Active decision to allow growth assets allocation to move towards top of rebalancing band** – We see the likely continuation of the 'recovery and reopening' thematic supporting slightly higher allocations to Australian and global shares. During April we have taken the opportunity to rebalance growth allocations back toward targets as share markets rallied strongly.
- **Foreign currency diversification** – Within global shares we continue to see foreign currency exposure as an important diversifier (holding both hedged and unhedged global shares).
- **Active fixed income** – Fixed income funds are actively managed, which we believe is essential in effectively navigating a rising interest rate environment. Our fixed income duration is relatively short to help reduce the portfolios' exposure to rising interest rates, and we selectively pursue investments in credit through Bentham's funds.

The MLC Managed Account Strategies are focused on providing investors with above-inflation returns through professionally managed portfolios that are extensively diversified across asset classes, specialist investment managers, and stocks.

- **Inflation Plus changes** – MLC Wholesale Inflation Plus portfolios provide important real return exposure and sources of low correlation return streams. Activity was focused on investing in gold and emerging markets through downside protected derivative strategies, and purchasing USD/JPY call options due to expectations of widening interest rate differentials, explained earlier.

While there are no changes to the target asset allocations or managers for the quarter, details of the rebalance and stock changes made since 31 March 2021 are available in the Portfolio Activity Reports available at **mlcam.com.au**

Asset class	**MLC Premium Model Portfolios change in target allocation over the 3 months ended 31 March 2021**		
	Moderate	**Assertive**	**Aggressive**
Australian shares	Steady	Steady	Steady
- Active, direct, all cap	Steady	Steady	Steady
- Active, ex-20	Steady	Steady	Steady
- Active, small cap	Zero	Steady	Steady
Global shares	Steady	Steady	Steady
- Active, quant, hedged	Steady	Steady	Steady
- Active, growth, unhedged	Steady	Steady	Steady
- Active, value, unhedged	Steady	Steady	Steady
- Active, emerging markets, unhedged	Zero	Steady	Steady
Global property securities	Steady	Steady	Steady
- Active, hedged			
Alternatives and other	Steady	Steady	Steady
- Inflation Plus	Steady	Steady	Steady
- Active, absolute return, hedged	Steady	Steady	Steady
Fixed income	Steady	Steady	Steady
- Australian, active, short maturity	Steady	Steady	Steady
- Australian, active, all maturity	Steady	Steady	Steady
- Global, active, all maturity, hedged	Steady	Steady	Steady
- Global, active, high yield, hedged	Steady	Steady	Steady
Cash	Steady	Steady	Steady

Asset class	MLC Value Model Portfolios change in target allocation over the 3 months ended 31 March 2021		
	Moderate	**Assertive**	**Aggressive**
Australian shares	Steady	Steady	Steady
- Passive, direct, large cap	Steady	Steady	Steady
- Passive, all cap	Steady	Steady	Steady
- Active, small cap	Zero	Steady	Steady
Global shares	Steady	Steady	Steady
- Passive, developed markets, unhedged	Steady	Steady	Steady
- Passive, developed markets, hedged	Steady	Steady	Steady
- Active, emerging markets, unhedged	Zero	Steady	Steady
Global property securities	Steady	Steady	Steady
- Passive, hedged			
Alternatives and other	Steady	Steady	Steady
- Inflation Plus			
Fixed income	Steady	Steady	Steady
- Australian, active, short maturity	Steady	Steady	Steady
- Australian, active, all maturity	Steady	Steady	Steady
- Global, active, all maturity, hedged	Steady	Steady	Steady
- Global, active, high yield, hedged	Steady	Steady	Steady
Cash	Steady	Steady	Steady

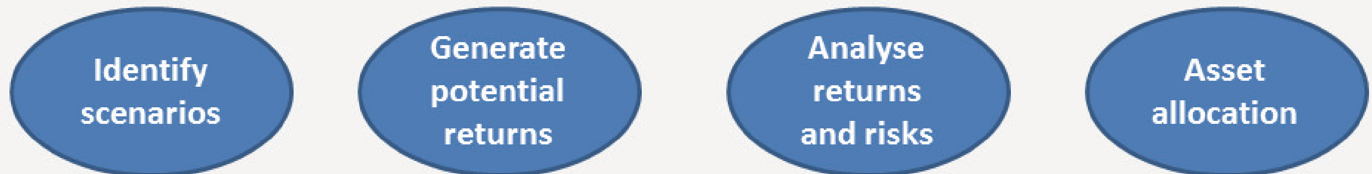
Any portfolio change shown above is not a guarantee of a change to a client's portfolio. There may be differences between the Model Portfolio and a client's portfolio due to the timing and transaction prices for portfolio changes, client investments and withdrawals during the period, timing of receipt of dividends and income distributions, platform administration fees, transactional costs associated with the client's portfolio, and any portfolio exclusions required by the client.

Appendix 1 – MLC's market-leading investment process

Step 1

Scenario analysis and portfolio construction

The Investment Futures Framework



- We can never be certain what the future will hold. To adequately understand risk we must take into account the things that *could* happen.
- We do this by building a comprehensive understanding of the possible future investment environments or scenarios that could occur. This includes not just those things most likely to occur, but also unlikely but very distinctive environments (such as financial crises and other 'tail risk' environments).
- The Investment Futures Framework builds a detailed understanding of how returns vary in each scenario. This also provides detailed information about the nature and extent of investment risks, the means to diversify those risks and how these change through time.
- Understanding how returns and risks can change over time means we can determine the best combination of assets, strategies and managers to generate returns while controlling risks in all scenarios - the asset allocation.

Step 2

Implementation

We implement the asset allocation as efficiently as possible to minimise costs.

Step 3

Review

We continuously apply our Investment Futures Framework to determine if portfolio adjustments are appropriate.

Important information (continued from page 2)

MLC funds and Managed Account Strategies referenced in this communication are listed below. These funds appear on MLC's platforms, in addition to a number of external platforms:

MLC Investment Trust:	MLC Super Fund:	MLC Managed Account Strategies:
MLC Wholesale Horizon 2 Income Portfolio	MLC Horizon 2 Capital Stable Portfolio	MLC Premium Moderate Model Portfolio
MLC Wholesale Horizon 3 Conservative Growth Portfolio	MLC Horizon 3 Conservative Growth Portfolio	MLC Premium Assertive Model Portfolio
MLC Wholesale Horizon 4 Balanced Portfolio	MLC Horizon 4 Balanced Portfolio	MLC Premium Aggressive Model Portfolio
MLC Wholesale Horizon 5 Growth Portfolio	MLC Horizon 5 Growth Portfolio	MLC Value Moderate Model Portfolio
MLC Wholesale Horizon 6 Share Portfolio	MLC Horizon 6 Share Portfolio	MLC Value Assertive Model Portfolio
MLC Wholesale Horizon 7 Accelerated Growth Portfolio	MLC Horizon 7 Accelerated Growth Portfolio	MLC Value Aggressive Model Portfolio
MLC Wholesale Inflation Plus Conservative Portfolio	MLC Inflation Plus Conservative Portfolio	
MLC Wholesale Inflation Plus Moderate Portfolio	MLC Inflation Plus Moderate Portfolio	
MLC Wholesale Inflation Plus Assertive Portfolio	MLC Inflation Plus Assertive Portfolio	
MLC Wholesale Index Plus Conservative Growth Portfolio	MLC Index Plus Conservative Growth Portfolio	
MLC Wholesale Index Plus Balanced Portfolio	MLC Index Plus Balanced Portfolio	
MLC Wholesale Index Plus Growth Portfolio	MLC Index Plus Growth Portfolio	

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If you have any comments, please email us at al.clark@mlc.com.au or ben.mccaw@mlc.com.au