Russell Investments

CAN THE HOUSING MARKET PULL THE ECONOMY DOWN?

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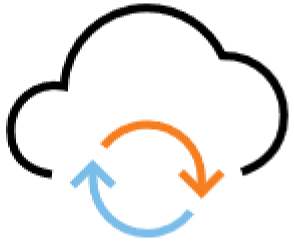
EMBRACE THE POSSIBLE®

Agenda/Learning Outcomes

- Overview of where the global economy and global markets are currently, and where opportunities present themselves
- Understand the dynamics of the housing market, and implications for the broader economy
- Understand the factors that are driving divergent outcomes for housing markets across the world
- Asset allocation in a time of uncertainty
- Importance of a well founded philosophy in constructing portfolios

Cycle, Valuation, Sentiment

Russell’s approach to thinking about the markets



CYCLE

Identifies changes in the macroeconomic environment that influences asset class behaviour. Large weight in the tactical framework.

VALUATION

Measures return potential across asset classes. Important for longer-term asset allocation but is given the smallest weight in the tactical framework

SENTIMENT

Looks at price momentum versus contrarian indicators that signal overbought/ oversold conditions. Large weight in the tactical framework.

Source: Russell Investments. For illustrative purpose only.

2023 Global market outlook: From darkness to dawn

ECONOMIC VIEWS

U.S. ECONOMY
- Inflation remains dominant issue
- View mild U.S recession as most likely outcome over next 12 months
- Private sector balance sheets appear healthy with no additional significant economic imbalances

EUROZONE
- Marginally improved outlook as winter has been unusually mild, but recession seems likely
- Appears energy rationing will not be required and shutdowns of energy intensive industries unlikely

CENTRAL BANKS RATE HIKES
- Believe Fed will begin to ease as unemployment rises
- ECB tightening seems likely with peak deposit rate of 2.75% - 3.0%
- Reserve Bank of Australia to pause ahead of other major banks

INFLATION
- Expect downward trend as global demand slows
- Eurozone Inflation to potentially move towards 2% by end of year as region's economy weakens

CHINA
- Expect easing of zero-COVID government rules
- Likely additional measure to support housing and boost spending when economy re-opens
- Equities now appear cheap after significant selloff

ASSET CLASSES

GLOBAL EQUITIES
- Uncertain outlook with potentially limited upside given recession risks
- Business cycle remains a headwind however sentiment is supportive for equities
- Non-us equities offer more attractive valuations relative to U.S

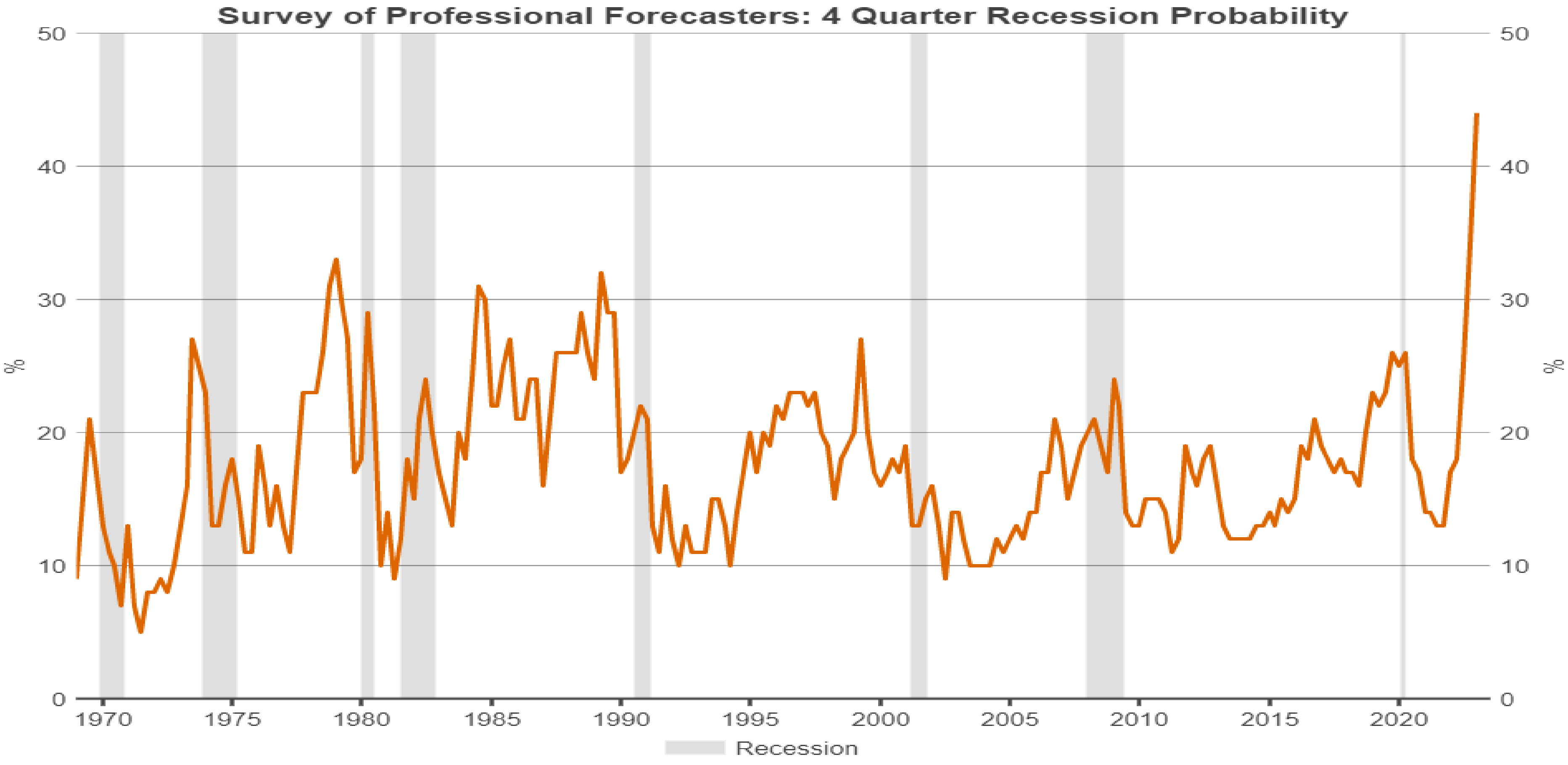
FIXED INCOME
- Expect rebound in 2023 after historically difficult 2022
- U.S., UK and German bonds as offering good value
- Target 3.3% yield on 10-year U.S. Treasury by year end

REAL ASSETS
- REITs look attractively valued relative to global equities
- Expect infrastructure to benefit from declining bond yields

CURRENCIES
- USD could weaken if inflation begins to decline and Fed pivots to less hawkish stance in early 2023
- Yen could also appreciate strongly with change from yield control strategy

Recession risk is elevated

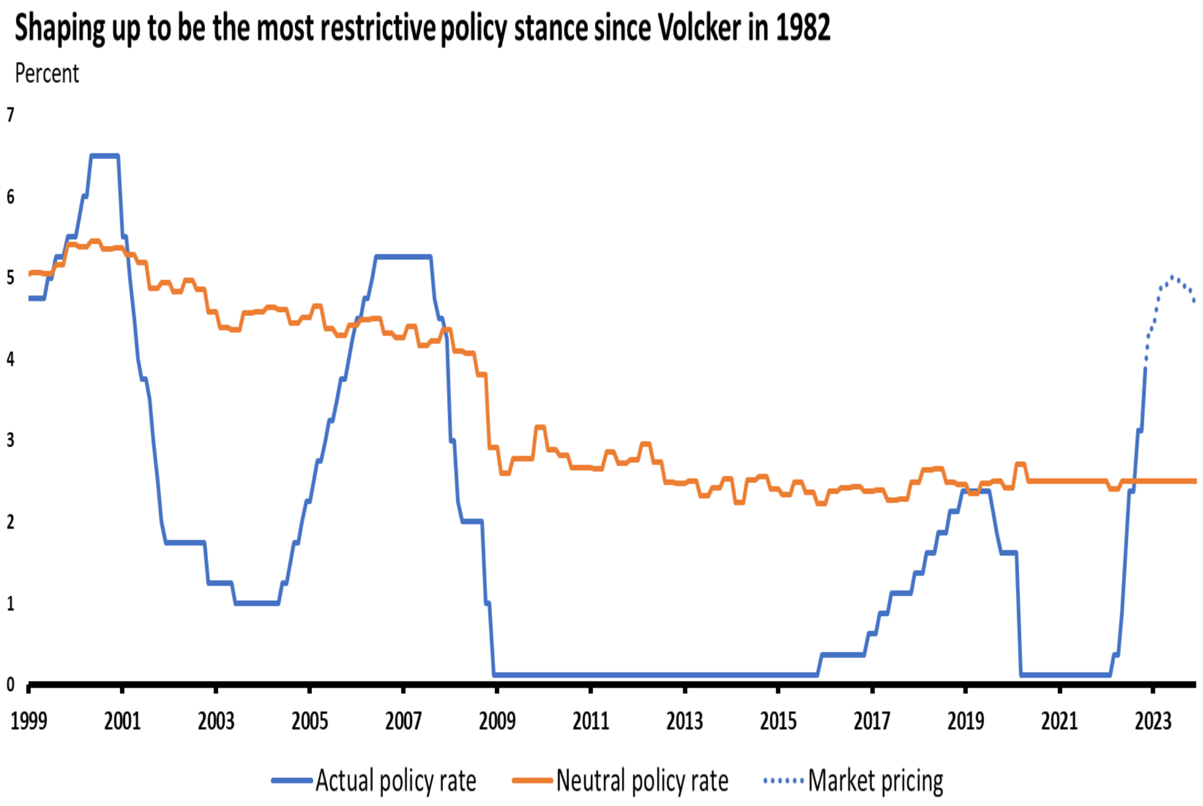
Expectations of recession are at record levels

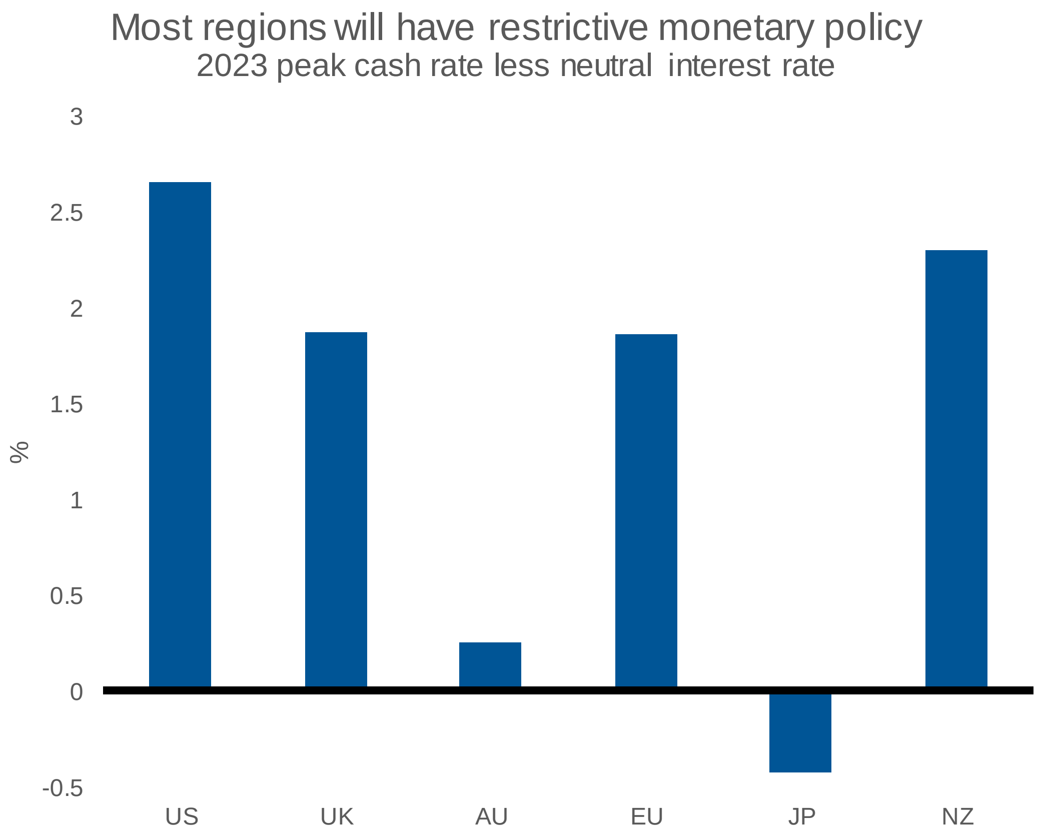


Source: Refinitiv Datastream, Philadelphia Fed, November 2022

Fed policy is in the danger zone

Along with most other central banks



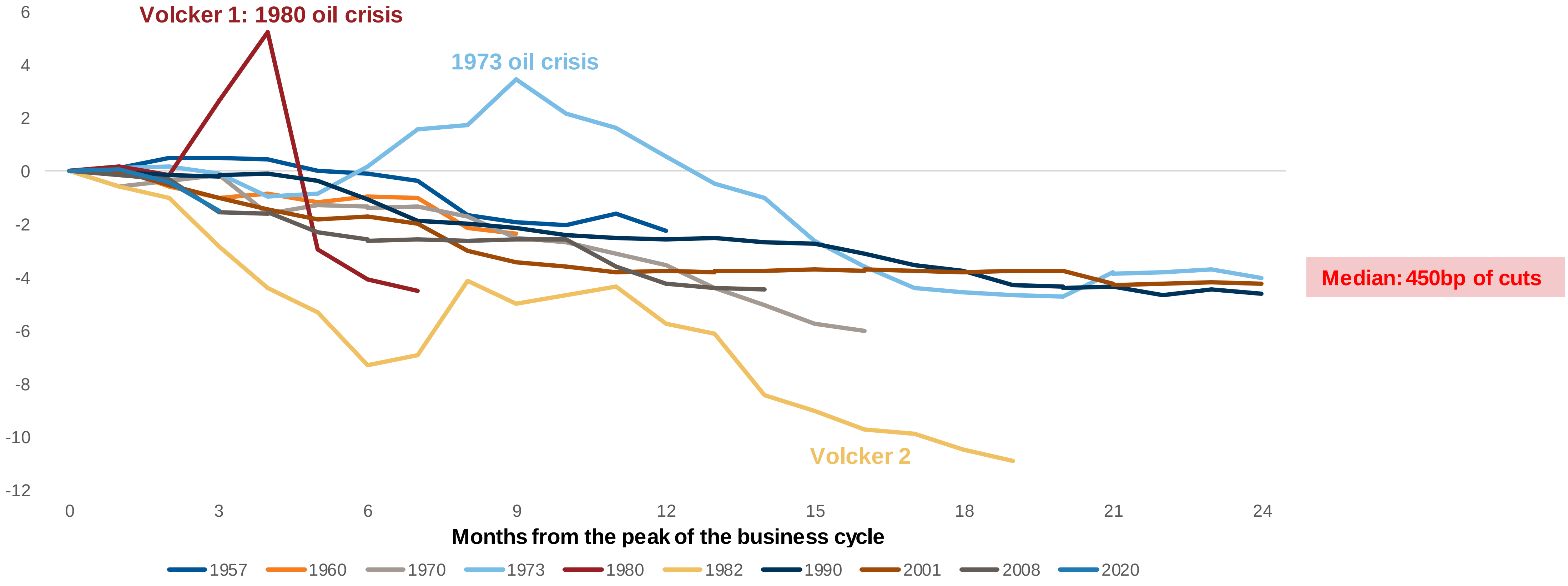


Source: Refinitiv Datastream, NY Fed, Russell Investments, 30 January 2023

The Federal Reserve responds to recessions with rate cuts

Tough talk on inflation will fade as job losses mount

Fed policy rate always cut to support the economy in a recession
ppt change in the Fed Funds Rate from the peak in the business cycle



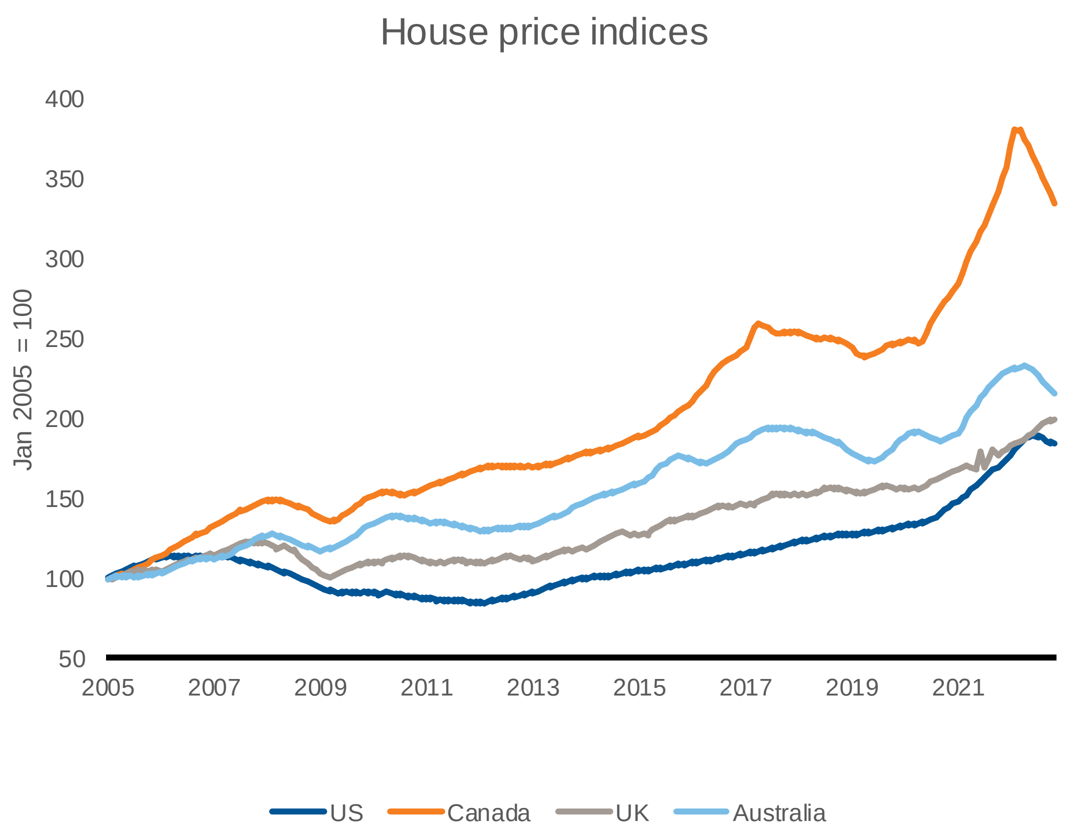
Source: Russell Investments, Refinitiv. Sample 1957 to present. Dates for business cycle peaks are taken from the National Bureau of Economic Research. Each series is cut off at the trough of the fed funds rate or 24 months (whichever is first). PPT refers to percentage point.

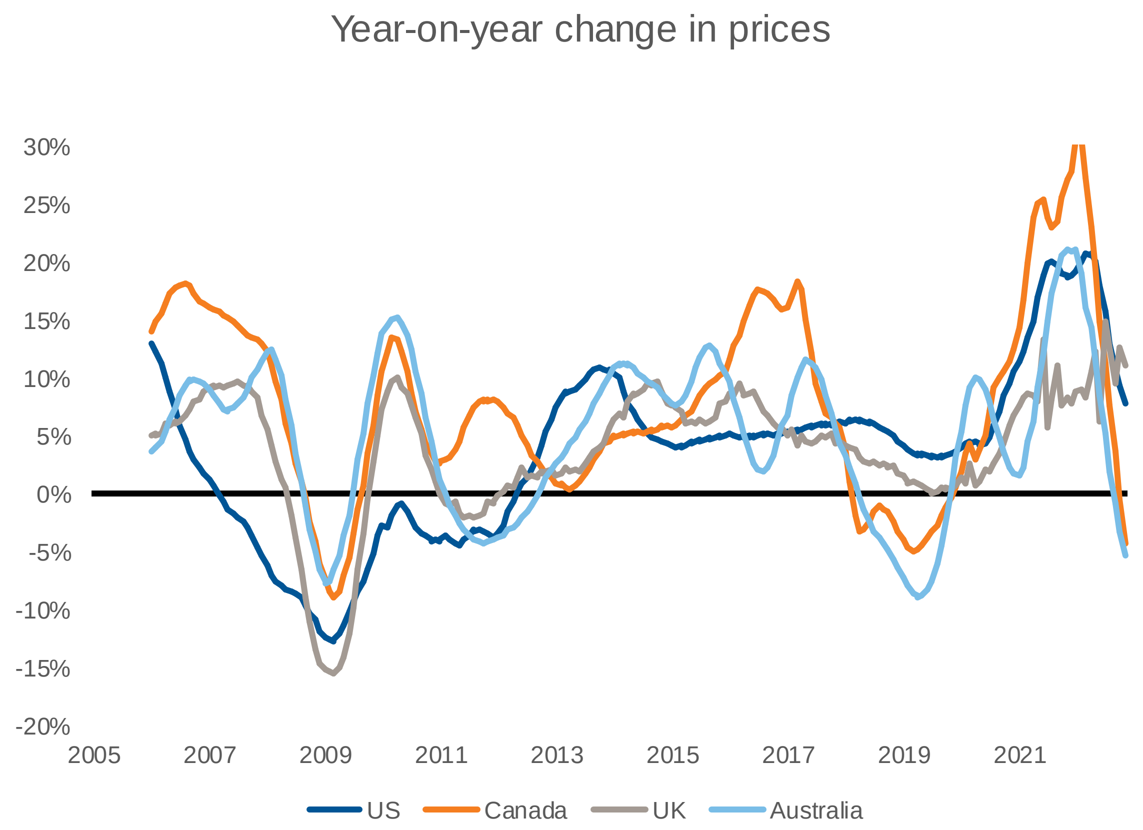
The Australian cash rate is more restrictive than:

- A) The United States
- B) European Union
- C) New Zealand
- D) Japan

Property prices in developed countries are falling

Canada and Australia are showing the largest falls

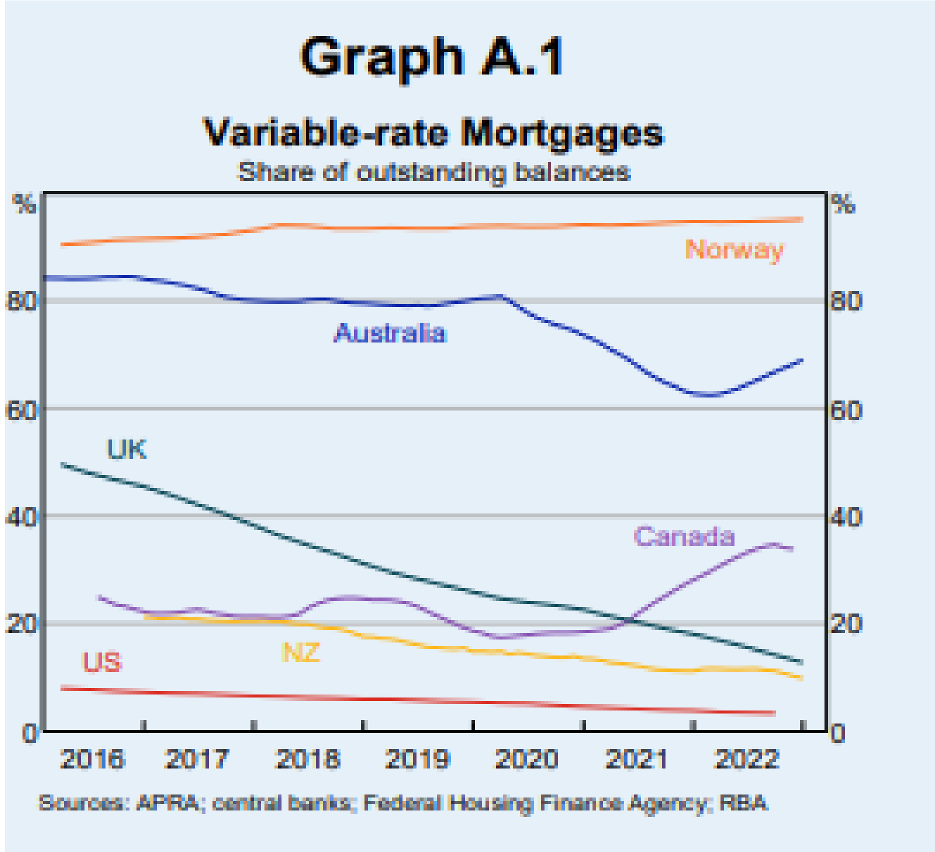


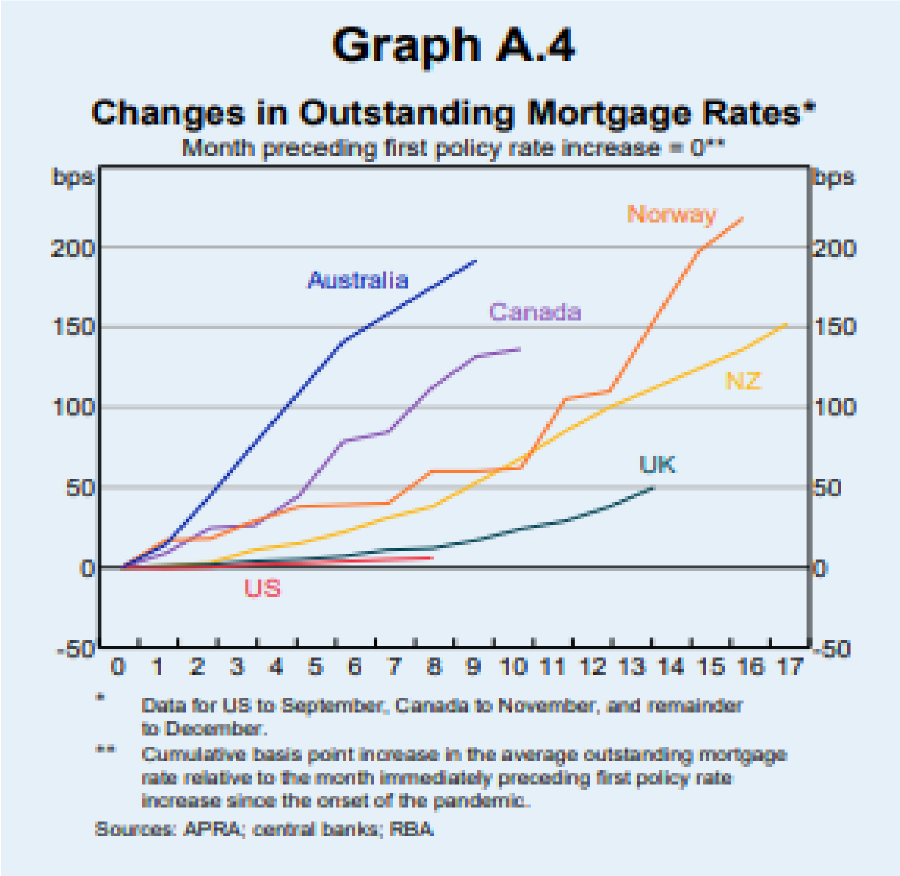


Source: Refinitiv Datastream, 14 February 2023

Mortgage structures explain a decent amount of the difference

Less variable rate mortgages = less pass through to outstanding mortgage rates

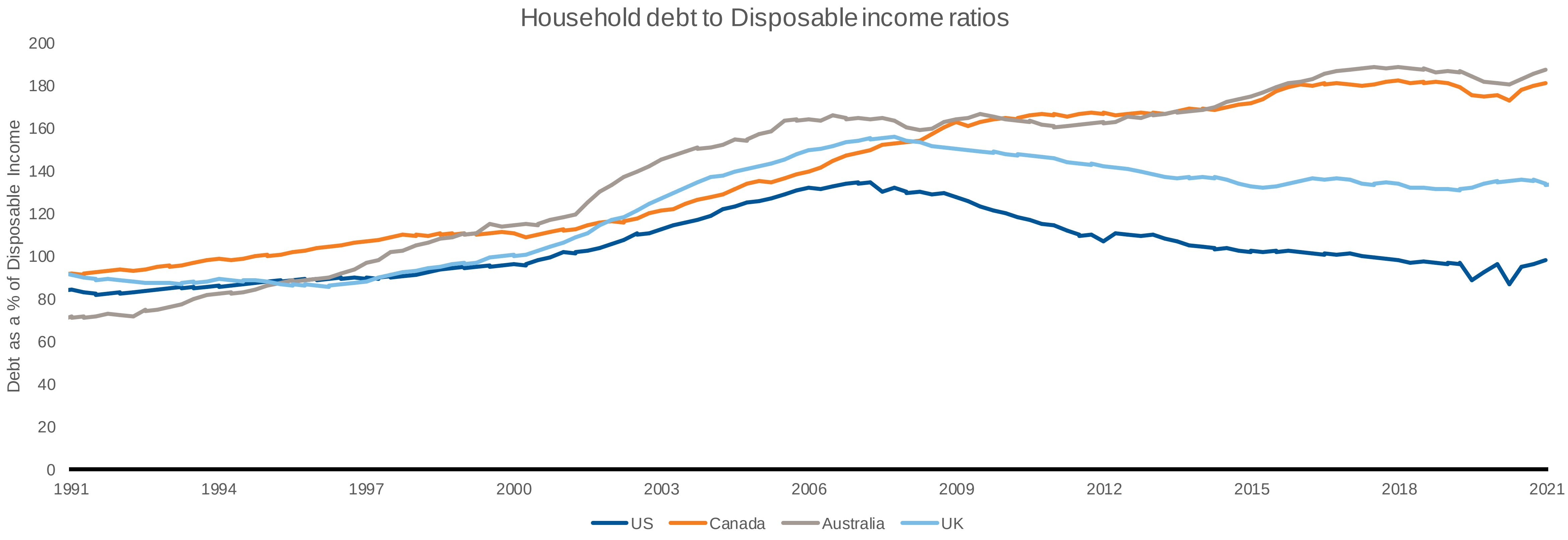




Source: RBA Financial Stability Review , 6 October 2022

U.S. household debt is not concerning

Australia and Canada is very elevated, however have less hawkish central banks

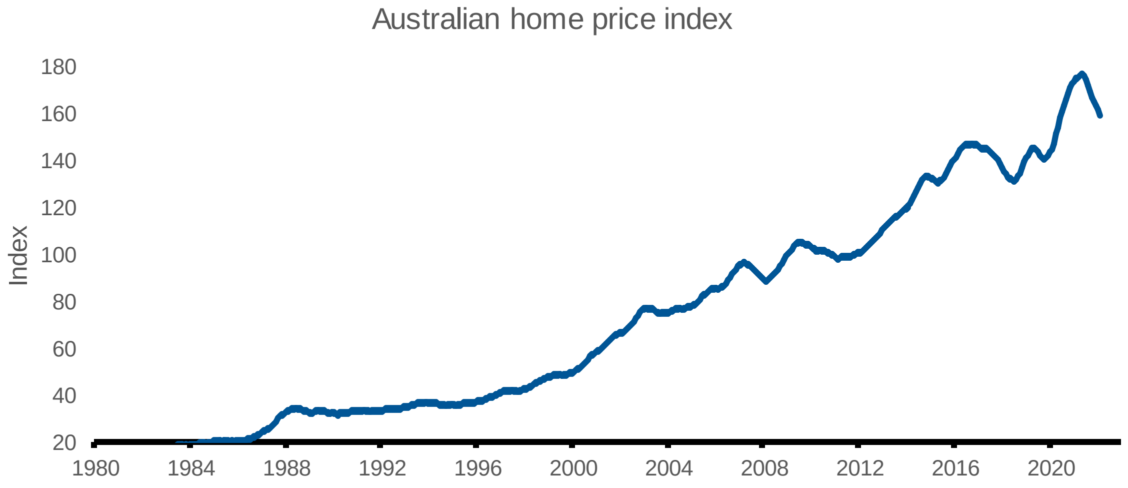


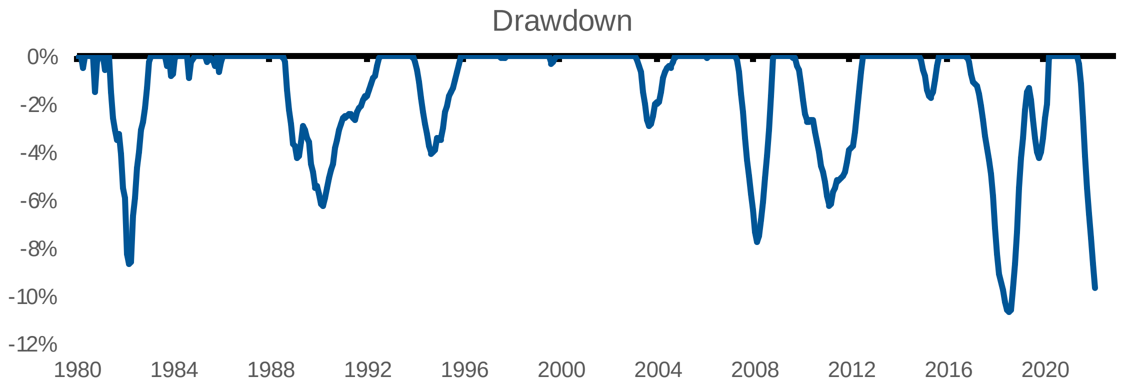
Source: Refinitiv Datastream, 14 February 2023

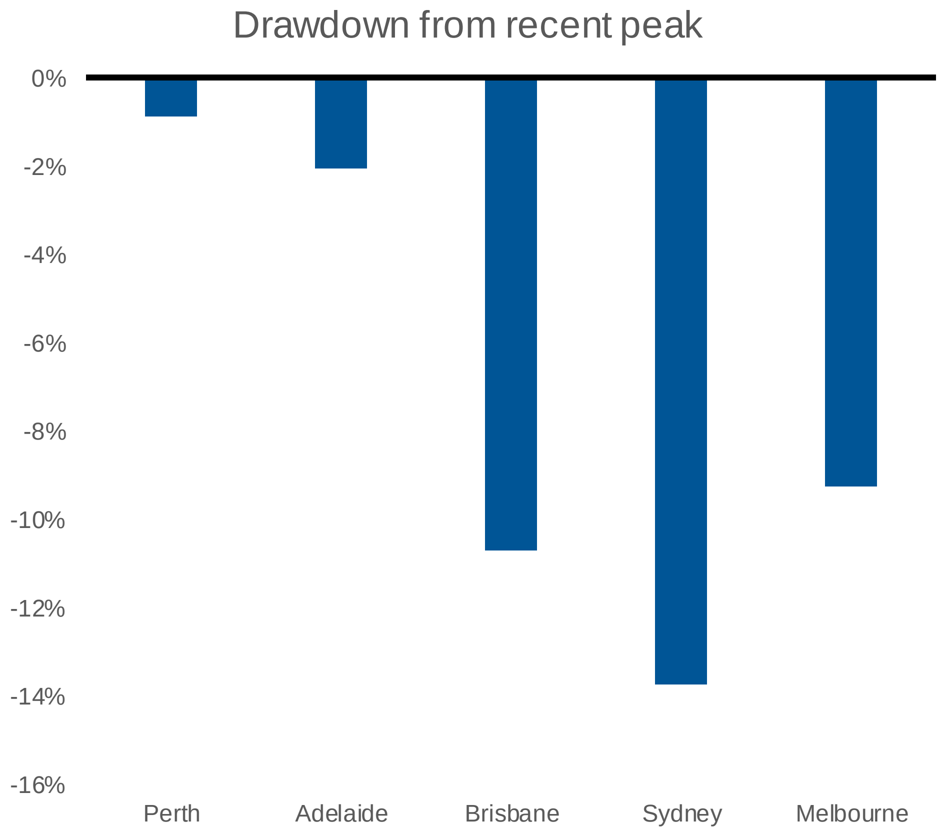
US mortgages tend to have which fixing period?

- A) 1 year
- B) 5 year
- C) 10 year
- D) 30 year

Australian drawdown has been fast







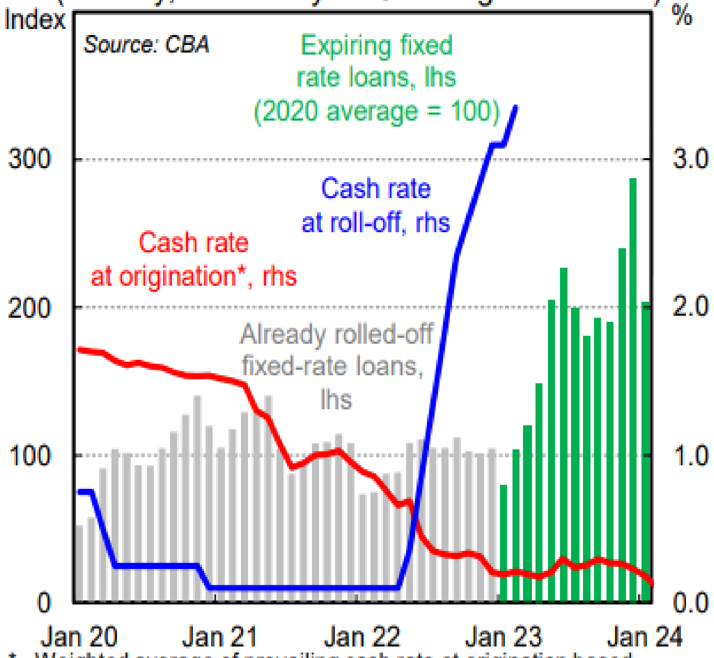
Source: Refinitiv Datastream, 15 February 2023

Australia faces a wave of refinancing starting from April

60% of borrowers will face increase in payments greater than 40% - but a similar number have prepaid by more than 3 months

FIXED RATE LOAN EXPIRY

(monthly, based only on CBA-originated loans)

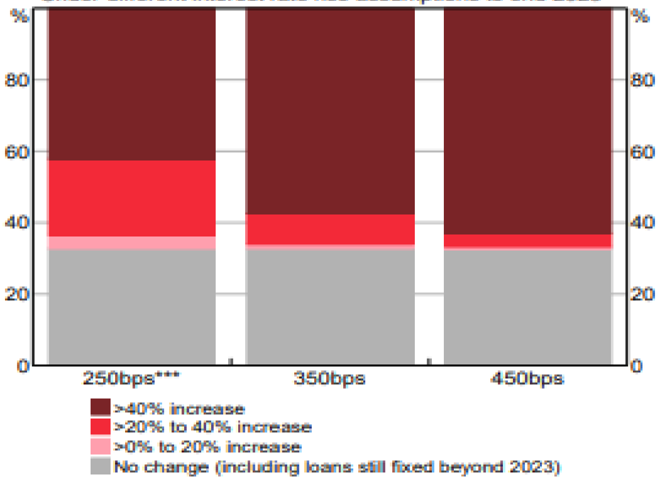


* Weighted average of prevailing cash rate at origination based on amount of fixed rate loans at different terms expiring in each month

Graph 2.10

Distribution of Required Payment Increases for Fixed-rate Loans*

Under different interest rate rise assumptions to end 2023**



* Fixed rate loans that expire in 2022 and 2023 are assumed to roll on to the average variable rate (which depends on the assumed change in rates); fixed rate loans that expire beyond 2023 are in the 'No change' category.

** Relative to the start of the monetary policy tightening cycle.

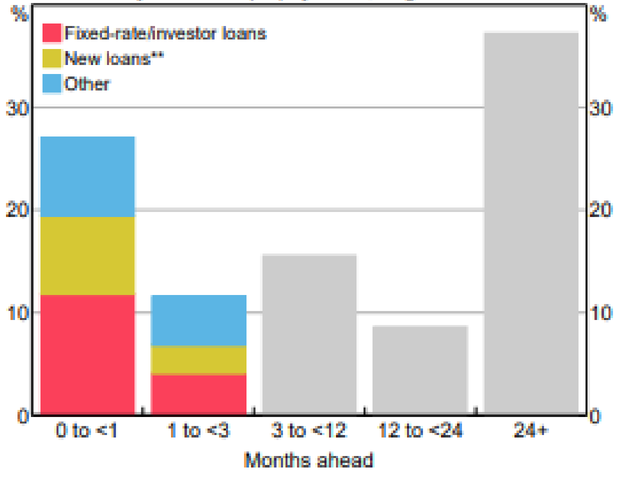
*** Changes announced as at October 2022 Board meeting.

Sources: RBA; Securitisation System

Graph 2.4

Household Mortgage Prepayments*

By months of prepayments, August 2022



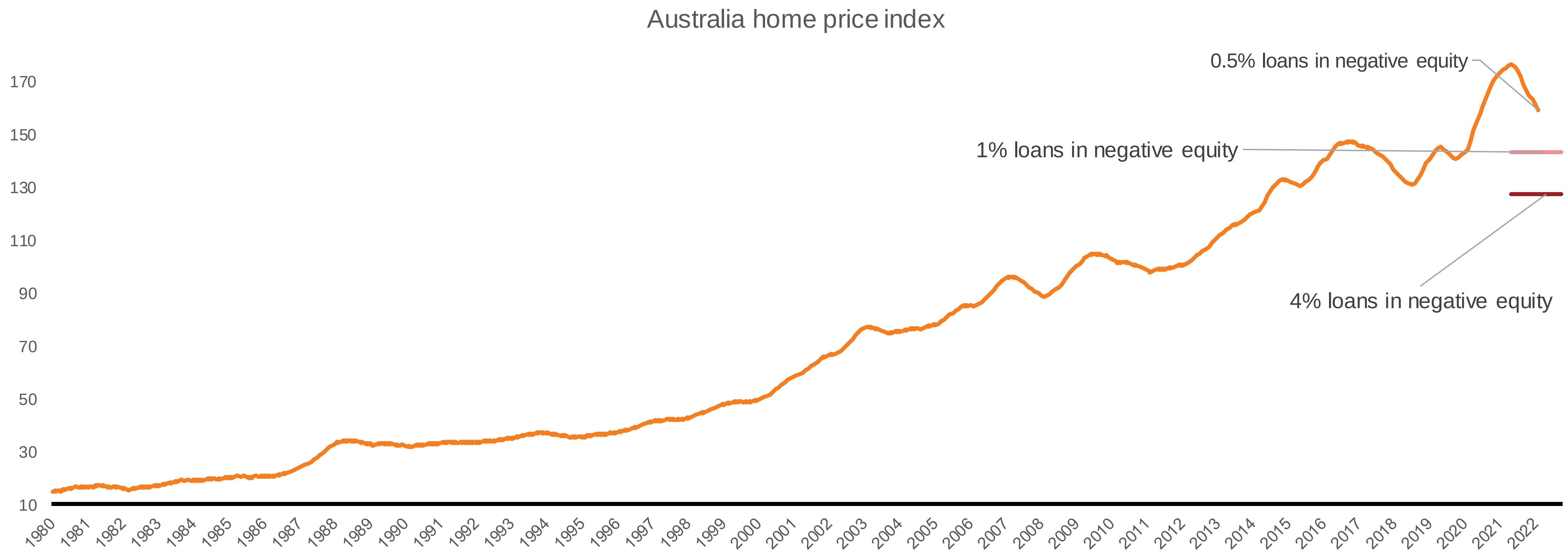
* Months ahead expressed as number of months that prepayments (including offset and redraw balances) can cover minimum scheduled payments. Includes split loans. Only loans with less than 3 months of prepayments are broken down by loan type.

** New loans are those originated during 2021 and 2022. These are somewhat under-represented in the Securitisation data as new loans can take some time to be securitised.

Sources: RBA; Securitisation System

Source: Commonwealth Bank 21 February 2023 , RBA Financial Stability Review November 2022.

Loans in negative equity are unlikely to be a big concern unless prices fall another 20%



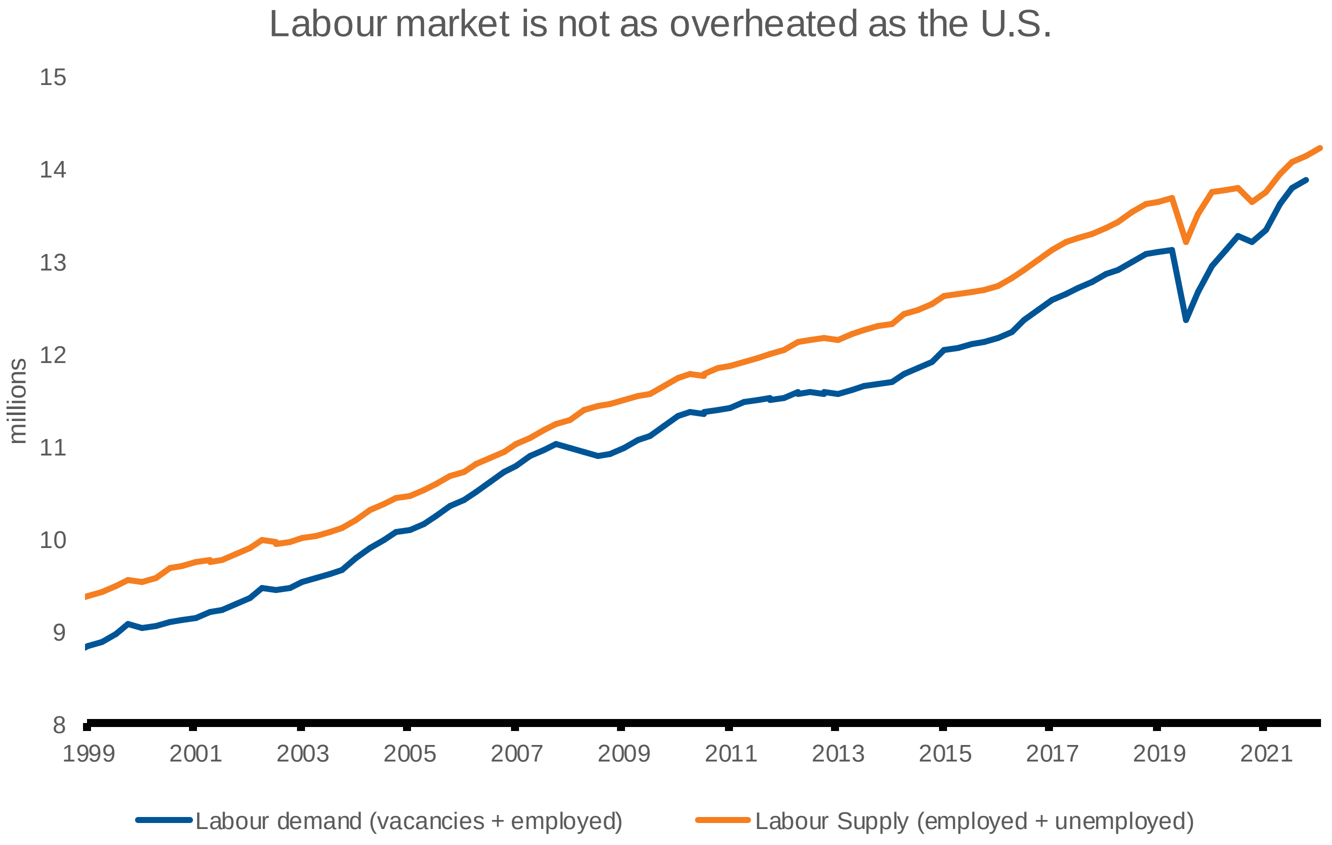
Source: Refinitiv Datastream, RBA, 15 February 2023

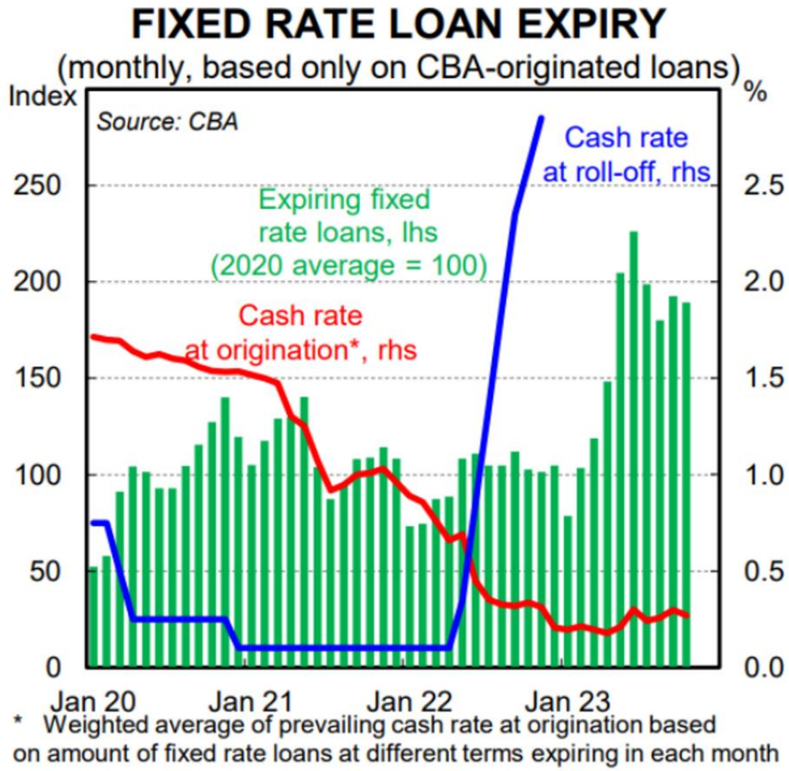
The Australian housing market would have to fall how much further for negative equity to become an issue?

- A) Already is a big problem
- B) 5%
- C) 10%
- D) 20%

Australia is in a reasonably good place given RBA has been less aggressive

Household disposable income set to fall given mortgage rate reset

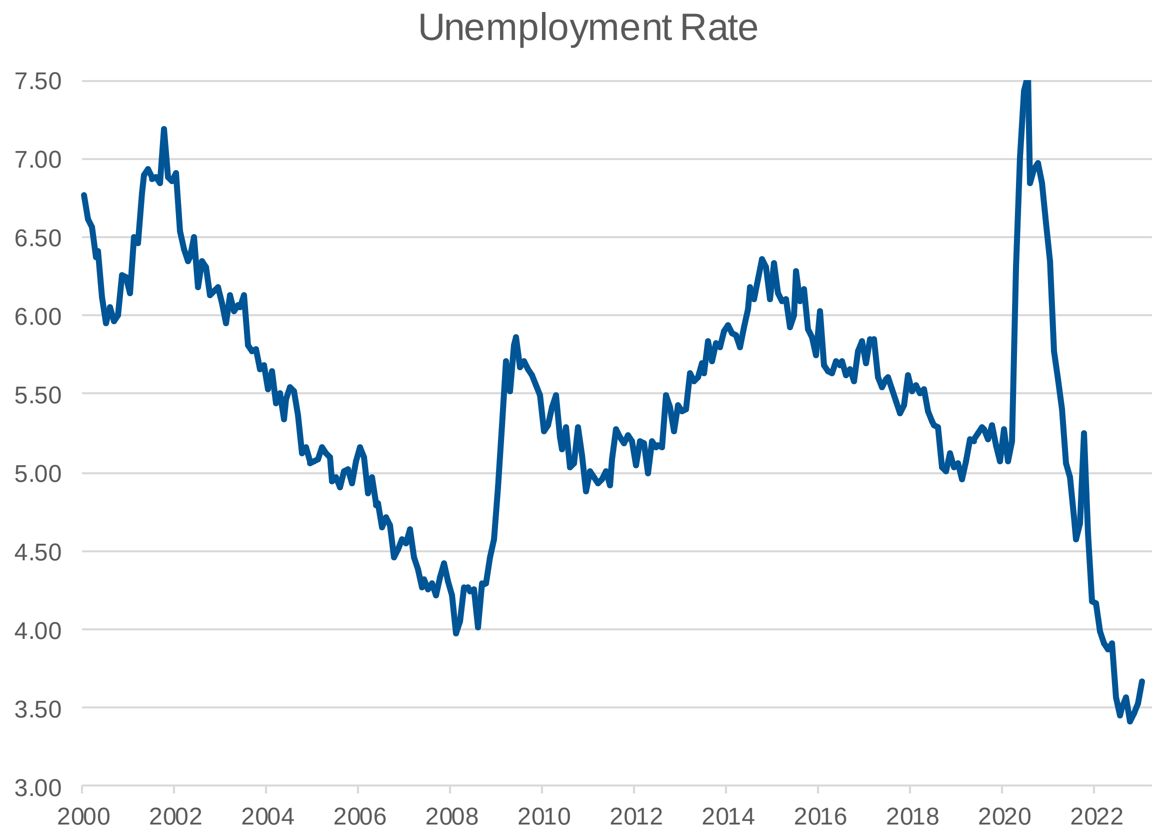




Source: Left graph - Refinitiv Datastream, Russell Investments, 30th January 2023. Right graph - Commonwealth Bank, 15th December 2022

Labour market deterioration will lead to RBA pause

Australian government bonds look attractive



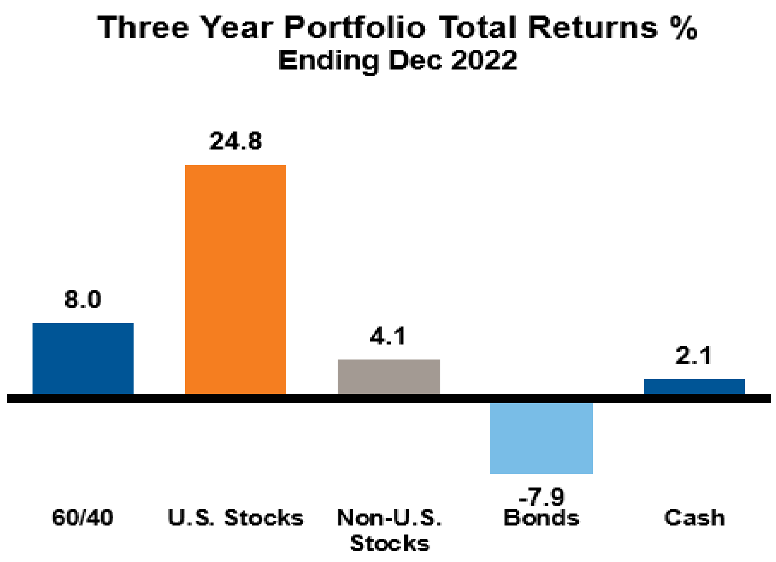
Source: Refinitiv Datastream, 7 March 2023

Stay disciplined, despite the uncertainty

Over the last three years, investors have faced:

1. Global pandemic
   Worst in 100 years
2. Two 20%+ stock corrections
   2nd & 3rd in five years
3. Return of high inflation
   Highest since the 1980's
4. Global conflicts

Knowing this in advance would have suggested "safe" havens



Sticking to your plan helps navigate through difficult environments

Sources: 60/40 portfolio – 40% S&P 500 Index, 20% MSCI EAFE Index, 40% Bloomberg U.S. Aggregate Bond Index; Cash: Citigroup Treasury 3Month T-bill Index, U.S. Stocks: S&P 500 Index, Non-U.S. Stocks: MSCI EAFE Index; Bonds: Barclays U.S. Aggregate Bond Index, Cash: Citigroup Treasury 3Month T-Bill Index. Index returns represent past performance, are not a guarantee of future performance, and are not indicative of any specific investment. Indexes are unmanaged and cannot be invested in directly.

From Darkness to Dawn

- Recession risk is elevated this year given aggressive central bank rate rises
- Whilst house prices are falling, we don't think they pose a systemic risk to the U.S. economy given relatively low debt levels
- Whilst Australia is facing a steep rise in payments due to fixed rate loans rolling off, households in aggregate have built in a healthy buffer
- This dynamic should mean that growth will meaningfully slow, but the risk of recession in Australia is lower than the rest of world

Important information and disclosures