Investment Watch

Summer 2022 Outlook

morgans

Welcome

Another year passes by and we look to 2022 with a sense of optimism as the world economy heals from the scars of 2020. With the holiday season around the corner, we take this opportunity to look back on a year that marked the transition out of a once-in-a-lifetime pandemic.

As for the 2022 outlook, Michael Knox and our Equity Strategy team continue to uncover compelling market opportunities amongst the uncertainty. While global economic growth rates are slowing, they are not slow. Instead, a high tide of growth aided by government spending and strong consumer demand is likely to help the global economy safely navigate through worries emanating from COVID-19, inflation, shortages and rate hikes.

We remind investors to remain vigilant against a series of macro-economic risks that are likely to make for a bumpy ride and as always, some asset classes will outperform others. That is why in this version of Investment Watch we include our key themes and picks for 2022 and our best ideas. As always, speak to your Morgans adviser about asset classes and stocks that suit your investment goals.

2021 has been a challenging and disruptive year and from all the staff and management of Morgans we appreciate your ongoing support as a valued client of our business. We wish you and your family a safe and happy festive season and we look forward to sharing with you what we hope will be a prosperous 2022.

Recently published research

- **Equity strategy** – 2022 sector outlook and strategies 6/12
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Corporate highlights

From 1 January 2021 to 30 November 2021

118 transactions

$8.9bn raised

17.2% average return on Morgans led IPOs

Outperformed the ASX 200 which returned 8.6% over the same period

Key IPOs for the year and performance from listing to 30 November 2021

Airtasker	STEP ONE	BlueBet	camplify	swoop
up 47.7%	up 79.1%	up 38.2%	up 181.7%	up 262%

Economics – interest rate and inflation outlook

Threat of inflation

Pretty much every finance writer is talking about the problems of inflation. Still, as shown in the Statement on Monetary Policy released on 5 November 2021, the Reserve Bank of Australia (RBA) believes that Australian inflation has already peaked and is beginning to decline. Their view on headline CPI is that it actually peaked at 3.8% in June 2021, will ease to 2.25% in December 2022 and flatten out at 2.5% in December 2023.

So why is it that everybody believes that we are entering a period of high inflation? Why does the RBA not believe that? We need to talk about the supply chain and just a little bit of economic history.

Back at the beginning of the century most of the developed world decided to outsource manufacturing to China. The major concern back then was high inflation. The idea was that if they could outsource manufacturing to what was then a lower wage country (China), we could produce manufactured products at a very cheap price. Should the price of those manufactured products increase at a slower rate than general inflation, the developed world could 'import' deflation.

Last year people were locked down at home, they discovered online shopping and they started buying goods to a much higher level than they previously were. This generated huge demand for imports from China at a time when COVID-19 was also wreaking havoc on factories in China. Ultimately leading to bottlenecks in shipping and other difficulties sourcing goods.

The acceleration of the US economy and the Australian economy has been extremely rapid. We noted last year that this was not a normal recession. This is like the recovery after a global natural disaster that is much more rapid where demand returns almost immediately. Government spending also kicks in a lot faster than a normal recovery from a recession.

Then you have this very rapid recovery. Some economies have changed their structure towards importing manufactured goods. You get these severe problems in supply chains in manufacturing goods and that generates a much higher level of potential inflation both in Australia and the US.

As the economy slows down to a normal pace you have a resurgence in the demand not for goods but for services. Services then come into the market at a much lower and sticky price to satisfy that demand. That is why in the RBA measures of inflation the headline inflation peaks at 3.8% then eases to 2.25% in 2022.

In practice the RBA seems to be thinking more about employment than inflation when it is setting monetary policy. This is because the RBA seems to be targeting not just price inflation but also wage inflation. The RBA governor, Philip Lowe, has noted on more than one occasion that he wants to get unemployment to a low enough level that Australia returns to an extended period of growth in real wages.

This means he has to get unemployment to a low enough level where wages need to be growing 1% faster than inflation. Hence, he will continue to provide support for the economy in terms of low interest rates until he gets unemployment down towards 4%. This emphasis on wages growth suggests that the RBA is going to stay with an expansive monetary policy for longer than the market currently believes.

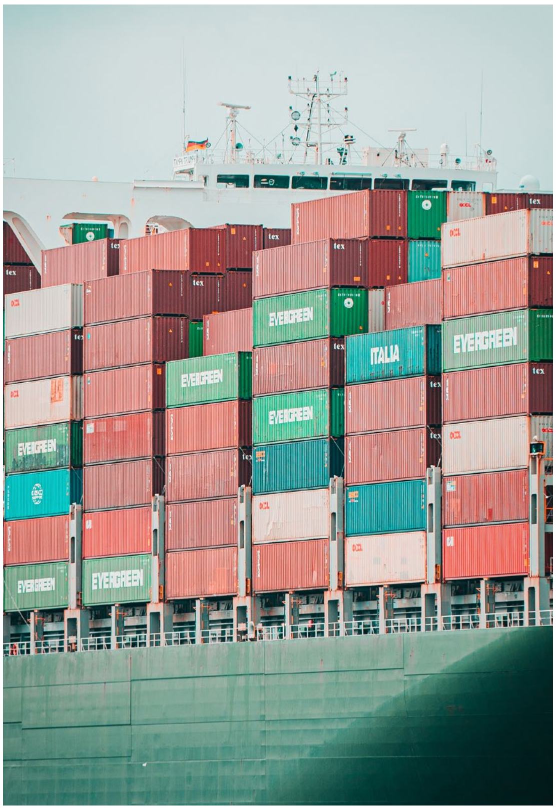
Our current base case is that the RBA will announce a reduction in asset purchases in February 2022 by A$1bn per week. This means that the asset purchase program will come to an end by the end of the 2022 calendar year. We believe this will be followed by the first increase in the cash rate from 10bp to 25bp in February 2023.

This scenario provides us with a more modest rate of tightening than we anticipate from the US Federal Reserve. The US is facing an outlook of significantly higher inflation than does Australia. This is because the US provided a budget stimulus which is much larger than that of Australia. The US has an inflation problem that Australia does not share.

Economic forecasts

	Morgans (CY22)	Consensus (CY22)
GDP Growth	5.0%	3.8%
Inflation	2.25%	2.5%
RBA Cash Rate	0.1%	0.25%
AUD/USD	75c	76c
ASX200	8100	7900

Source: Morgans, Bloomberg



This emphasis on wages growth suggests that the RBA is going to stay with an expansive monetary policy for longer than the market currently believes.

For more economic coverage subscribe to our podcasts

Asset allocation – 2022 outlook

The path for further gains in risk assets looks to have narrowed after a long run higher, but we reaffirm our tactical pro-risk stance, supported by a broadening global restart and ongoing negative real interest rates. Rising bond yields and elevated valuations will limit the probability of strong capital returns in 2022.

Tactically, we stay overweight equities as we expect the tailwinds from the economic restart to overshadow the near-term risks. We tilt toward cyclicality and maintain a bias for quality. We like having some inflation protection with rising prices unlikely to unwind on strong demand dynamics and supply chain constraints. We believe non-traditional return streams (alternatives), including private credit/equity, unlisted and real assets, have the potential to add value and diversification.

Tighter financial conditions to restrain returns in 2022

We forecast that long-term bond yields will continue to rise across most major economies and especially in the US, where we think short-term inflationary pressures are particularly strong. Otherwise, we think the returns from most risky assets will be less impressive in 2022 than they have been over the past 18 months. That reflects not only a view that bond yields will climb further, but also how we see limited room for global growth to surprise on the upside and how, in many cases, valuations already appear quite stretched.

Inflation is back as a major force influencing policymakers and markets. Shutting and then reopening developed economies has had three distinct impacts: simple base effects pushed up inflation, supply-side bottlenecks emerged and demand-pull inflation is causing a self-reinforcing cycle of rising wages and more demand in economies like the US. These pressures are far from universal as China and Europe are not seeing rising producer prices feed directly into higher consumer goods prices. However, all economic policymakers are forced to reassess their crisis-period settings and plan for tighter financial conditions. How these forces play out will be the key driver of markets in the coming year.

Journey to net zero

Climate risk is investment risk and the narrowing window for governments to reach net-zero goals means that investors need to start adapting their portfolios. The green transition comes with costs, yet the economic outlook is unambiguously brighter than a scenario of no action, although risks around a disorderly transition are high; particularly if execution fails to match governments' ambitions to cut emissions. Policy remains the main tool. Some carbon-heavy companies already are changing their business models, creating potential investment opportunities.

We see sustainability-driven repricing as having just begun with accelerating flows into ESG products a big drive. Commodities such as copper and lithium will likely see increased demand from the drive to net zero. It's important to distinguish between near-term drivers of commodities prices, the economic restart and the long-term transition. Tactical implication: we see opportunities in companies rapidly adapting their business models for net zero.

Key changes to our asset allocation settings

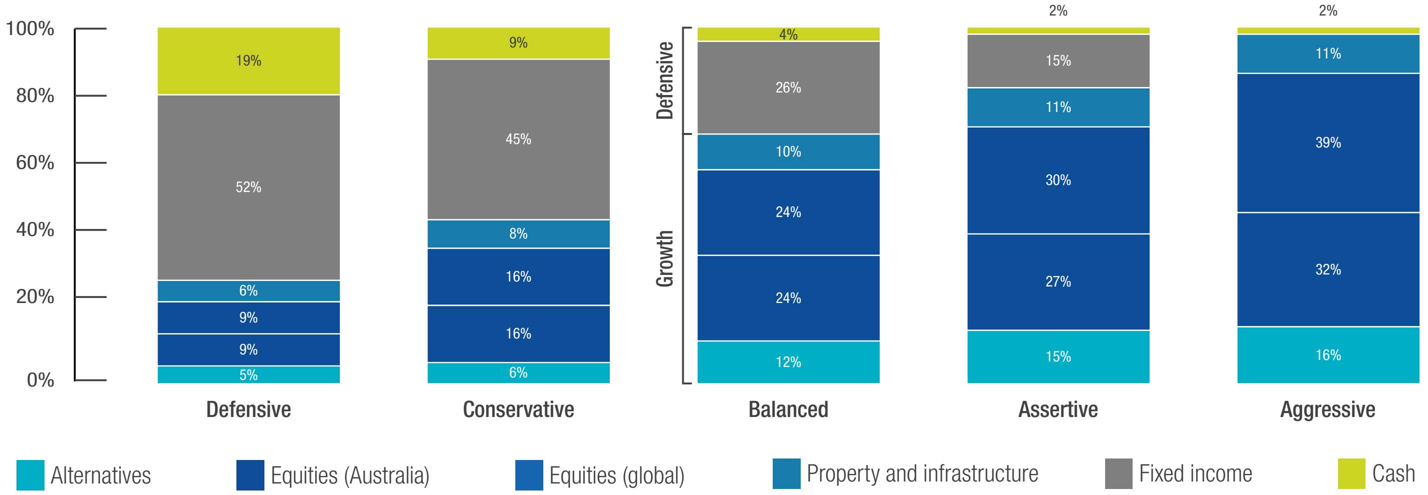
We maintain an overweight position to risk assets and underweight traditional income assets. In line with our updated asset allocation methodology, we introduce alternatives to add value and diversification to portfolios. With global short rates edging higher and conditions in place for a return of volatility, we see the need have some dry powder.

The Morgans strategic asset allocation methodology takes a systematic approach in optimising exposure to the various asset classes at different stages of the economic cycle. Refer to our full publication "Asset Allocation Update – 2022 Outlook" for product recommendations.

Global equities	−−	−		+	++	The path for further gains in risk assets looks to have narrowed after a long run higher, but we reaffirm our tactical pro-risk stance, supported by a broadening global restart and ongoing negative real interest rates. Rising bond yields and elevated valuations will limit the probability of strong equity returns in 2022. Despite rising COVID-19 cases globally, governments are unwilling to resort to drastic lockdown restrictions and central banks appear to be patient with inflation, we think the reflationary economic backdrop will continue to favour being invested in global equities tilted toward cyclicals and quality franchises. The key risk to the outlook is a significant slowdown in China and the resetting of the crisis-period economic settings for tighter financial conditions which will restrict growth.
Australian equities	−−	−		+	++	The ASX 200 is up 16% for the year to the end of November, but as volatility returns and risks around Chinese growth resurface, we moderate our overweight position. Materials, energy and financials have benefitted from the bounce back in economic activity, but a potential further tightening in financial conditions and a slowdown in China will limit the upside for the key sectors of the Australian economy. On the flipside, household balance sheets are in great shape, which should continue to support the recovery in consumption. We also see upside risks to dividends as uncertainty from the virus clears, keeping payout ratios elevated. Accordingly, we prefer a targeted portfolio approach favouring reflation (financials and energy) and COVID-19 reopening beneficiaries (travel, gaming and traditional retail).

Fixed income		We are underweight nominal government bonds as their ability to act as a portfolio defence is diminished with yields at current levels and inflation risks may eventually pose risks to the low-rate regime. We prefer inflation-linked bonds as we see risks of higher inflation in the medium term. We are underweight long-duration bonds on a tactical basis as we anticipate gradual increases in nominal yields supported by the economic restart. While underweight government bonds, we are more constructive in corporate floating rates (hybrids) and sub-investment grade credit. On a tactical basis, the implicit solvency guarantee by the Fed will limit defaults and provide opportunities in the high yield credit space.
Property and infrastructure		A recovery in broader risk appetite should see infrastructure benefit relatively less than other assets. However, infrastructure is also an inflation-sensitive asset class with the opportunity for upside participation given the pass-through structure of many contracts. If inflation rates hold on better economic growth, it would be positive for asset class returns. We remain neutral infrastructure with a preference for assets linked to economic activity such as tollroads, airports and data. We are neutral on the Australian property sector. While we continue to expect strong growth in housing and the industrial sub-sectors, we think macroprudential measures and the reopening of the economy will moderate the strong tailwinds powering the two sub-sectors.
Alternatives		We believe non-traditional return streams, including private credit/equity, unlisted infrastructure, venture capital and real assets have the potential to add value and diversification. Our neutral view is based on a starting allocation that is much larger than what most qualified investors hold. Many institutional investors remain underinvested in alternatives as they overestimate liquidity risks. In our view, alternatives are a complex and broad asset class and not suitable for all investors.
Cash		We pare back our underweight position this quarter. With global short interest rates edging ever so higher and conditions in place for a return of pricing volatility, we see the need to build up some dry powder. Cash acts as a buffer against rising interest rates driving both stocks and bonds lower.

Recommended asset allocation and tactical tilts



Benchmark long-term asset allocation and tactical tilts

	Defensive	Conservative	Balanced	Assertive	Aggressive	Tactical tilts (Aggresive*)
Equities (Australia)	7%	14%	22%	25%	32%	2% (0%)
Equities (global)	7%	14%	22%	28%	39%	2% (0%)
Property and infrastructure	6%	8%	10%	11%	11%	0% (0%)
Fixed income	55%	48%	29%	18%	0%	-3% (0%)
Alternatives	5%	6%	12%	15%	16%	0% (0%)
Cash	20%	10%	5%	3%	2%	-1% (0%)

*Implemented tactical tilts for the aggressive risk profile.

Equity strategy – stick to the fundamentals

Morgans research analysts re-set their equity sector views, strategies and best stock ideas as the Australian economy emerges from a prolonged period of uncertainty. While near-term risks remain, we see potential for another solid year of returns driven by improving corporate earnings and strong household spending.

Equity portfolio construction

Recent adjustments to the Morgans equity model portfolios reflect shifts in our sector preferences.

We continually seek to re-balance core equity portfolio exposure to all of yield, value, cyclical and growth factors. Ultimately we're looking for best-of-breed companies capable of thriving regardless of the macro-economic backdrop.

Resources, energy and financials have benefitted from the bounce back in economic activity, but a potential tightening in lending standards for residential housing and a slowdown in China will may limit upside in the short term. On the flipside, household balance sheets are in great shape which should continue to support the recovery in consumption. We also see upside risks to dividends as uncertainty from the virus clears, keeping payout ratios elevated.

Our approach to core portfolio construction continues to favour the beneficiaries of reflation (banks, financials and energy) balanced against stable yielders. For growth portfolios we like higher exposure to "re-opening" plays (travel, gaming and traditional retail).

Refer to updated 2022 sector outlooks for more coverage.

Refer to our **Morgans best ideas** for more.

Key sector outlooks

Category	Sector	Rating	Best ideas	Overview
Financials	Banks	−− / − / / ▼+ / ++	WBC MQG	Their increasingly robust dividend outlook and potential for capital management supports ongoing rotation into the banks. While balance sheet strength and dividend yield are the key attractions, improvement in system home loan growth is supportive of earnings growth.
	Diversified financials	−− / − / / ▼+ / ++	QBE TYR HUB MME	The operating backdrop for financials has progressively improved with stronger markets, upward pressure on interest rates and improved sentiment. A gradual lift in bond yields reflecting steadily improving economic activity would be broadly positive for the sector.
Defensives	Consumer staples	−− / − / ▼ / + / ++	EDV TWE	Some supermarket spending is now being redirected towards restaurants, pubs and cafes however the working-from-home trend will be an ongoing tailwind. While valuations are relatively full, sector defensiveness does offer downside protection if markets become volatile.
	Healthcare	−− / − / / ▼+ / ++	RMD SHL M7T VHT	Near term appetite for healthcare stocks will likely grow as the northern hemisphere winter approaches and new COVID-19 variants circulate. Long-term exposure is justified by the re-assertion of strong underlying structural fundamentals driving organic sector growth.
	Telco	−− / − / / ▼+ / ++	TPG NXT	Events of the last 18 months have only fast-tracked digitisation of everyday life. Digital infrastructure providers like NEXTDC are key suppliers into this theme and will continue to benefit.
	Infrastucture and utilities	−− / − / ▼ / + / ++	TCL DBI ALX	Critical service providers with regulated revenues, resilient demand, or long-term take-or-pays should remain in-demand. Ultimately, ultra-low interest rates can re-intensify appeal for strong cash generators once volumes recover.
	A-REITs	−− / − / ▼ / + / ++	HDN DXC HPI WPR HCW	Capital performance will fluctuate with bond rate expectations but REITs continue to offer attractive distribution yields to investors with the sector average around 5%.

	Sector	Outlook	Stocks	Comment
Cyclicals	Consumer discretionary	−	LOV APE UNI TAH	Retail is generally likely to remain subdued while the threat of a return to lockdown lingers and consumers remain reluctant to return to stores in large numbers. Input cost and labour cost inflation is likely to affect margins, while labour availability could be an issue for some.
	Industrials	++	CTD ANN RWC AQZ ACF PTB PPE	Despite higher supply chain and raw material costs, most industrials are arranging price increases to offset inflation. We expect supply bottlenecks to persist, but to ease through 2022, subject to no further COVID-19 escalation. Companies with sustainable pricing power in industries with strong underlying demand should continue to perform well.
	Online	−	FDV BKG	The consumer shift to online and buoyant end markets sees the sector well placed to continue to grow ahead of market expectations. This dynamic does however look well captured in current pricing, with the smaller-caps offering better opportunities.
	Technology		TNE	Selective exposure to technology stocks is likely to deliver customer and shareholder value regardless of interest rate movements. However, interest rates across the world all remain less than 2%, so quality companies with high growth will remain well bid.
	Agriculture	+	NUF IPL NAM	Following successive years of drought, robust seasonal conditions combined with strengthening soft commodity prices (economic reflation, USD weakness) offer strong sector tailwinds into 2022.
Resources	Metals and mining		BHP WHC RMS PAN	We think Chinese steel dynamics are approaching 'as bad as it gets' and feel that the diversified mining equities are now looking to price in a normalisation of activity (steel/iron ore price) to more sustainable levels as required by the Chinese economy and its leadership.
	Energy	++	STO WPL KAR	We think broad sector underperformance has been driven by local energy stocks' large exposure to upstream, which requires greater conviction in prices. We expect that strengthening oil/gas prices will drive a gradual re-rating in Australian energy stocks.

Agriculture/Food – the bumper crops keep rolling in

Soft commodities broadly benefit from the same forces supporting metals and energy commodities (economic growth, lower USD and supply/demand dynamics). Exposure to agricultural companies offers diversification and a partial de-coupling from the broader market as performance is driven more by seasonal conditions in domestic/global markets and less by general economic conditions. We still need to eat!

ABARES' most recent Australian Crop Report is forecasting winter crop production in 2021–22 to reach a new national record following favourable growing conditions over the spring. Furthermore, the Bureau of Meteorology's three-month rainfall outlook suggests that rainfall is likely to be above average for eastern Australia, given La Nina was recently declared. This, coupled with already high subsoil moisture levels and with plenty of water in the dams and storages, means Australia is on track to benefit from the largest summer cropping season in recent years, with high plantings of cotton, rice, and sorghum. Another bumper crop bodes well for FY22 earnings across the listed agricultural and chemical companies.

With big crops, high soft commodity prices, the AUD falling again and low interest rates, everything appears to be heading in the right direction for the Australian agricultural industry. According to ABARES, Australian farmers are on track to produce a record A$73bn worth of produce this financial year, with about A$55bn to be exported and thus helping to feed the world. The National Farmers' Federation has set a government-endorsed goal to grow the industry to be worth A$100bn by 2030.

Recent publications

Graincorp
ADD TP A$7.90
ABARES upgrades the crop again

Incitec Pivot
ADD TP $3.75
The upgrade cycle isn't over

Banks – strong capital and dividend outlook

We continue to see the key reasons for being invested in the major bank sector to be the strength of balance sheets and robust dividend yields. Dividend yields remain attractive relative to the yield curve and we expect this to remain the case if the RBA keeps the official cash rate on hold for the next couple of years. Once the RBA commences raising interest rates, we expect bank earnings to benefit from this through net interest margins. That is, we expect a rising rate environment, in the absence of material asset quality deterioration, to generally be supportive of bank earnings.

We also continue to see cost out potential as being supportive of bank earnings over the medium term, particularly as the banks continue to digitise and automate processes.

While some investors are concerned about the threat to major bank market share from emerging fintechs, we are not too concerned about this factor; reason being that the major banks have large balance sheets with the capacity to acquire fintechs which have attractive prospects. The major banks already have in place venture funds through which the major banks have stakes in several fintech players.

Whilst several non-bank lenders have emerged in the home lending space over recent years, we believe major bank balance sheets will generally prove to be more resilient than non-bank lender balance sheets over the long term, particularly from a credit risk and funding risk perspective. The new bank capital framework announced by the prudential regulator in late November 2021 requires banks to hold more capital for higher risk mortgages. We consequently expect the banks to charge a higher interest rate for riskier mortgages, which may see higher risk mortgages ending up on non-bank lender balance sheets.

Recent publications

WBC
ADD TP A$30.50
NIM disappoints but overreaction creates more value

CBA
REDUCE TP A$73.00
Premium relative to peers remains unjustifiably large

Ranking	Stock	Recommendation	Share price	Target price	Dividend yield	Gross yield	12-month forecast TSR
1	WBC	ADD	$20.72	$29.50	5.7%	8.1%	51%
2	ANZ	ADD	$27.04	$31.00	5.3%	7.5%	22%
3	NAB	HOLD	$28.04	$28.50	4.5%	6.5%	8%
4	CBA	REDUCE	$97.24	$73.00	3.6%	5.1%	-20%

Source: IRESS, Morgans. Data at 8 December 2021

Diversified financials – opportunity in a lagging segment

We continue to see value in the diversified financials sector, with the sector overall still lagging the post-pandemic recovery. Having said that, the domestic focused general insurers (IAG and SUN) continue to face a frustrating environment, with a recent run of unfavourable weather events remaining a headwind for stock share prices. On a more positive note, several of our stocks (MQG and CPU), are beneficiaries of the current robust global M&A and ECM environment, which is expected to continue in the near term given large levels of global liquidity.

We see three key sector themes at present:

1. We think the outlook for the general insurers is one of likely underlying margin expansion from here as they push through solid price increases across their books. We think the resolution of COVID-19 cases on business interruption claims, as they advance through the courts, will also be a positive removing future uncertainty.
2. The potential for rising yield curves globally, noting the Federal Reserve has commenced policy normalisation. We note that nearly all the insurance/diversified financial stocks would see improved earnings from higher interest rates, none more so than QBE and CPU.
3. The health insurers continue to see a favourable environment linked to COVID-19 with low elective surgeries reducing claims, coupled with improved industry participation rates.

Given that insurance/diversified financials stock prices have been slower to recover than those of the major banks, post COVID-19, coupled with a similarly improved earnings outlook, means they probably deserve a larger weighting than usual in the 'financial' segment of a portfolio. We remind investors that the insurance and diversified sector remains favourably exposed to increasing global inflation, which would likely be accompanied by rising interest rates, thereby supporting sector earnings.

Recent publications

MQG
HOLD TP A$200.00
Capitalising on a favourable environment

QBE
ADD TP A$13.70
Best result in a long time

Resources and energy – missing the forest for the trees

Our positive medium-term view on commodities recognises:

1. pent-up demand being unlocked by the global economic re-start
2. constrained supply due to both short (pandemic) and longer-term factors (underinvestment)
3. ongoing growth in global money supply
4. US dollar headwinds. These forces also complement commodities strength during periods of rising inflation.

We recommend core holdings in the diversified miners and large-cap energy stocks for balanced portfolios. More assertive/growth oriented investors should consider tactical exposure to our favoured energy, copper, nickel and specialty metals (lithium et al) stocks exposed to growth in battery markets.

After a painful correction, we think dynamics in Chinese steel are nearing 'as bad as it gets'. We consider the triggers as transitory (e.g. clear skies Olympic policy) and primarily linked to efforts to curb speculation/overheating in the property and indirectly the steel, markets. Caution has been prudent, but we feel the diversified mining equities are now looking to price in a normalisation of improved Chinese steel activity (steel/iron ore price) to more sustainable levels as required by the Chinese economy and its leadership.

Tactical exposure to gold is worth considering as an additional inflation hedge while it poses macro-economic risk. Gold is also a hedge against the risk that (we think inevitably) equity market volatility breaks above abnormal calm seen through most of 2021. The favoured ASX gold majors (NCM, EVN) offer both the defensive attributes of gold and increasing cyclical exposure to copper.

COVID-19 Omicron uncertainty may trigger energy market volatility, but we maintain our conviction that growing under-supply, not helped by a transformation in global energy policy, will support medium-term pricing well above the levels that energy equities are currently imputing.

Recent publications

BHP
ADD TP A$45.70
More moves to make

Woodside
ADD TP A$29.95
Scarborough sanctioned

Infrastructure – M&A thins the cohort

ASX-listed infrastructure covers a broad group of economic, regulatory and contractual exposures with different balance sheet and risk management settings. This ranges from energy haulage and storage networks (regulated and contracted growth from investment), airports (travel growth and commercial earnings), toll roads (population growth and regional development) and coal-related infrastructure (Asian-driven demand growth for power generation and steel making). Balance sheets are typically investment grade quality, allowing competitive access to debt markets. Outside of core infrastructure, we also consider waste management (waste generation, government policy) and logistics (trade flows, economic growth).

In a normal environment, the core infrastructure sector boasts a mix of defensive qualities, structural growth drivers and appealing distribution yields. This translates into sector returns that historically have been less volatile than the broader market. Within the sector itself, the market risk of patronage-driven assets (toll roads, airports) is typically higher than regulated and/or long-term contracted businesses because they have greater linkage to economic conditions. Given economic uncertainties, we recommend investors balance their infrastructure exposures between these two asset classes.

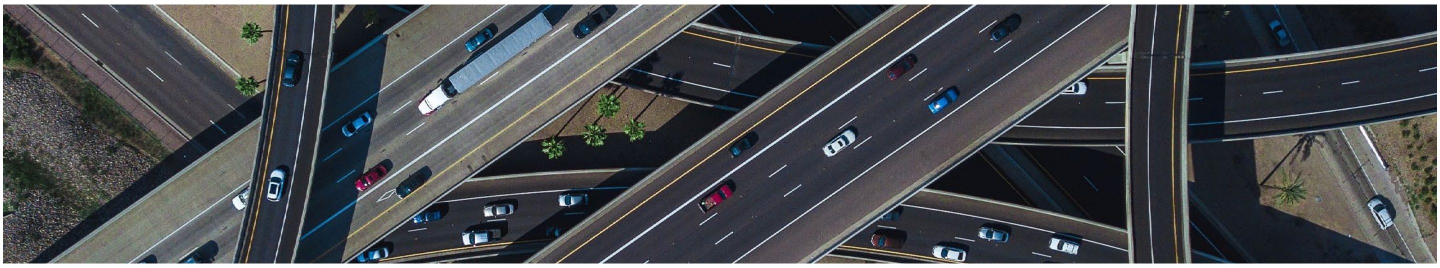
During periods of rising interest rates, concerns usually surface about the performance of the infrastructure space. We think the asset companies have a number of mitigants to this risk, including inflation-linked revenues and debt that is largely fixed rate and long dated debt.

Historically, takeover activity has boosted returns in the sector as unlisted investors pursued the scarce but high quality listed assets. This year, SYD, SKI and AST each received and accepted takeover bids, significantly reducing the number of investable names in the space. On the flipside, TCL's consortium successfully acquired the remaining stake in WestConnex. APA also launched an (ultimately unsuccessful) takeover bid for AST as it pursued its electrification investment strategy (APA is now looking at the troubled Basslink electricity interconnector).

Recent publications

APA Group
ADD TP A$9.98
Investment considerations

Transurban
ADD TP A$14.79
COVID symptoms continue



Telco – an easy call for now

The telco sector has the positive attributes of earnings defensiveness, growth and in some cases yield. Incumbents have more yield and less growth due to their relative defensiveness while challengers and digital infrastructure provides have ample growth. Overall the sector is set for growth as macro trends remain constructive.

Exposure to the telco sector via incumbents broadly suits balanced investors targeting a modest yield while challengers are more appropriate for investors seeking capital growth. Given the shifting dynamics, we prefer to take a more tactical approach to growth stocks and on price dislocation opportunities as they emerge. With the NBN complete and 5G mobile rollout continuing, companies are taking the rational approach to pricing and taking the pressure off profit margins. One of the key takeaways from the recent Morgans Technology Conference was that digital transformation (including cloud computing and remote working) is here to stay. Companies that are part of this digital infrastructure (specifically those providing communication and data centres) are critical suppliers and are set to continue benefiting from this medium term structural trend.

Recent publications

Telstra
ADD TP A$4.55
Smart structure makes Digicel risk/ reward compelling

Property – open for business

Year-to-date the property sector has delivered returns of approximately 21% vs the broader market at around 15%. Bond yields currently sit around 1.75% which is around levels seen in March; however, after reaching lows in August yields have been steadily increasing (although remain low vs historical levels). Distribution yields remain attractive for the sector at around 5% and we note most REITs go ex distribution at the end of December.

With NSW and VIC recently exiting lockdowns, some groups that didn't provide FY22 guidance during the August reporting season have now done so (mainly REITs exposed to retail and office sectors). However, we note that groups focussed on funds management have also been upgrading FY22 earnings expectations since reporting season. Charter Hall (CHC) expects Operating EPS to be a minimum +36% growth on the pcp which has been driven by transactional activity, strong valuation growth and performance fees. Goodman Group (GMG) also upgraded FY22 earnings guidance and now expects to post +15% growth on the pcp given rental growth/customer demand and increased development activity. GMG's total assets under management sit at $62bn (expected to be ~$70bn at June 2022) with $12.7bn in development work in progress. Home Consortium (HMC) also upgraded guidance on the basis the HDN/AVN merger proceeds in early CY22 with AUM to hit around $5bn well ahead of expectations.

Industrial focused REITs remain active, post reporting season, Centuria Industrial REIT (CIP) and Dexus Industria Group (ADI) took advantage of strong security prices and revaluations and raised new equity for acquisitions. CIP continues to be acquisitive with further infill industrial sites acquired in November. Dexus (DXS) recently became the manager of ADI and we have already seen evidence of new opportunities with DXS co-investing in several new acquisitions alongside ADI. The favourable tailwinds for industrial/logistics assets remain in place with significant demand for the asset class given the growing shift to e-commerce and increased focus on supply-chain resilience.

M&A activity has also ticked up: a Charter Hall (CHC) managed consortium will acquire ALE Property Group (LEP) after gaining securityholder approval in December. The Independent Expert assessed the fully diluted value of LEP securities at between $5.40 to $5.71 on a 100% controlling interest basis vs the implied value range of the Scheme Consideration of $5.67 to $5.79 per LEP security. HomeCo Daily Needs REIT (HDN) also announced a proposed merger with Aventus Group (AVN) to create a portfolio of Large Format Retail, convenience and health services assets across Australia. The combined HDN/AVN portfolio is valued at A$4.1bn with exposure to 'last mile' logistics, as well as a significant land bank with future development potential. Scheme booklets (including the Independent Expert report) will be distributed to AVN security holders in mid-December with Scheme meetings to be held late January 2022. Irongate Group (IAP) also received a non-binding indicative proposal from 360 Capital Group (TGP) for $1.6547 cash per stapled security for all securities it doesn't own already. IAP has rejected the bid saying it materially undervalues IAP.

We expect the next trading updates with the February 2022 reporting season.

Near-term unknowns and risks include movement in bond yields, the general economic environment/recovery coming out of COVID-19 and impacts on leasing/rental markets, particularly for office.

Our preferred REITs under coverage are:

- **Specialised** - HealthCo Healthcare and Wellness REIT; Waypoint REIT, APN Convenience Retail REIT
- **Retail** - HomeCo Daily Needs REIT (convenience retail)
- **Industrial** - Centuria Industrial REIT (pure play Australian industrial assets)

Recent publications

HomeCo Daily Needs REIT
ADD TP A$1.69
Proposed merger of HDN & AVN

HealthCo REIT
ADD TP A$2.48
Well placed to focus on health

Recent initiations

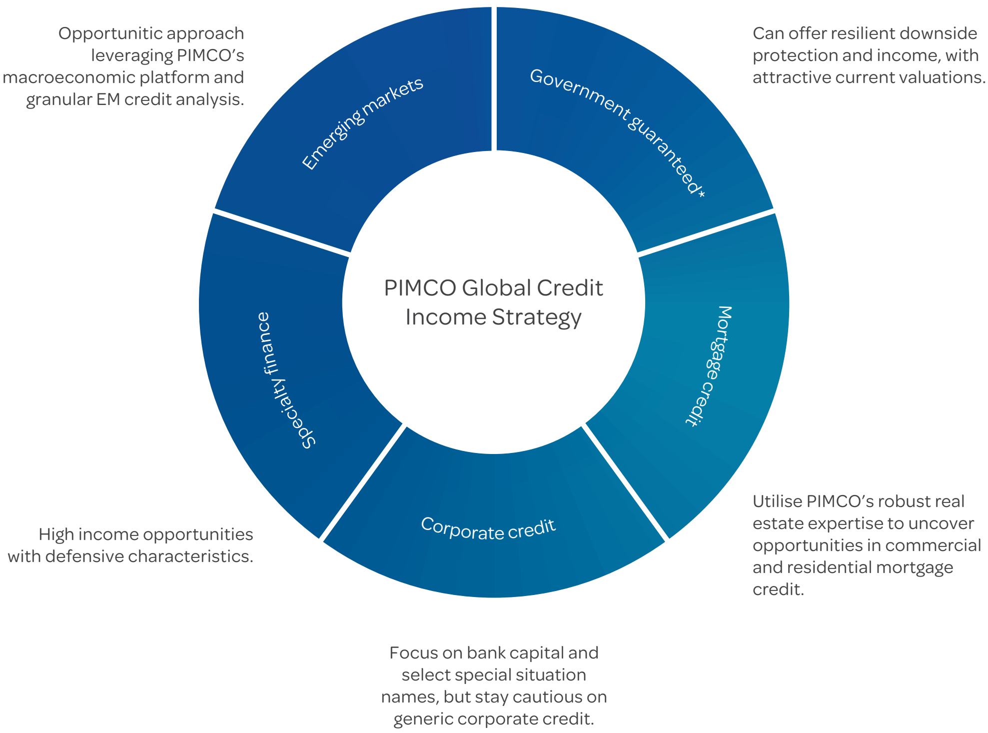
Namoi Cotton – ADD PT A$0.56	NAM was established in 1962. Its business spans fibre, feed, supply chain and marketing, with ginning being at the core.
HealthCo – ADD PT A$2.48	HCW offers investors exposure to healthcare and wellness assets with the portfolio expected to grow via accretive acquisitions and development projects.
Step One Clothing – ADD PT A$3.20	STP is a pure play, direct-to-consumer online business that has brought much-needed innovation to the men's underwear market.
Veem – ADD PT A$1.25	VEE designs and manufactures stabilisation and propulsion technology and provides products and services to the marine, defence and mining industries.

Fixed interest – PIMCO

PIMCO is one of the world's largest fixed income investment managers focusing on active fixed income management of global assets. PIMCO has 25 years of experience managing closed-end funds (such as listed investment trusts) globally. PIMCO manages in excess of US$2.2t for investors from individuals to pension funds and corporations. With over 270 portfolio managers and over 80 credit research analysts PIMCO has a global presence with offices and clients around the world including an office in Sydney. PIMCO has been managing fixed income assets for Australian clients since 1996 and manages A$59bn for Australian investors.

The Global Credit Fund is PIMCO's flagship fund which employs its Global Credit Income Strategy by investing in a diversified portfolio of predominantly investment grade bonds including corporate, mortgage and asset-backed securities. Combining PIMCO's forward-looking macroeconomic outlook and bottom-up global credit research, the fund takes advantage of opportunities in higher-quality corporate bonds while seeking to preserve capital. Over 90% of PIMCO assets are outperforming benchmarks over a five-year period (after fees) including the Global Credit Fund.

PIMCO Global Credit income strategy investment approach



*Securities issued by Freddie Mac (FHMLC) and Fannie Mae (FNMA) provide an implicit US government guarantee. Securities issued by Ginnie Mae (GNMA) provide an explicit US government guarantee. Source: PIMCO

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Regulatory disclosures

NAM: Morgans Corporate Limited was Lead Manager to the Placement and Share Purchase Plan of shares in Namoi Cotton Limited in April 2021 and received fees in that regard. **HCW:** Morgans Corporate Limited was Joint Lead Manager to the Initial Public Offer of shares in HealthCo Healthcare and Wellness REIT in July 2021 and received fees in that regard. **STP:** Morgans Corporate Limited was Lead Manager to the Initial Public Offer of shares in Step One Clothing Limited in October 2021 and received fees in that regard. **VEE:** Morgans Corporate Limited was Lead Manager to the Placement and Sell-down of shares in VEEM Limited in September 2021 and received fees in that regard. **HCW:** Morgans Corporate Limited was Joint Lead Manager to the Initial Public Offer of shares in HealthCo Healthcare and Wellness REIT in July 2021 and received fees in that regard. **AQR:** Morgans Corporate Limited was a Participating Broker to the Placement of shares in APN Convenience Retail REIT in August 2021 and did not receive fees in that regard. **HDN:** Morgans Corporate Limited was Co-Manager to the Entitlement Offer of units in HomeCo Daily Needs REIT in April 2021 and received fees in that regard. **WBC:** Morgans Corporate Limited was Joint Lead Manager to the Public Offer of capital note securities in Westpac in August 2021 and received fees in that regard. **CBA:** Morgans Financial Limited was Joint Lead Manager to the CommBank Perls XIII Capital Notes Offer by Commonwealth Bank of Australia in February 2021 and received fees in that regard. **IPL:** Morgans Corporate Limited was a Participating Broker to the Placement of shares in Incitec Pivot Limited in May 2020 and did not receive fees in that regard. **ART:** Morgans Corporate Limited was Lead Manager to the Placement of shares in Airtasker Limited in May 2021 and received fees in that regard. **BBT:** Morgans Corporate Limited was Joint Lead Manager to the Initial Public Offer of shares in BlueBet Holdings Ltd in June 2021 and received fees in that regard. **CHL:** Morgans Corporate Limited was Lead Manager & Underwriter to the Initial Public Offer of shares in Camplify Holdings Limited in April 2021 and received fees in that regard. **SWP:** Morgans Corporate Limited was Lead Manager and Underwriter to the Placement of shares in Swoop Holdings Limited in October 2021 and received fees in that regard.

Recommendation structure

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For analyst qualifications and experience, refer to our website at morgans.com.au/research-and-markets/our-research-team

Research coverage policy

For an overview on the stock selection process, refer to our website at morgans.com.au/research-and-markets/company-analysis/Research-Coverage-Policy

Research independence statement

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Stocks under coverage

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