StanfordBrown Private Wealth

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# Investment Markets Report

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Chief Investment Officer

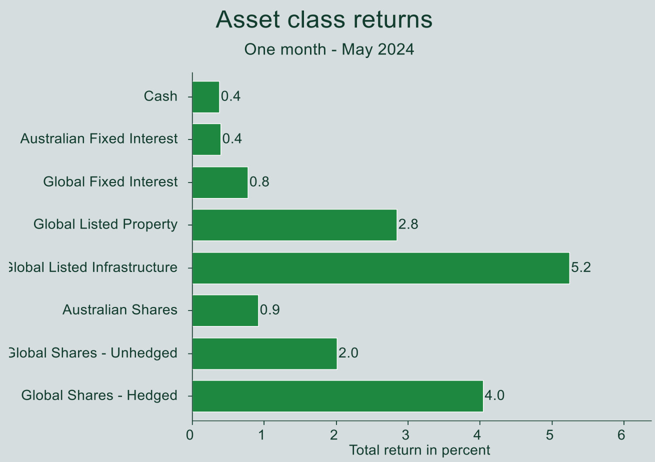
**Our investment office unpacks what happened in the past month, current tactical positioning and what this means for our portfolio weightings to different asset classes.**

# What's changed in May?

Following the weakness in April, financial markets bounced back in May, helped by data that suggested that inflation in the US was resuming its downward trend and that the US economy may be cooling. This saw US bond yields decline as investors became less worried that the US Federal Reserve may need to lift interest rates further. Equities also benefited from solid first quarter earnings reports, including those of heavyweight US technology companies such as Nvidia.

## EXECUTIVE SUMMARY

- In currency-hedged terms, developed market equities (MSCI World ex-Australia) rose 4.0% in May with the US S&P 500 rising 5.0%. Emerging market shares (MSCI Emerging Markets) gained 0.5% and Australian shares (S&P/ASX 200) returned 0.9%.
- 10-year government bond yields fell 19 basis points (bps) in the US, 1bps in Australia and 3bps in the UK. Yields rose 7bps in Germany and 20bps in Japan.
- Investment-grade corporate bond spreads in the US narrowed by 3bps to 88bps over US treasuries while US high yield bond spreads rose by 2bps to 320bps.
- The Australian Dollar rose 1.6 US cent to US$0.6651.
- Oil prices fell 6.6% to US$77.97 per barrel (WTI). Gold rose 1.8% to US$2,348 per troy ounce. Iron ore prices rose 0.9% to US$118.58 per tonne.




Source: LSEG Datastream 6/06/2024

# Tactical Positioning

Economic data released over the past month suggests that the broad downtrend in inflation remains intact in many countries despite some recent road bumps that scared investors in April. US inflation, which tends to get the most focus because of its impact on US treasury bonds was in line with expectations in April while other US data such as consumer spending, employment and job openings were softer. This has provided investors with more comfort in the goldilocks narrative, slowing inflation alongside moderate economic growth, with few signs of a recession.

US CPI motor vehicle insurance

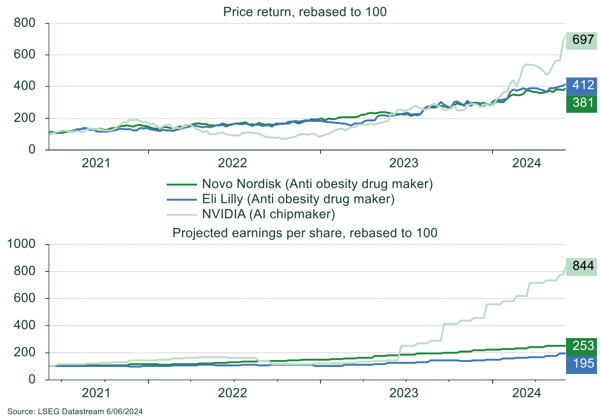

As discussed previously, we continue to expect inflation to moderate slowly with risks of further setbacks likely along the way, back to central bank targets. The April US inflation data shows that some of the recent hot inflation was likely due to catch-up price increases, rather than economic overheating. This is due to lags in the pass-through of higher input costs into consumer prices, particularly for regulated sectors and categories such as rents and car insurance where the cost to consumers only changes annually. This catch-up inflation should slow as input costs have moderated in many sectors.

Notwithstanding elevated geopolitical uncertainty, equity markets are trading near record highs, and there has been a decline in equity market volatility to levels not seen since just before the pandemic. This is due to rising expectations of robust economic growth and interest rate stabilisation. Although expected rate cuts for 2024 have decreased, this has had a relatively limited impact on equities, particularly large-cap companies with strong balance sheets, compared to bonds. The recent earnings season has also been positive, and earnings sentiment has improved.

Markets now seem to be relatively comfortable with the higher-for-longer interest rate outlook and have downplayed risks of further interest rate rises or a hard economic landing.

Reduced economic uncertainty and more confidence in an extension of the economic cycle is generally good for risk assets such as equities. However, a lot of this optimism is already priced in so current equity and credit valuations do not provide much room for any economic setbacks.

Artificial intelligence and anti-obesity drugs

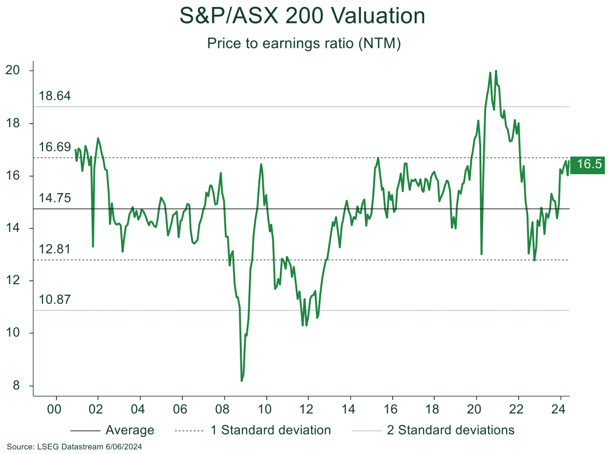



We still have a neutral weighting in equities, although with global equity indices having risen 26% since October, and trading at relatively high valuations, the near-term upside appears somewhat capped. A higher but more stable interest rate environment means income should begin to represent a larger part of returns in many asset classes, with capital value changes a smaller contributor as government bond yields and equity valuation multiples become more range bound.

## **EQUITIES**:

Global equity valuations are somewhat expensive relative to both history and bond yields, but they reflect the view that earnings growth can remain solid, and the cost of capital should decline. There is also a high degree of optimism around the potential of artificial intelligence and anti-obesity drugs to benefit some companies directly and others indirectly through higher labour productivity. High equity valuations in isolation are not usually a reliable guide to short term market performance and we suspect that like interest rates, equity valuations could remain higher for longer.

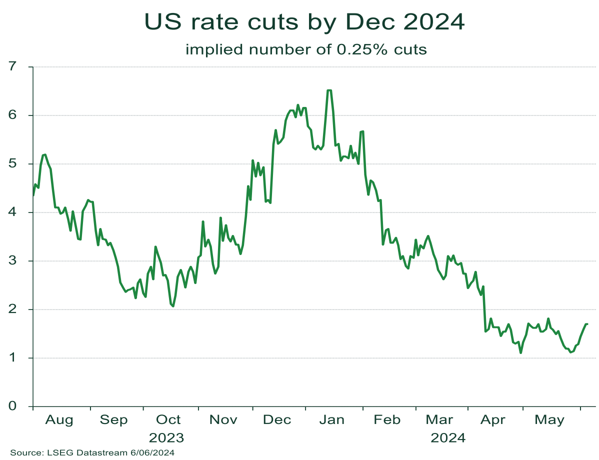
The current market environment is both a challenge and opportunity for active stock pickers. On the one hand, the high weighting of the US large capitalisation technology stocks in major indices has made it challenging to beat the index without overweighting these few companies and further exposing portfolios to single stock risk. On the other hand, the narrow market rally has increased stock picking opportunities in those sectors, styles and regions left behind where relative valuations are now more attractive.




The Australian equity market is also expensive based on relative valuations and softer earnings growth. Recent corporate trading updates were downbeat, particularly for sectors exposed to consumers and housing. Earnings forecasts have been cut for fiscal 2024 but analysts still expect a large acceleration in earnings next year which seems optimistic. Despite the weaker earnings outlook, Australian shares, particularly the top 20 have benefited from foreign investors reallocating money out of China into other Asia-Pacific countries such as Japan, India and Australia.

## FIXED INCOME:

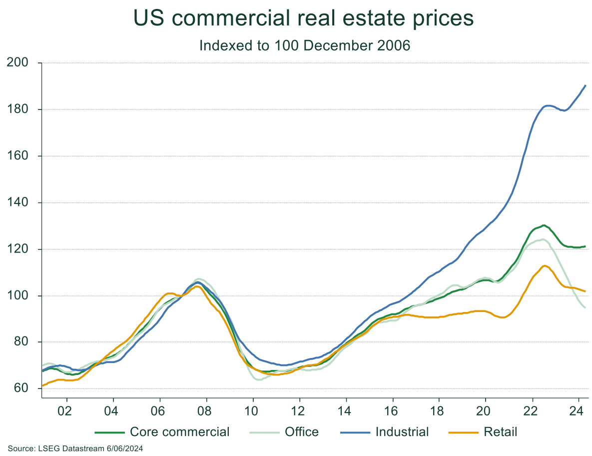
Risks of another material rise in bond yields remains relatively low now that investors have priced in a delayed and shallower policy easing cycle. Concerns over US fiscal deficits and large supply of government bonds could re-emerge at some point again after last year's jitters, but for now investors seem comfortable with the supply/demand dynamics and debt profile in major government bond markets.




We remain comfortable with our neutral weighting to fixed interest with around 5-6 years of interest rate duration. We currently prefer to use a barbell approach to fixed income with a combination of long-duration government bonds, for portfolio protection, combined with lower quality, high yield corporate bonds that provide higher levels of income.

## PROPERTY AND REAL ASSETS:

Over the medium term, the outlook for both infrastructure and property is positive given interest rates have likely peaked and revenues for many sub-sectors continue to grow strongly. We are also becoming more constructive on the outlook for commercial property valuations outside the office sector.

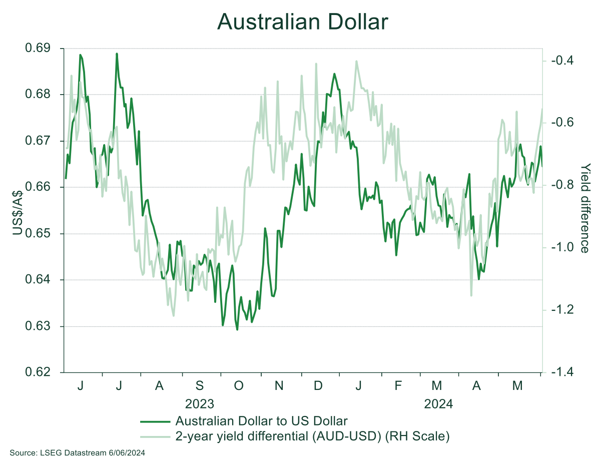



## ALTERNATIVE ASSETS:

Liquid alternative assets returned 0.60% in May (HFRX Global Hedge Fund Index in US$) with long/short equity funds having the largest gains followed by relative value and event-driven funds. Macro/CTA funds were down marginally over the month. We remain neutral in alternative assets.

## CURRENCY:

The Australian Dollar rose US 1.6 cents in May after US data reduced risks of another rate hike and equity markets recovered. Given our rangebound currency outlook and the diversification benefits, we remain currency unhedged.



# Current Balanced portfolio positioning summary

| ASSET CLASS | POSITIONING | VIEW |
|---|---|---|
| Cash | Neutral | Cash rates are most likely at their peak but rate cuts in 2024 look less likely which should see Australian cash rates remain higher for longer. |
| Australian Debt | Neutral | Retain a neutral weighting with interest rate duration close to benchmark of around five years. Longer term yields are more attractive, and risks are evenly balanced given cash rates are at their cyclical peak. Credit is generally expensive, but some sub-sectors offer relative value. |
| Global Debt | Neutral | Hold a neutral weighting with interest duration close to benchmark of around six years. Bond yields are likely to stay range bound in a slightly higher range. Credit spreads are low and are unlikely to tighten much further, but credit can perform well as default rates stay contained. |
| Alternative Defensive | Neutral | Alternative strategies generally benefit from higher base interest rates as cash is used as collateral to secure derivatives and short positions. These strategies have held up relatively well when more traditional defensive strategies, tied to interest rates and the credit outlook, have suffered. |
| Property & Real Assets | Neutral | Property and infrastructure valuations have reset lower due to higher bond yields, but the interest rate headwinds should fade. Listed real estate and infrastructure are more volatile than unlisted assets but the headwinds from declining asset valuations appears to be fading and demand for high quality property and infrastructure assets has increased. |
| Alternative Growth | Neutral | Alternative growth strategies benefit from higher price volatility and dispersion with returns less correlated to broader risk sentiment. Trend-following strategies can often provide insurance-like characteristics by capturing downtrends and uptrends in prices of bonds, equities, commodities, and currencies. |
| Australian Shares | Neutral | The earnings outlook is relatively muted due to soft profit growth for banks and miners. Earnings guidance is being trimmed during the current earnings confession season as we head into year end. Equity valuations are above average relative to history and dividend yields are low relative to cash and bond yields. Remain neutral for now. |
| Global Shares | Neutral | Valuations, economic and corporate fundamentals, and investor sentiment suggests a neutral allocation to equities is still warranted. Investor focus is still largely on economic and corporate earnings growth which remains reasonable and ultimately should drive equities higher. Markets may remain range bound until US rate cuts commence – possibly later this year. |
| Currency hedging | Fully unhedged | The headwinds on the Australian Dollar from interest rate differences between Australia and the US and weak Chinese growth are fading but the currency is likely to remain in the US$0.64-0.68 range where it has been for the past year or so. Prefer to remain currency unhedged in Global Shares as a source of additional portfolio diversification as the Australian Dollar tends to move in line with global investor sentiment. |

## Strategic Asset Allocation (SAA) and Dynamic Asset Allocation (DAA) weights

| PORTFOLIO | CONSERVATIVE | | MODERATE | | BALANCED | | GROWTH | | HIGH GROWTH | |
|---|---|---|---|---|---|---|---|---|---|---|
| ASSET CLASS | SAA | DAA | SAA | DAA | SAA | DAA | SAA | DAA | SAA | DAA |
| Defensive Assets | 70.0 | 70.0 | 50.0 | 50.0 | 35.0 | 35.0 | 20.0 | 20.0 | 5.0 | 5.0 |
| Cash | 15.0 | 15.0 | 10.0 | 10.0 | 5.0 | 5.0 | 2.5 | 2.5 | 2.5 | 2.5 |
| Australian Debt | 20.0 | 20.0 | 10.0 | 10.0 | 5.0 | 5.0 | 0 | 0 | 0 | 0 |
| Global Debt | 30.0 | 30.0 | 25.0 | 25.0 | 20.0 | 20.0 | 15.0 | 15.0 | 0 | 0 |
| Alternative Defensive | 5.0 | 5.0 | 5.0 | 5.0 | 5.0 | 5.0 | 2.5 | 2.5 | 2.5 | 2.5 |
| Growth Assets | 30.0 | 30.0 | 50.0 | 50.0 | 65.0 | 65.0 | 80.0 | 80.0 | 95.0 | 95.0 |
| Property & Real Assets | 5.0 | 5.0 | 7.5 | 7.5 | 10.0 | 10.0 | 7.5 | 7.5 | 7.5 | 7.5 |
| Alternative Growth | 5.0 | 5.0 | 7.5 | 7.5 | 10.0 | 10.0 | 10.0 | 10.0 | 10.0 | 10.0 |
| Australian Shares | 5.0 | 5.0 | 15.0 | 15.0 | 20.0 | 20.0 | 25.0 | 25.0 | 25.0 | 25.0 |
| Global Shares | 15.0 | 15.0 | 20.0 | 20.0 | 25.0 | 25.0 | 37.5 | 37.5 | 52.5 | 52.5 |
| Total | 100.0 | 100.0 | 100.0 | 100.0 | 100.0 | 100.0 | 100.0 | 100.0 | 100.0 | 100.0 |

## Major Financial Markets

| To 31 May 2024 | Latest | 1 month | 3 month | Year-to-date | 1 year | 3 year | 5 year |
|---|---|---|---|---|---|---|---|
| Equities | Local currency returns including dividends in percentage, not annualised | | | | | | |
| Australia - S&P/ ASX 200 | 7702 | 0.9 | 1.2 | 3.2 | 12.9 | 21.8 | 56.2 |
| Japan - Nikkei 225 | 38488 | 0.2 | -1.1 | 15.9 | 26.9 | 57.1 | 43.3 |
| US-S&P 500 | 5278 | 5.0 | 3.9 | 11.3 | 28.2 | 31.5 | 108.3 |
| US - NASDAQ Composite | 16735 | 7.0 | 4.2 | 11.8 | 30.4 | 24.6 | 134.0 |
| UK – FTSE 100 | 8275 | 2.1 | 9.9 | 9.0 | 15.6 | 32.1 | 39.2 |
| Europe – STOXX 600 | 518 | 3.5 | 6.9 | 10.7 | 18.6 | 27.8 | 63.2 |
| Developed Markets – MSCI World | 2709 | 4.1 | 4.3 | 11.1 | 25.9 | 29.4 | 91.2 |
| Emerging Markets – MSCI EM | 64922 | 0.5 | 5.1 | 6.6 | 15.1 | -6.8 | 34.3 |
| Government bond yields | Change in annual yield in percentage points | | | | | | |
| Australia - 2 year | 4.13 | 0.03 | 0.39 | 0.42 | 0.56 | 4.06 | 3.01 |
| Australia -10 year | 4.41 | -0.01 | 0.26 | 0.45 | 0.81 | 2.76 | 2.94 |
| US - 2 year | 4.87 | -0.17 | 0.24 | 0.62 | 0.47 | 4.72 | 2.92 |
| US - 10 year | 4.49 | -0.19 | 0.24 | 0.62 | 0.85 | 2.89 | 2.35 |
| UK - 10 year | 4.32 | -0.03 | 0.20 | 0.78 | 0.14 | 3.53 | 3.44 |
| Germany -10 year | 2.65 | 0.07 | 0.24 | 0.62 | 0.38 | 2.83 | 2.85 |
| Currencies and Commodities | Change in price | | | | | | |
| Australian Dollar (US$) | 0.6651 | 0.016 | 0.014 | -0.017 | 0.018 | -0.109 | -0.028 |
| US Dollar Index | 104.67 | -1.55 | 0.52 | 3.34 | 0.35 | 14.64 | 6.92 |
| Gold (US$/ounce) | 2348.25 | 41.25 | 300.20 | 279.58 | 383.85 | 448.30 | 1052.70 |
| Iron Ore (US$/tonne) | 118.58 | 1.11 | 4.01 | -21.34 | 17.21 | -66.05 | 20.82 |
| Crude oil (WTI, US$/barrel) | 77.97 | -5.52 | -1.25 | 6.08 | 9.88 | 11.65 | 24.47 |

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