Portfolio Perspectives

Insights from the CIO Office – FLASH NOTE
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Key Messages for Investors

- The Trump administration's tariff plans have negatively affected global markets, underscoring the need for investors to focus on their Strategic Asset Allocation (SAA).
- Investors early in their investment journey typically have a greater allocation to Growth assets, which can be more volatile, while investors later in their journey lean toward Defensive assets for stability and income.
- Historical performance, such as during the Global Financial Crisis, shows that Growth assets can recover significantly after downturns.
- Current market volatility lacks evidence of financial distress or systemic issues, indicating that it stems from specific policy choices that could be reversed.
- A well-structured SAA prepares investors for negative return periods, encouraging them to stay the course and trust in a diversified portfolio to achieve long-term financial objectives.

Reviewing First Principles

Over the past few days, the Trump administration's tariff plans have negatively impacted global markets. During these times of stress, stepping back and reviewing first principles is essential. From an investor's standpoint, this means understanding the impact on portfolios.

Now is the time for investors to lean harder into their Strategic Asset Allocation (SAA), which encompasses an implicit financial plan and clear financial objectives. Depending on an investor's circumstances, they are generally either early or late in their investment journey. As a general comment, if they are early, they likely have a greater allocation to Growth assets. In a portfolio, Growth assets typically increase in value faster than Defensive assets as the investor seeks to grow their savings for use when they retire. That faster growth does come with greater risk, as is evident in the markets over the past few days, where anyone with Growth assets would have seen a decline in portfolio values. However, negative return periods are not unusual and, more importantly, are expected. Consider the worst period for Growth assets that most people will remember: the Global Financial Crisis. Using the MSCI World Index as a proxy for global equity markets (a key Growth asset), from its peak in July 2007 to the bottom in March 2009, the index returned about -52%. From July 2007 to today, the same index made back that entire decline and is up 240% from that point in time. If you had managed to pick the bottom (by dollar cost averaging), capital allocated at the market bottom in March 2009 would have increased in value by 603%. The key lesson is to stay invested and keep contributing to your savings through the good and bad times.

If an investor is later in their investment journey, they likely have a greater allocation to Defensive assets. Here, a greater focus on income and capital preservation will dominate their financial objective as they are either nearing retirement or in retirement. The Bloomberg Global Aggregate Index is the best proxy for the global bond market (a key Defensive asset). Since the start of the year, the Bloomberg Global Aggregate Index is up around 1% while the MSCI World is down 11%. Looking back at the Global Financial Crisis, from July 2007 to March 2009, the Bloomberg Global Aggregate index returned 7%. The key lesson is not all assets behave the same way over time and through a crisis. It is how Growth and Defensive assets are blended that matters.

The correct SAA reflects the circumstances and objectives of the investor, so allow the design choices built into the SAA to work for them now. For example, at Lonsec Investment Solutions (LIS), we expect periods of negative returns in our portfolio, where for High-Growth investors, we expect the portfolio to have at least four and up to six negative return years over any 20-year period. Even with these assumptions, we still expected to deliver over 7% a year through the cycle.

The SAA's design choices will either favour investors' Growth or Defensive needs. As such, don't take the seatbelts off just before the crash or get off the train before it leaves for sunny shores. The financial journey investors are taking is well-trodden and understood. Previous work building an investor's financial plan should leave them well-placed to weather this and future storms. Periods of negative returns have come before and will come again. Just trust your well-diversified multi-asset portfolio to deliver against your long-term objectives.

Are we in a crisis?

Despite the sharp declines in Growth assets globally, it is important to remember what is NOT present:

1) There is no material evidence of financial excess in markets

2) There is no material evidence of financial distress in markets

3) There is no systemic issue evident in markets

The current volatility is entirely the result of the policy choices of the Trump administration, meaning that if reversed, the impact on financial markets will likely reverse as well.

LIS's focus is the growing political pressure on President Trump to change his policy stance on tariffs. We believe that any democratically elected official is not immune to political pressure. However, if this will be President Trump's signature policy choice for his administration, the likelihood of a recession is very high. That is ok because, remember, our SAA already accounted for the unaccountable by reflecting bad years in our portfolio construction.

Periods of negative returns are never pleasant in portfolios, but trusting that you are on a journey that anticipated these ups and downs means your financial goals should remain within reach.

Growth Assets	Underweight			N	Overweight		
Australian Equities – Large Cap				⚪			
Australia Equities - Small Caps			⚪				
Developed Market Equities – Large Caps			🟠	⚪			
Developed Market Equities - Small Caps			⚪				
Emerging Market Equities			⚪	🟠			
Global Listed Property					⚪		
Global Listed Infrastructure				⚪			
Growth Alternatives				⚪			
Defensive Assets	**Underweight**			**N**	**Overweight**		
Australian Bonds						⚪	
Global Bonds				⚪			
Diversified Income				⚪			
Defensive Alternatives				⚪			
Cash			⚪	🟠			
Current Position ⚪ New Position 🟠							

Growth Assets

Asset Class	Position	Rationale
Australian Equities – Large Caps	Neutral	Australian equity valuations remain stretched and require a re-rating in bank and resource earnings. Earnings season was volatile and confirmed our view for a lacklustre growth outlook. Market growth expectations, in aggregate have been trending lower over the past year. Inflation is receding, paving the way for Reserve Bank of Australia (RBA) cuts. While Australia does not yet appear to be in Trump's sights for tariffs owing to our trade surplus with the US, second order impacts (particularly in relation to China) cannot be ignored.
Australian Equities – Small Caps	Slight Underweight	The prospect of an all-out trade war continues to complicate the outlook. This should disproportionately impact junior miners who make up a large portion of the Small Caps sector vs Large Caps.
Developed Market Equities – Large Caps	Slight Underweight	President Trump's unwavering commitment to pursue tariffs is a growing economic headwind, especially for the US itself. With valuations already stretched and the US Federal Reserve more circumspect given the potential for higher inflation, we see a scenario where headwinds increase as the year progresses should a global trade war escalate.
Developed Market Equities – Small Caps	Slight Underweight	Valuations remain somewhat attractive however with US companies forming 63% of the small cap index, a weaker growth outlook remains a key headwind for the sector.
Emerging Market Equities	Neutral	Emerging market equities are dominated by China, where a policy shift to support consumption and an economy that has recalibrated to be less dependent on the US since 2018 are supported by compelling valuations.
Global Listed Property	Slight Overweight	Attractive subsector valuations warrant an active approach to this sector. Office sector remaining structurally challenged but rental growth and healthy fundamentals are appearing in other areas of the sector (age care, data management, supply chains).
Global Listed Infrastructure	Neutral	With key policy rates lower than this time last year, a key headwind to the sector is gone. Valuations are attractive versus long term averages.

Defensive Assets

Asset Class	Position	Rationale
Australian Bonds	Overweight	Australian bond yields offer good value and provide safety from overseas volatility. Positive supply/demand dynamics in play with budget deficit likely to be less than government forecasts.
Global Bonds	Neutral	The size of the US fiscal deficit is a headwind given the need for funding, however safe-haven buying provides some support. Japan is still in hiking mode.
Diversified Income	Neutral	Floating rate public credit still offers relatively attractive yields.
Conservative Alternatives	Neutral	Gold acts as a risk-diversifier against a further deterioration in economic conditions or escalation in geopolitical tensions.
Cash	Neutral	Cash is a balancing item.