Portfolio Perspectives

Insights from the CIO Office

November 2024

Key Messages for Investors

Lonsec

- Release of our updated Strategic Asset Allocation (SAA) with a more granular asset class taxonomy
- More dynamic Growth and High Growth risk profiles to improve upside capture
- Directionally, the new SAA broadly aligns with our recent Dynamic Asset Allocation (DAA) positioning
- We remain constructive on the global economy and are putting risk assets to work
- Amongst Growth Assets, we favour Global Equities and Global Listed Property over Australian and Emerging Market Equities
- Amongst Defensive Assets, we favour Australian Bonds over Global Bonds, Diversified Income and Cash
- The best way to deal with the uncertain of the US Presidential and Congressional elections is to have a well diversified portfolio

2024 Strategic Asset Allocation (SAA) Review

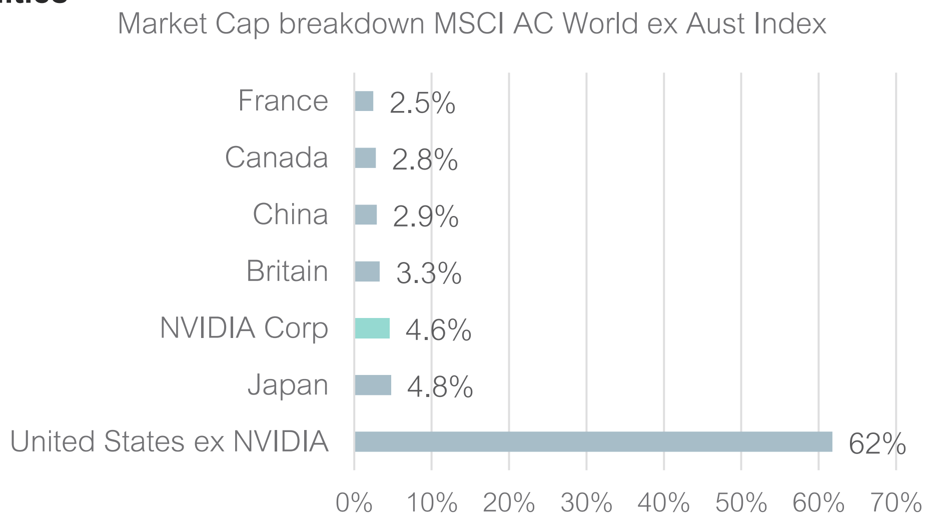
Lonsec

Lonsec has released its 2024 SAA Review

A new asset class taxonomy

- This year Lonsec has introduced a new asset class taxonomy, adopting a more granular approach to asset class selection within the Australian and global equity sectors.
- Explicit allocations have been made to small caps within both Australian and global equities, along with changes to the assigned benchmarks within the Australian and global equity asset classes.
- A more granular asset class taxonomy provides greater flexibility for portfolio construction given the extended starting valuations and increased concentration we are observing in the large cap end of these respective markets.

Rising concentration and higher starting valuations in large cap equities



- The Magnificent Seven (NVIDIA, Apple, Microsoft, Amazon, Meta, Alphabet and Tesla) now account for over 20% of the MSCI AC World ex Aust Index. That weight has more than doubled since the end of 2019 when the same companies accounted for less than 10% of the index.
- NVIDIA is now the world's largest company at 4.5% of the global index. It is now larger than the market cap of all member countries other than Japan and the US.
- High starting valuations in both the Magnificent Seven and domestically, in the financials sector, presents less attractive forward-looking returns in the large cap end of these respective markets.

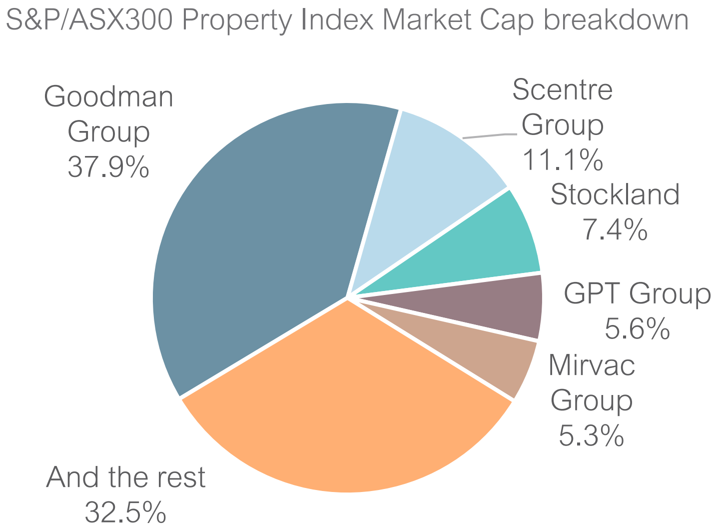
Source: Bloomberg, Lonsec estimates.

2024 Strategic Asset Allocation (SAA) Review

Lonsec

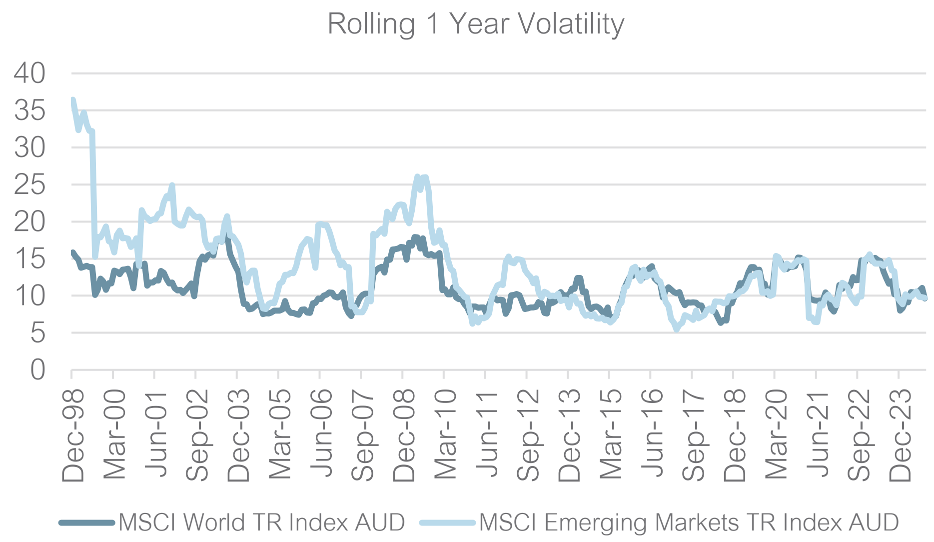
AREITs are out, more upside capture designed into higher risk profiles

Removal of Australian Listed Property (AREITs)



- Australian Listed Property (AREITs) has been removed across all risk profiles. The concentration in the sector has become problematic from a diversification perspective.
- The S&P/ASX 300 A-REIT Total Return Index consists of just 31 securities. Goodman Group, the largest security in the index, now accounts for ~38% of the index, while the top 10 securities account for ~83% of the index.
- With the sector's performance increasingly reliant on the performance of just one security (Goodman Group), Lonsec sees better diversification opportunities in global REITs and broader equity markets.

Adding risk to the Growth and High Growth risk profiles as markets evolve



- At the higher risk profiles (Growth and High Growth) we have reduced the overall exposure to real assets (AREITs) in favour of equities (small caps and emerging markets).
- Structural changes in markets have led to shifts in capital market assumptions and correlations. Emerging markets, for example, have evolved substantially over the last decade having spent years improving their policy frameworks to mitigate external pressures. Emerging market equity indices have become more stable, with risk measures such as volatility and drawdowns now similar to those observed in developed markets.

Source: Bloomberg, Lonsec estimates.

Updated Dynamic Asset Allocation - Growth Tilts

Lonsec

Remain constructive with risk

Balanced Risk Profile Asset Classes	Current Portfolio Weight	New SAA	New DAA Tilt	Change to Current Portfolio
Australian Equities – Large Cap	17.25%	16.00%		-1.25%
Australian Equities – Small Cap	0.00%	2.00%	-0.75%	1.25%
Developed Market Equities – Large Cap	19.00%	15.00%	2.50%	-1.50%
Developed Market Equities Small Cap	0.75%	4.00%		3.25%
Emerging Markets	0.00%	5.00%	-1.50%	3.50%
Global Listed Property	2.75%	2.00%	0.75%	0.00%
Global Listed Infrastructure	6.00%	5.00%		-1.00%
Growth Alternatives	11.00%	11.00%		0.00%

- Supply-side focused stimulus measures in China unlikely to drive economic growth materially and, by extension, reignite China's appetite for Australian natural resources.
- Australian Small Caps have a larger portion of unprofitable miners who should continue to struggle absent strong commodity demand from China.
- With about half of the Australian market expected to report near-zero or negative profit growth in FY25, we expect Australia to continue to underperformed Developed Market (DM) peers.
- Our preference for DM Small Caps has carried forward into our updated SAA but so as not to overextend our conviction we have resized our relative preference between DM Large Caps verse DM Small Caps mindful of where our current positioning is starting from.
- We remove our preference for Europe as earnings and economic conditions have turned decided lower, and the conflict in Ukraine drags on.
- We continue to be Slightly Overweight Global Listed Property as a beneficiary of the current easing cycle and favour the non-Office sector in any allocations.
- The recent rally in Chinese equities has not closed the discount this market trades versus other major markets. Watching for further policy changes and the outcome of the US elections for further direction in both consumer and market sentiment. If estimates are correct, Chinese earnings growth is some of the strongest in the world, yet market participants are not rewarding this bullish outlook.

Source: FactSet, Bloomberg, Lonsec estimates.

Regional divergence

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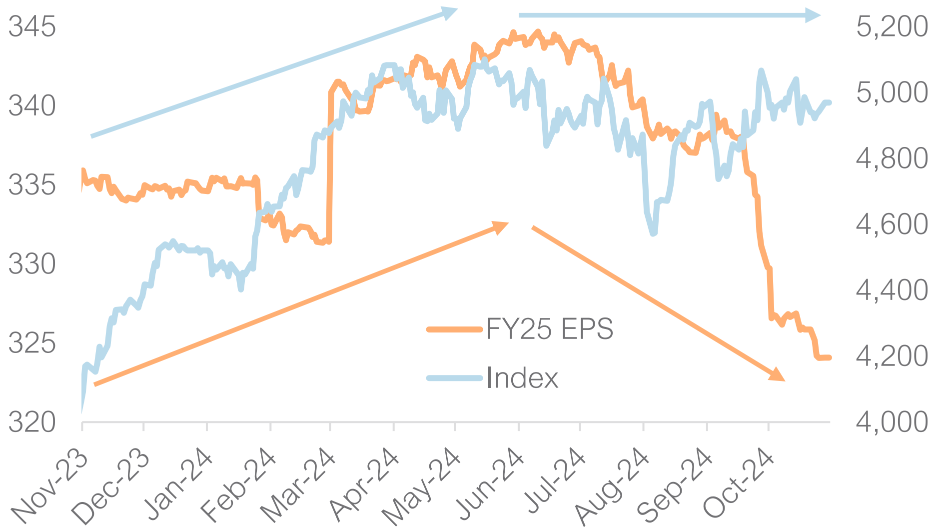
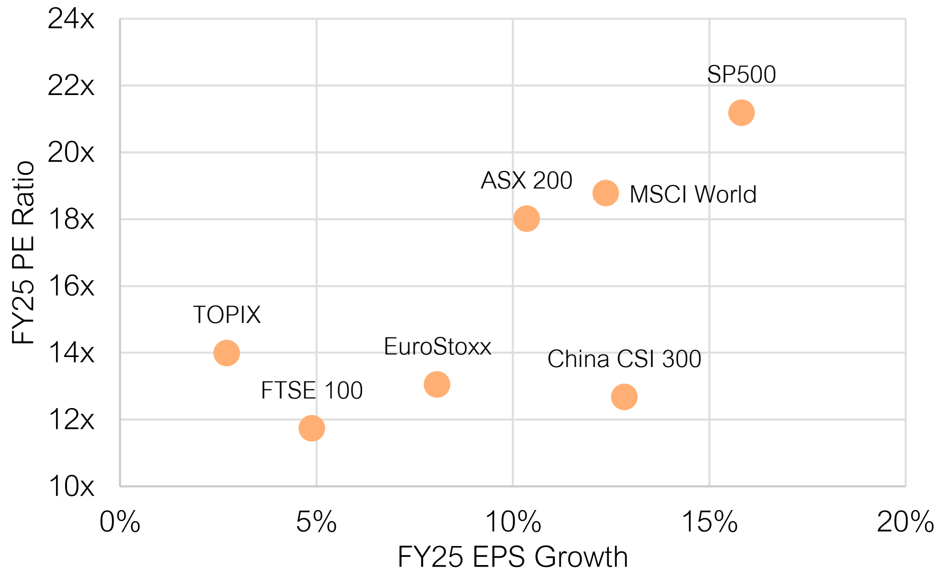
Fundamentals in Europe deteriorating / China still looks cheap

Rapid decline in the Euro Stoxx 50 corporate profit estimates for FY25 is a headwind for the European markets



- Europe's earnings and economic conditions have turned decided lower.
- The conflict in Ukraine drags on hurting sentiment and pressuring energy costs for Europe's industrial core (Germany).

China still looks cheap even after its rally since late September



- Market estimates put China's corporate profit growth in FY25 amongst the highest in the markets we follow.
- Even after the exceptional rally in Chinese equity prices since late September, there is the potential for further appreciation based on its relative position against Developed Market peers.
- We remain cautious on China until there is evidence consumer sentiment turns higher which is the missing piece in China's economic recovery.

Source: FactSet, Bloomberg, Lonsec estimates.

Updated Dynamic Asset Allocation - Defensive Tilts

Lonsec

Don’t forget about Duration

Balanced Risk Profile Asset Classes	Current Portfolio Weight	New SAA	New DAA Tilt	Change to Current Portfolio
Australian Bonds	13.75%	12.00%	1.75%	0.00%
Global Bonds	10.00%	10.00%		0.00%
Diversified Income	7.00%	7.00%	-1.00%	-1.00%
Defensive Alternatives	6.00%	6.00%		0.00%
Cash	3.50%	5.00%	-1.75%	-0.25%

- We continue to favour Australian Bonds, especially at current levels, where they represent attractive levels for building duration.
- The policy direction of the new US President will cause us to review our relative preferences between Global and Australian Bonds.
- Our constructive view on risk and belief that the Reserve Bank of Australia will eventually lower its key policy rate next year sees us shift allocations to other parts of the portfolios resulting in a reduction in Diversified Income and Cash.

Source: FactSet, Bloomberg, Lonsec estimates.

US Presidential and Congressional Elections - November 5

Lonsec

A well-diversified portfolio remains your best position ahead of uncertainty

Early voting at 30 October favours a Trump victory

Election Year	2016	2020	2024
President	Trump	Biden	???
Democrat	42.0%	44.8%	39.1%
Republican	34.5%	30.5%	36.3%
None/Minor	23.5%	24.7%	24.6%
How many early votes counted	23.3M	49.7M	26.1M

- The University of Florida tallies early votes from 25 states where voters can declare their party affiliation.
- Affiliation does not mean the person voted for their declared party as ballots only counted on election day.
- Using the past two elections for guidance, with 36.3% of early votes in 2024 cast by Republican voters, this suggests a Trump victory at this time.

- US Presidential and Congressional elections will be consequential for portfolios, but not necessarily on November 5.
- A dividend government (neither Republications or Democratics hold both the Presidency and Congress) likely leads to policy grid lock and modest economic impacts.
- The market believes a Republication sweep is net positive for the economy as corporate tax cuts would offset the harm from universal tariffs.
- A Democrat sweep also positive for the economy but led by increased household consumption offsetting corporate tax increases.
- Analysis implies either a neutral or upside risk to the economy regardless of the outcome.
- However, the road from political victory to policy implementation is long and winding.
- Our primary recommendation to deal with uncertainty is to have a well-diversified portfolio that aligns with your financial objectives and reflects your risk tolerance.

Source: University of Florida – Election Lab: figures at 30 October 2024, Lonsec estimates.

Outlook and Positioning

The interest rate cycle has turned creating a tailwind for equity markets. Overweight Global Listed Property as there is more to the sector than Office. Australia's profit growth relative to peers is challenged.

Growth Assets		Underweight		Neutral		Overweight	
Australian Equities – Large Cap				●			
Australian Equities – Small Cap			●				
Developed Market (DM) Equities – Large Cap						●	
Developed Market Equities – Small Caps				●			
Emerging Market (EM) Equities			●				
Global Listed Property					●		
Global Listed Infrastructure				●			
Growth Alternatives				●			

Defensive Assets		Underweight		Neutral		Overweight	
Australian Bonds					●		
Global Bonds				●			
Diversified Income			●				
Defensive Alternatives				●			
Cash			●				

We are taking a constructive approach to risk with the overall Growth/Defensive split just above Neutral

Growth Assets

- DM Equities. The distortion caused by the Magnificent 7 in the US has us preferring Europe and Japan given more attractive valuations.
- DM Equities. DM Small Caps typically move ahead of the turn in the economic cycle, and US Small Caps, in particular, have responded positively to the Fed starting its easing cycle. This leads to a Slight Overweight DM Small Caps with a preference for US over ex-US Small Caps.
- EM Equities. Slight Underweight until evidence household spending returns.
- Global Listed Property. Slight overweight as the sector should benefit from the turn in the interest rate cycle. Office is challenged but only represents ~5% of the overall market.

Defensive Assets

- Australian Bond yields are now offering good value and bonds can once again play a defensive role in diversified portfolios. Focus on long-duration assets.
- Global Bonds. Supply/demand imbalances in the US treasury market remain a focus, reducing their relative preference versus Australian government bonds. The end of YCC policy in Japan should lead to an extended period of relative underperformance in Japanese Government Bonds.
- Start to easing cycle reduces the relative attractiveness of floating rate yields.
- Maintain an allocation to gold as a risk-diversifier against a further deterioration in economic conditions or escalation in geopolitical tensions.

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