

31 January 2023

## Market review

Australian equities rallied in January, with the S&P ASX 200 Total Return Index returning 6.2% (in Australian dollar, AUD, terms). The MSCI World Index also increased 3.6% in January (in AUD).

Australian shares, like global equities, were partly buoyed by robust economic data and decreasing recessionary fears. Expectations that China's reopening would boost consumer demand helped the commodity-heavy market of Australia. Meanwhile, Australia's inflation rate increased to 7.8% in the fourth quarter of 2022, the highest level in over three decades. Investors expect the Reserve Bank of Australia (RBA) to continue to increase interest rates. Meanwhile, the AUD hit a five-month high against the US dollar, rising above the psychologically important level of US\$0.70 for the first time since August 2022. Australian 10-year government bonds also advanced in January, with yields declining by close to 50 basis points (bps).

In the US, the 2022 fourth-quarter earnings season started with mixed results, while a large number of companies announced redundancies. Yet, US stocks rose as investors saw silver linings in the news, and the tech-heavy NASDAQ Composite index outperformed the S&P 500 Index. Equities in Germany, France and Switzerland also rose. Lower energy prices and China's sudden U-turn from its strict zero-Covid-19 policy announced in December 2022, gave hope that the Eurozone could avoid a recession. While UK shares also gained, they lagged their regional peers. Chinese equities rallied after the market's lunar new year shutdown. Most emerging markets (EM), including Latin America and Asia, rose notably as well. But Brazil's gain was modest, while India was an outlier, falling over the month.

Global bonds performed well in January, with falling yields and rising prices among both sovereign and corporate issues. Inflation data showed decelerating price rises across major economies. As a result, investors were now expecting smaller rate hikes from major central banks. The Bank of Canada gave cause for optimism after

it raised interest rates by 0.25% in January but signalled it would pause future hikes. US, European and EM bonds had a strong month.

In aggregate, commodities underperformed in January, led by double-digit declines in European natural gas. Oil prices also dropped early in the month. However, energy prices rebounded later in the period. In precious metals, the price of gold rose, while silver fell. Lumber was a standout performer, delivering double-digit gains, supported by tight supplies and prospects of a demand recovery.

## Performance

In January, the Fund returned 2.25% in gross terms and +2.17% net of fees.

The portfolio still maintains an overall defensive stance in its positioning. It also remains slightly underweight across all asset classes in favour of cash while risk assets are tilted toward more defensive styles particularly across equities. In fixed income, the syndicated loan strategy and the recently added exposure to floating-rate notes and subordinated debt enjoyed rallies throughout the month, posting positive returns as more traditional government bonds sold off.

## Activity

In portfolio activity, we added to Asia and EM bond given attractive yields, easing inflation pressure and a slowdown of central bank hawkish stance. We also closed our CNH short position while further increasing the short TWD position, which is still under pressure due to weakening tech goods demand.

## Outlook & strategy

One month into 2023, we continue to face an environment where growth and inflation are moderating, driven by monetary policy tightening, despite pockets of upside surprises. Our view remains that the US will enter a recession sometime in the second half of 2023, and the US Federal Reserve (Fed) will hike policy rates to 5% and potentially higher if needed. Meanwhile, the RBA's more hawkish tone now has

## Investment strategy

The Fund will apply dynamic asset allocation to a diversified portfolio of traditional and alternative assets, without reference to a benchmark. The Fund may shift its investments quickly and significantly, based on valuations and expected returns, and may completely divest from a particular asset class. Fund volatility will be controlled through the use of dynamic asset allocation and effective diversification of assets.

## Investment objective

To achieve a real return equivalent to 5% per annum above inflation (before fees) over a full market cycle (generally 3 to 5 years).

expectations reflecting a peak in the cash rate at around 4%.

We expect the 2023 estimated earnings growth to be downgraded as higher rates lead to demand destruction. Despite this base case view, recent positive developments, including China's reopening, lower energy prices in Europe, and a solid US labour market, have opened the door a little wider to the possibility of a soft-landing.

Later in the year, markets could potentially see central banks pivoting, and signalling rate cuts. Yet, there is uncertainty on the timing of the pivot, as it may take some time before the preconditions are met. However, when central banks pivot, we expect a meaningful recovery as markets will shift focus on the change in monetary regime, better economic and corporate fundamentals.

In summary, we expect two distinct phases of market performance in 2023-24. Across both phases, we expect sovereign bonds to benefit. In the first phase, as growth deteriorates and recession risks increase, markets will re-allocate more to sovereign bonds as a safe-haven play, more so given the attractive levels of interest rates at present. In the second phase, with central banks cutting rates and easing, sovereign bonds will receive an additional monetary policy tailwind.

While we expect central bank driven volatility in developed markets, we see countercyclical opportunities in areas such as China, where the reopening is well underway with data recently reflecting a surge in China-related activity. As this reopening accelerates, we expect upside potential for earnings of Chinese corporates. Elsewhere we also expect China's reopening to support growth in Asia, including Australia, offsetting some of the drag from the slowdown in developed market.

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