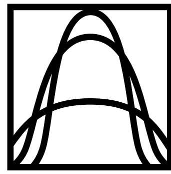


INNOVA
ASSET MANAGEMENT

QUARTER FOUR 2023 | TRADITIONAL
MARKET OUTLOOK REPORT

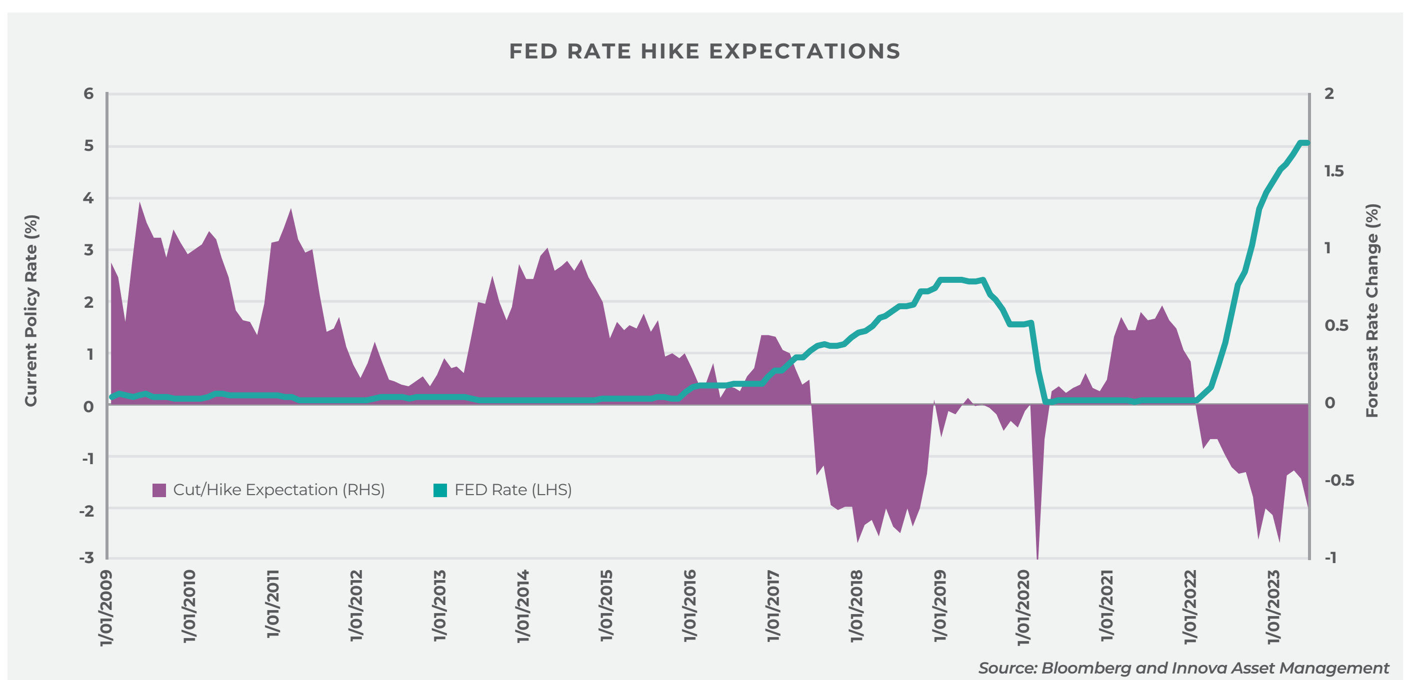
KEY TAKEAWAYS

- In the first half of the CY, markets rallied on strong economic trends. In the September quarter however, markets traded lower. If inflation continued to recede and the US economy remained strong, there would be little impetus for the Fed to cut rates and stimulate the economy.
- This rhetoric started playing out in the September quarter, as rising bond yields have detracted performance of interest rate sensitive sectors and long duration assets such as large cap tech stocks.
- Cautious of US fiscal position, increasing debt levels outside of quantitative easing periods can raise supply more than demand, leading to higher yields.
- Discrepancies between market behaviour and Innova's leading economic indicators raise concerns and call for a cautious approach. This consequently leads to slower economic trends, market volatility and therefore defensive positioning.
- There has been a clear separation between US large cap and the rest of the equity universe valuations. Unlike US large caps, many equity markets globally are trading close to or slightly below fair value.

WHAT'S HAPPENED IN MARKETS

In the recent quarter major market indices such as the MSCI ACWI fell roughly 4% for the month and are down moderately for the quarter. Overall, 2023 has been driven by narratives including strong economic trends, normalising inflation and AI driven sentiment. If GDP and employment remains robust, there would be little impetus for the Fed to cut rates.

Given the market is pricing for rate cuts, in contrary action, rising bond yields meant interest rate sensitive sectors came under pressure. We're cautious of the dynamics behind US budget deficits, which is also causing the US government to push supply to fund their interest expenses and budget deficits. Whilst this is not the sole cause of rising yields, it is a factor that should be monitored closely given they are no longer engaging in QE and letting these bonds roll-off.



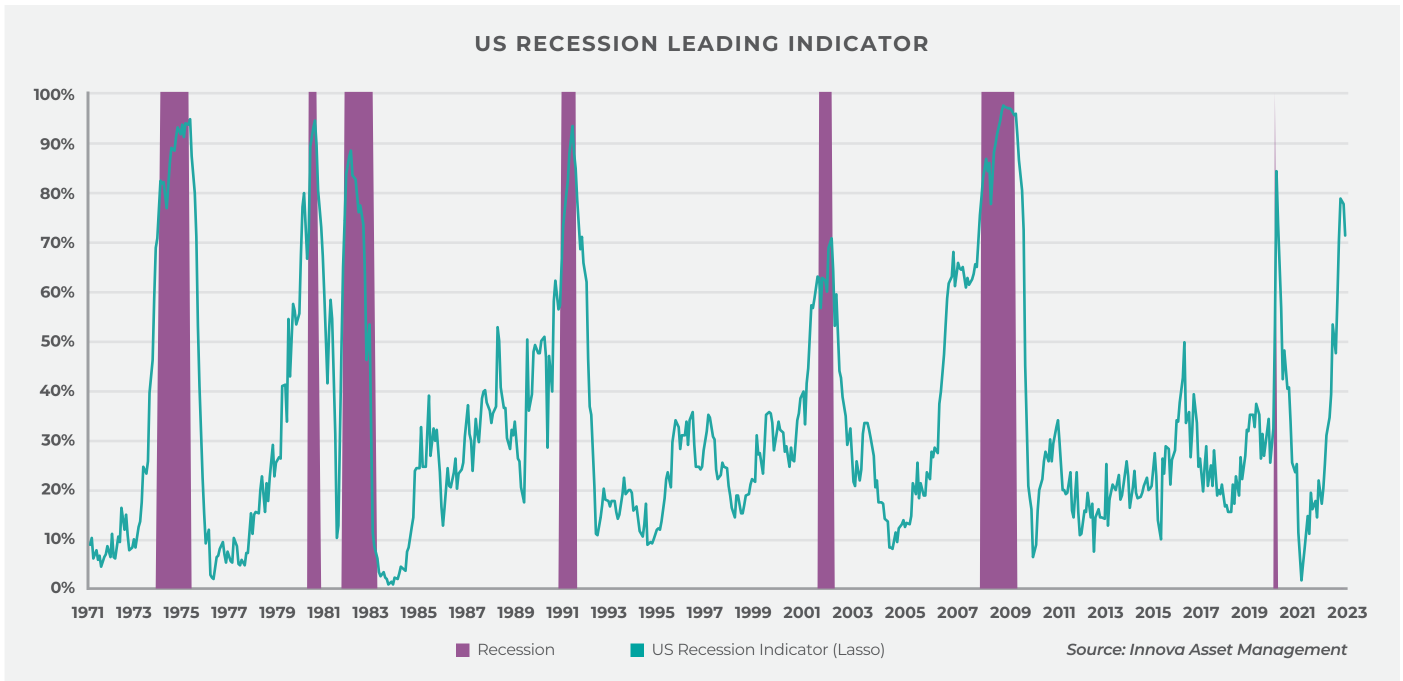
Source: Bloomberg and Innova Asset Management

INNOVA HOUSE VIEW

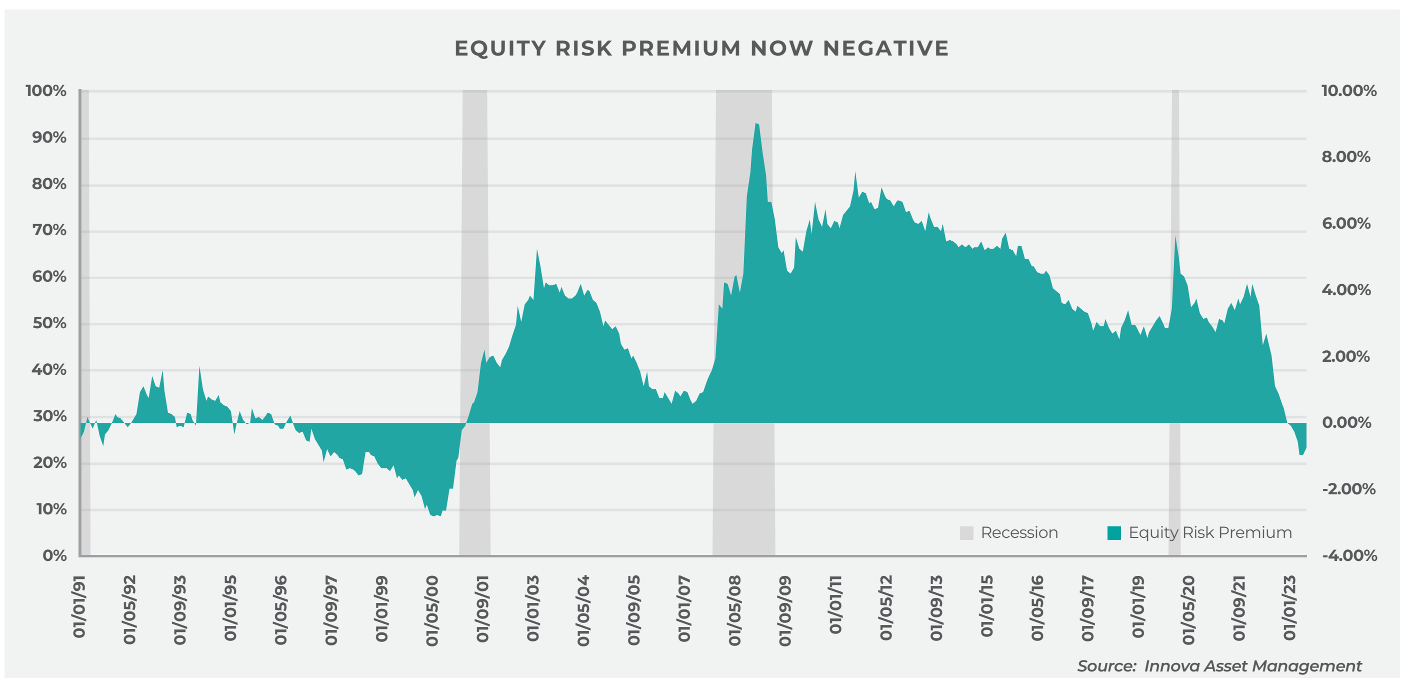
Innova's Leading Economic Indicators (LEI's) continue to suggest that the economic backdrop is less resilient than headline numbers indicate. Whilst these are not a driver of our portfolio positioning, they are a 'sensibility check' for our return and risk forecasts.

In terms of valuations, there is a large dispersion between US large cap and the rest of the equity universe. Many equity markets globally are trading close to or slightly below fair value (e.g., Australia, the UK, emerging markets).

We believe this dispersion in valuations has created an interesting opportunity to allocate to equity markets that should provide some level of downside protection if markets continue to fall, or greater upside participation if equity markets rebound from here.



The Equity Risk Premium measures the difference between the yield on short term government debt and earnings yield on US equities. This has now turned negative, meaning T-Bills (short term debt) have a greater expected return than US equities, if earnings yield is your preferred measure of expected equity returns. Generally, risk premiums predict subsequent 5–7-year returns and show a significant positive relationship between the two.

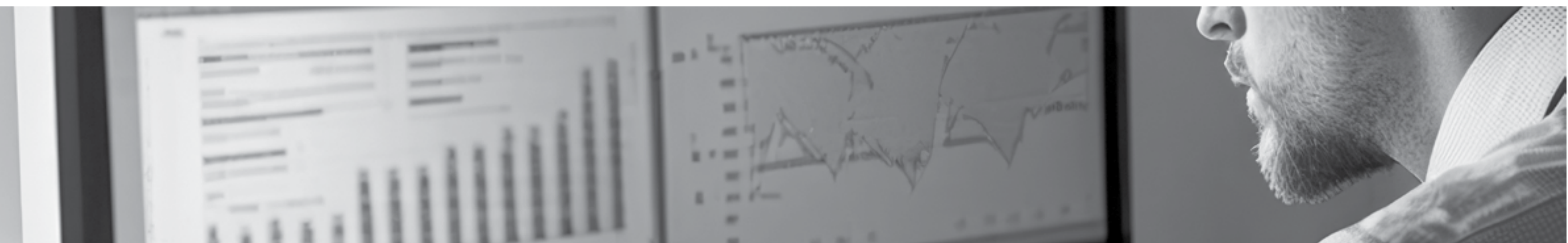


HOW WE'RE POSITIONING OUR PORTFOLIOS

Given our view on equity valuations, we remain underweight US equities based on valuations, particularly growth style equities. However, we maintain a key overweight in value equities and relative value equity positions. These include positions in UK equities, via the FTSE100 ETF, which continues to demonstrate outsized forecast returns from our systematic outputs, as does Emerging Market equities. We remain divested from A-REITs and underweight Infrastructure, as well as underweight Real Assets more generally.

Within fixed income we now have a more balanced position between long duration fixed rate Government bonds and floating rate credit. Our duration positions are diversified across US Treasuries (via USTB), retain some Aus 10y exposure (via VGB) and have added the Western Asset Australian Bond Fund. In the credit space, Domestic 'A' rated floating rate credit still looks attractive on a relative and absolute basis, though is unlikely to act as a positively performing equity-hedge in the event of equity market weakness.

We remain largely unhedged in our global asset positioning. We believe defensiveness is warranted based on our poor outlook for corporate earnings and the global economy, so we retain active positioning across the board. However, as mentioned above in our "House View" these same defensive allocations should provide outsized upside if we are wrong, and new bull market resumes.



RECENT PORTFOLIO CHANGES

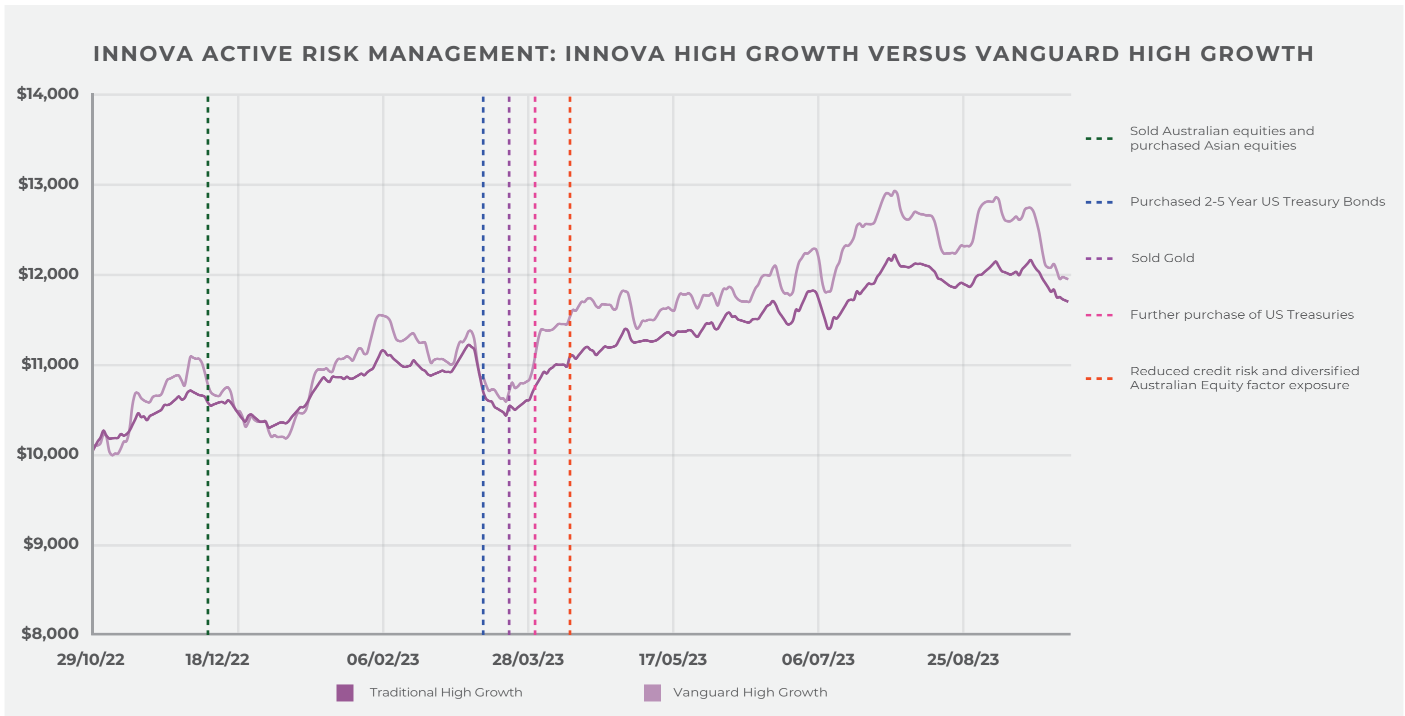
No recent portfolio changes made over the quarter.

PERFORMANCE

PERFORMANCE TO SEPTEMBER 30TH

	1 MTH	3 MTH	6 MTH	1 YR	3YR	5YR	10YR
CONSERVATIVE							
Innova Active Conservative Portfolio	**-1.25%**	**-0.36%**	**0.07%**	**4.88%**	**2.47%**	**2.78%**	**3.53%**
Morningstar Benchmark	-1.29%	-0.54%	-1.00%	3.66%	-0.23%	1.11%	2.39%
MODERATELY CONSERVATIVE							
Innova Active Moderately Conservative Portfolio	**-1.52%**	**-0.34%**	**0.64%**	**6.60%**	**4.42%**	**3.79%**	**4.57%**
Morningstar Benchmark	-1.64%	-0.62%	-0.30%	5.15%	1.64%	2.15%	3.30%
BALANCED							
Innova Active Balanced Portfolio	**-1.93%**	**-0.44%**	**0.92%**	**8.35%**	**6.07%**	**4.62%**	**5.56%**
Morningstar Benchmark	-2.17%	-0.79%	0.43%	7.83%	4.48%	3.57%	4.82%
GROWTH							
Innova Active Growth Portfolio	**-2.21%**	**-0.56%**	**1.41%**	**9.76%**	**7.90%**	**5.40%**	**6.64%**
Morningstar Benchmark	-2.69%	-1.05%	0.87%	9.81%	6.01%	4.34%	5.75%
HIGH GROWTH							
Innova Active High Growth Portfolio	**-2.41%**	**-0.57%**	**1.57%**	**10.71%**	**8.86%**	**5.93%**	**7.56%**
Morningstar Benchmark	-3.21%	-0.95%	2.26%	13.35%	8.35%	5.30%	7.21%

PORTFOLIO CHANGES (PREVIOUS 12 MONTHS)



31/03/2023 US Treasuries (Buy) & Relative Value (Sell)	The bond market has been unstable lately and other investment options are now offering higher returns, making less traditional fixed income options less attractive. As a result, we plan to invest more in US Government bonds and less in other fixed income strategies.
22/03/2023 Cash (Buy) & Gold (Sell)	Gold prices had reached record highs in Australian Dollars and had successfully protected portfolios during periods of equity market volatility, which was its intended purpose. However, at the price it was trading at, we believed the upside potential for gold was limited, and the downside risk significant. Therefore, we decided to sell some of our gold holdings to take profits. We allocated the proceeds to cash as we anticipate continued volatility in equity and bond markets.
13/03/2023 2-5 Year US Treasury Bonds (Buy) & Global Government Bonds (Sell)	Our economic indicators suggested a high likelihood of a global economic slowdown or recession, which was concerning. To hedge our equity market exposure, we found the most attractive option to be 2-5 year US Treasury bonds. These bonds offered an attractive inflation premium, yielding around 5%, and have the potential for significant capital gains in the event of a stock market decline. To fund this investment, we sold Global Government Bonds,, as we believe a more US-centric allocation will offer a better return profile in the future.
08/12/2022 Asian Equities (Buy) & Australian Equities (Sell)	We decided to decrease our investment in Australian Equities because it had performed well, and we expected lower returns in the future. Additionally, we had concerns about the domestic economic landscape in 2023. Instead, we chose to invest the money in Asian equities because our short-term forecasts for this region were among the highest compared to other asset classes. After thorough research and analysis, we also felt comfortable with the risks associated with investing in Asia that we were previously concerned about.

Important Information

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