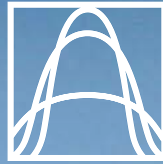

INNOVA
ASSET MANAGEMENT

QUARTER FOUR 2024
CFS FIRSTCHOICE

— MARKET OUTLOOK REPORT

Key Takeaways

- **Australian Market Outlook:** Despite weak economic growth and declining earnings, the Australian market continues to rally, though we believe a defensive stance is prudent given concerns about the RBA's stance and market valuations.
- **Global Positioning:** Globally, maintaining a long-term, valuation-driven strategy has historically outperformed. We favour value and size factors, which are well-positioned for a reflationary regime, particularly in sectors like small-cap and cyclical stocks.
- **Monetary Policy and Economic Conditions:** The U.S. economy shows resilience with stable labour markets, supported by government spending and rate cuts. We expect a soft landing, led by cyclical and small-cap stocks, and a weakening U.S. dollar, benefiting emerging markets.
- **China's Market Surge:** China's stock market rally, driven by government support, depends on further fiscal stimulus to sustain momentum, particularly in addressing the property market downturn.
- **Portfolio Adjustments:** We have adjusted our portfolio to maintain a neutral equity weight, with a mild overweight in fixed income.

What's happened in markets

The third quarter was highly volatile, with Japan's Nikkei index experiencing a sharp decline of roughly 25% from late July to early August. However, it has since rebounded by around 25%, though it is still hovering near its all-time highs. Concerns about Labour market weakness emerged during the August Yen crisis, but part of the increase in unemployment was due to a rise in the labour force from immigration. Underneath the headline data, labour markets continue to show signs of softening, with further downward revisions expected.

Germany's economy has struggled since the start of the Russia-Ukraine war, losing access to the cheap energy that once powered its manufacturing sector. The country's growth has been sluggish, and economic surprises remain negative. While Germany still has a skilled workforce and high living standards, its economic outlook is uncertain, with GDP lagging behind pre-COVID trends. Australia, on the other hand, faces its own challenges. The Reserve Bank of Australia (RBA) is stuck between a weak economy and stubborn inflation, with the share market seemingly defying economic conditions by reaching new highs despite slowing GDP growth and declining corporate earnings.

Innova House view

- The Australian market continues to rally despite declining earnings and weak economic growth, largely due to faith in potential monetary policy loosening. However, Australian banks remain expensive relative to global peers, despite weaker returns.
- Globally, sticking to a long-term, valuation-driven strategy has historically led to outperformance. Innova remains committed to long-term positioning while refining short-term signals to enhance forecasts.
- Factor valuations for quality and growth are stretched, and cheaper factors like value and size are preferred, especially in a reflationary environment where value typically outperforms.
- The U.S. is experiencing a mild slowing in labour markets, but ongoing government spending and rate-cutting cycle suggest a soft landing with cyclical recovery in small-cap and undervalued stocks.
- China's stock market has surged due to supportive government policies, though the rally's sustainability depends on further fiscal stimulus to address the property market and boost consumer spending.

Potential scenarios and positioning:

CYCLICAL REBOUND (PRIMARY OR BASE CASE)	GROWTH SHOCK	INFLATION SHOCK	VALUATION DOWNGRADE
• Rates to remain sticky and higher for longer as economy stays strong • Recent market leaders unlikely to be future market leaders • Pro-cyclical sectors, regions and styles should do well • Currently these are fairly priced, the cyclical rebound hasn't been priced in as a goldilocks scenario • They are inherently less interest-rate sensitive	• GDP unexpectedly turns negative, we see a recession • Underweight equities, hold equities with downside protection • Long Government bonds should do well	• It's not inflation, but unexpected inflation that shocks markets and causes higher volatility • Low probability scenario, but hold assets with little interest rate sensitivity (e.g. FRNs, Value equities) • Alternatives can be invaluable in this environment (trend following and defensive alts)	• Market falls under its own weight • Same positioning as Growth Shock • Underweight equities, hold equities with downside protection • Long Government bonds should do well

How we're positioning our portfolios

SUB ASSET CLASS	12 MONTH RETURN	LONG TERM RETURN FORECAST	CURRENT POSITIONING
Asia Pacific ex Japan Equity	30.1%	5.04%	Overweight
Global Value Equity	29.7%	5.03%	Overweight
Japanese Equity	19.6%	3.68%	Neutral Weight
Global Equity	37.3%	2.08%	Underweight
US equities	36.3%	0.86%	Underweight
Global Quality	28.9%	-0.24%	Underweight
Australian Equity	23.4%	5.92%	Neutral Weight
Global Infrastructure	34.7%	3.85%	Underweight
Australian REITS	46.6%	1.78%	Underweight
Domestic Credit	5.7%	4.65%	Overweight
Domestic Treasury	6.9%	4.19%	Neutral Weight
Global Treasury	10.33%	3.78%	Underweight
Cash	4.35%	4.35%	Underweight

- The portfolio remains neutral on equities, while maintaining a mild overweight to fixed income, balanced between long-duration government bonds and floating rate credit.
- Value equities and relative value positions are key overweights, with a focus on cyclical sectors globally, but defensives in Australia due to concerns about its economy and earnings outlook.

Recent portfolio changes

TRADE	SUMMARY
14/08/2024 Global Quality (Sell) & Global Growth (Buy)	Our fundamental outlook for economic resilience and a stronger rebound in the US market remained unchanged, therefore we wanted to increase our growth equity exposure in these portfolios. This was executed through a manager switch, as our global quality manager had not delivered consistent outperformance relative to the quality factor. The global growth manager we selected provided an opportunity for more consistent outperformance while increasing our overall growth exposure.

Performance

	1 MTH	3 MTH	6 MTH	1 YR
CONSERVATIVE				
Innova Active Conservative Portfolio - FC Wholesale Pension	**0.83%**	**3.40%**	**3.55%**	**9.57%**
Innova Active Conservative Portfolio - FC Wholesale Super	**0.72%**	**3.01%**	**3.14%**	**8.76%**
Morningstar Benchmark	0.76%	2.66%	2.74%	8.99%
MODERATELY CONSERVATIVE				
Innova Active Moderately Conservative Portfolio - FC Wholesale Pension	**1.02%**	**4.00%**	**3.66%**	**11.52%**
Innova Active Moderately Conservative Portfolio - FC Wholesale Super	**0.89%**	**3.55%**	**3.28%**	**10.64%**
Morningstar Benchmark	0.96%	3.54%	3.32%	10.85%
BALANCED				
Innova Active Balanced Portfolio - FC Wholesale Pension	**1.33%**	**4.54%**	**3.75%**	**13.18%**
Innova Active Balanced Portfolio - FC Wholesale Super	**1.17%**	**4.05%**	**3.39%**	**12.24%**
Morningstar Benchmark	1.22%	4.21%	3.70%	13.81%
GROWTH				
Innova Active Growth Portfolio - FC Wholesale Pension	**1.59%**	**5.15%**	**4.10%**	**14.81%**
Innova Active Growth Portfolio - FC Wholesale Super	**1.40%**	**4.60%**	**3.74%**	**13.78%**
Morningstar Benchmark	1.49%	4.75%	4.10%	16.46%
HIGH GROWTH				
Innova Active High Growth Portfolio - FC Wholesale Pension	**1.79%**	**5.58%**	**4.34%**	**15.89%**
Innova Active High Growth Portfolio - FC Wholesale Super	**1.58%**	**5.00%**	**3.98%**	**14.79%**
Morningstar Benchmark	1.76%	5.30%	4.80%	20.56%

Portfolio changes PREVIOUS 12 MONTHS

TRADE	SUMMARY
08/07/2024 Australian Index (buy) & Australian Alpha (sell)	We had observed several cyclical headwinds in relation to the domestic equity market (services inflation remained sticky, real GDP per capita was signalling a recession and forward earnings had declined while prices were still high). For these reasons we preferred quality and defensive exposures domestically. We executed a manager switch to reduce exposure to the discretionary spending sector, though we wanted to maintain a hedge against our base case for domestic equities (underweight cyclicals and overweight defensives) and therefore allocated to the Australian Equity Index to retain exposure to cyclical sectors while bringing down the overall cost of the portfolio.
15/02/2024 Global Equities (Buy) & Cash (Sell)	Based on our leading economic indicators, economic fundamentals had improved, and inflation was trending lower, therefore we decided to increase our allocation to global equities, using a low cost index option to increase our overall global equity market exposure. This was funded from excess cash that had been kept aside for tactical investment opportunities.
16/11/2023 Australian Equities (Buy) & Credit and Cash (Sell)	Australian Equities were looking more attractive with better forecast short- and long-term returns, given their poor performance this year. Our large allocation to domestic floating rate credit had performed extremely well and our model suggested selling this less attractively priced asset to buy the more attractively priced Australian Equities. Simply put, we were selling high (credit) and buying low (Australian Equities). This was to be funded with our overweight to cash, as we were waiting for an opportunity to deploy this into attractively priced growth assets
26/06/2023 Long term fixed rate AUS government Bonds (Buy) & Credit (Sell)	After an extended fixed income sector review, we determined that long term fixed rate Australian Government Bonds had moved to attractive levels and offered an opportunity to hedge equity market risk in the face of tightening economic fundamentals. This was funded through a reduction in Australian floating rate credit. This was because it was unlikely to appreciate in the event of equity market weakness, even though it still appeared attractively priced at the time.

Important Information

This document has been prepared by Innova Asset Management Pty Ltd (Innova), ABN 99 141 597 104, Corporate Authorised Representative of Innova Investment Management, AFSL 509578 for provision to Australian financial services (AFS) licensees and their representatives, and for other persons who are wholesale clients under section 761G of the Corporations Act.

To the extent that this document may contain financial product advice, it is general advice only as it does not take into account the objectives, financial situation or needs of any particular person. Further, any such general advice does not relate to any particular financial product and is not intended to influence any person in making a decision in relation to a particular financial product. No remuneration (including a commission) or other benefit is received by Innova or its associates in relation to any advice in this document apart from that which it would receive without giving such advice. No recommendation, opinion, offer, solicitation or advertisement to buy or sell any financial products or acquire any services of the type referred to or to adopt any particular investment strategy is made in this document to any person.

All investment involves risks, including possible delays in repayments and loss of income and principal invested. Any discussion of risks contained in this document with respect to any type of product or service should not be considered to be a disclosure of all risks or a complete discussion of the risks involved. Past performance information provided in this document is not indicative of future results and the illustrations are not intended to project or predict future investment returns.

Although non-Fund specific information has been prepared from sources believed to be reliable, we offer no guarantees as to its accuracy or completeness. Any performance figures are not promises of future performance and are not guaranteed. Opinions expressed are valid at the date this document was published and may change. All dollars are Australian dollars unless otherwise specified.