INNOVA
ASSET MANAGEMENT

QUARTER TWO 2025
CFS FIRSTCHOICE

— MARKET OUTLOOK REPORT

Key Takeaways

- **A volatile quarter, now overshadowed by April's trade headlines:** Markets were turbulent throughout the quarter, but attention quickly shifted in April following President Trump's dramatic tariff announcements on what he dubbed 'Liberation Day' (2 April), particularly targeting China. The back-and-forth since then has added to global uncertainty.
- **Global markets driven by policy moves:** Investment markets experienced heightened volatility, much of it driven by politics rather than fundamentals. The inauguration of President Trump and the announcement of new tariffs caused sharp sell-offs, especially in US shares. Smaller companies and large technology stocks were hit the hardest, while bonds rallied (as yields fell).
- **Australian equities – a mixed quarter, but outlook improving:** Australian equities ended the quarter in negative territory, dragged down by a sell-off that started mid-February. Valuations, particularly in the banking sector, had become stretched, but earnings upgrades and forecast improvements support Innova's increasingly more constructive view. With potential interest rate cuts from the RBA and moderating inflation, the domestic outlook has brightened. Australia's economy is highly sensitive to changes in mortgage rates, so any rate cuts would provide welcome relief to consumers.
- **Global equities – diverging returns:** The US market (S&P500 and Nasdaq), including the high-profile 'Magnificent Seven' tech stocks, remained volatile. By contrast, European shares surged thanks to large government spending announcements in infrastructure and defence, along with more accommodative policy from the European Central Bank.
- **Our base case: slow growth, not a recession:** We continue to expect a 'soft landing'—a slowing in global growth without a major downturn—unless unexpected policy shocks escalate. Risks of higher inflation and weaker growth remain elevated due to tariffs and geopolitical uncertainty. We remain defensively positioned but ready to take advantage of valuation-led opportunities, recycling capital where appropriate.

What's happened in markets

The first quarter of 2025 saw big shifts across global markets, largely driven by political developments and surprise fiscal policy moves. Europe adjusted its monetary settings, while the US Federal Reserve stayed the course.

President Trump's inauguration and his immediate tariff announcements on Canada, Mexico, and China unsettled markets, sparking fears of a global trade war and a potential US-led recession. While we believed those fears were premature, US equities—especially smaller companies and tech stocks—fell sharply. Meanwhile, European shares rallied on the back of massive government infrastructure spending.

Australian equities initially held up, supported by financials, but followed the US market lower from February. The outlook is improving, particularly with rate cuts now on the table. The RBA is still however navigating a tough inflation environment due to structural housing problems – though it may have to shift its focus if global tensions continue.

Bond markets also saw significant movement. Long duration bonds rose in price (as yields fell), reflecting investor demand for safer assets. However, volatility increased as concerns grew around the US dollar and political uncertainty. The US dollar, which had surged on the back of US inflation concerns, relatively stronger domestic growth, and anticipated weakness in foreign currencies, has since re-rated meaningfully as the economic outlook for international ex-US economies has improved significantly.

In Europe, bonds sold off as investors shifted into shares off the back of a ~1 trillion Euro stimulus, supporting defence spend and infrastructure. Credit markets remained tight, with only modest spread widening, while US employment and wage growth stayed strong.

Innova house view

- **Australian Outlook:** We are becoming more positive on the local share market. While valuations have been elevated, recent market corrections combined with earnings upgrades are creating a more appealing entry point. If the RBA does cut rates, it would be a meaningful tailwind—especially given the high level of floating-rate mortgages in Australia.
- **Global Equity Strategy:** Though we have some exposure to broad market indices, we remain cautious on broad market indices which we believe have not fallen enough to justify re-entry. Instead, we favour targeted exposures based on relative value, steering clear of expensive growth and momentum sectors. Our positions in the RQI Global Value have performed positively. Over time, we hope to rotate into high-quality global companies when valuations are more attractive.
- **Bond and Credit Markets:** Although bonds traditionally act as a safe haven, recent US political risks have driven heightened volatility. While bond yields fell broadly, European yields moved higher due to fiscal stimulus optimism. Credit spreads have widened slightly, but not enough to trigger a significant shift in positioning. We continue to monitor for better entry points or use credit as a funding source when we identify stronger equity opportunities.
- **Macro and Economic View:** The global economy is slowing but not contracting. Soft data (consumer and business surveys) are pointing to a slowdown, though we haven't seen this represented in hard data, such as the unemployment rate yet. The US remains a relative bright spot, with strong jobs and wage data. However, the unpredictability of tariffs and currency movements is complicating business planning. We think the US is better placed than most to handle global shocks—but the equity market may not be fully pricing in some of the risks, such as inflation spikes or a sharper growth slowdown.
- **Portfolio Positioning and Base Case:** We maintain a soft-landing base case: modest growth, not a deep recession. Our portfolios remain neutral on equities overall but are positioned with flexibility. We continue to favour value stocks, long-duration bonds, and selected cyclical US sectors. We are prepared to shift positioning as opportunities emerge, guided by valuation discipline and our risk management framework.

Potential scenarios and positioning:

SOFT LANDING (PRIMARY OR BASE CASE)	GROWTH SHOCK	INFLATION SHOCK	VALUATION DOWNGRADE
• The U.S. labour market is experiencing a mild slowdown, but ongoing government spending and an expected rate-cutting cycle point towards a soft landing. This environment supports a potential cyclical recovery. • The portfolio currently maintains a neutral stance on equities, with diversified exposure across broad market indices (market beta), Asian markets, and global value stocks. • If market volatility creates more attractive opportunities, we will look to selectively increase our equity exposure. This approach allows us to add risk when the potential reward is higher, rather than chasing markets at elevated levels. • Our allocation to Asian markets has remained steady, largely due to ongoing concerns around China. While geopolitical and economic tensions continue to create uncertainty, we also recognise that such periods can present attractive opportunities.	• If the effect on tariff's is a meaningful change in consumer behaviour, with less spending and less activity, GDP could surprise to the downside. • The Federal Reserve is holding fast on any further rate cuts, which may hurt confidence in the U.S. In Australia, the RBA is likely to cut rates in 2025, and with the high percentage of floating rate mortgages here, we should be somewhat insulated in this environment	• Inflationary pressures from tariffs, deportation (tighter labour markets), and a macroeconomic regime based on fiscal dominance justifies holding assets that are resilient to inflationary shocks.	• Overall, the U.S. CAPE ratio sits in the 98th percentile historically, dating back to 1920, indicating stretched valuations. • Meanwhile, developed markets outside the U.S. are trading at historically reasonable valuations relative to the US, presenting potential opportunities. • In this environment, long-term government bonds should perform well.

How we're positioning our portfolios

ASSET CLASS	VIEW	RATIONALE
EQUITIES		
Global Value Equity	Overweight	Value shares (companies trading at relatively low prices) remain attractively priced compared to broader markets. Historically, they've done well during periods of government spending and when the economy grows steadily.
Australian Equity	Neutral Weight	The local outlook has improved as markets begin to expect interest rate cuts. Australia's mining sector could benefit if China increases infrastructure spending to meet its growth targets. We're still cautious in some areas, but company earnings and valuations have improved.
US Mega Caps	Underweight	We're cautious on large US tech companies due to high prices, reliance on overseas earnings, and earnings uncertainty. For example, Nvidia recently faced restrictions on selling chips to China. We're choosing to take investment risk in other areas.
REAL ASSETS		
Global REITs (Property)	Neutral Weight	Could benefit from interest rate cuts and are trading at reasonable valuations compared to asset values. However, volatility is likely to persist due to economic sensitivity.
Global Infrastructure	Underweight	These assets look fairly valued but currently lack a clear short-term catalyst to drive strong performance.
Australian REITS	Underweight	Appear expensive on the surface, mainly due to the influence of one large company, Goodman Group. We see better value in global property markets, where there is more certainty about falling rates.
FIXED-INCOME		
Australian Credit (Floating Rate Notes)	Overweight	These investments continue to provide solid income with relatively low volatility, even though yields have tightened slightly.
Australian Treasury (Government Bonds)	Neutral Weight	We prefer Australian bonds over US bonds. Australia is expected to cut interest rates more than the US, and our positioning sits in the middle of the yield curve for balance.
Global Credit	Underweight	These investments currently offer less return for the level of risk taken, especially when compared to Australian credit.
Global Treasury	Underweight	We favour local bonds instead. International bond markets, especially in the US, are facing more volatility due to political factors and concerns over long-term government spending.
Global High Yield	Underweight	These are offering lower returns for their risk level and are less attractive than domestic credit.
Cash	Underweight	
CURRENCY / COMMODITY		
AUDUSD	Underweight	We're increasing our hedging on global shares due to the Australian dollar being relatively undervalued. While short-term volatility may persist, the currency tends to return to long-term averages over time.

Recent portfolio changes

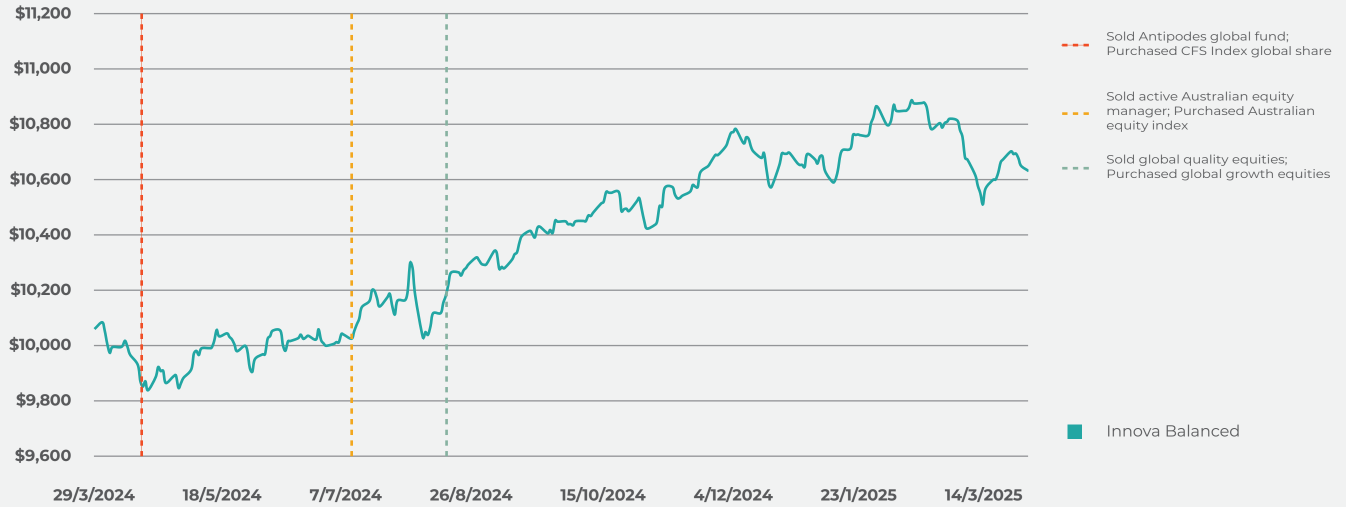
TRADE	SUMMARY
No recent trades have occurred since last quarter on CFS FirstChoice	-

Performance

	1/03/2025	1/01/2025	1/10/2024	1/04/2024
	1 MTH	3 MTH	6 MTH	1 YR
CONSERVATIVE				
Conservative Portfolio - FC Wholesale Pension	-0.68	0.56	1.24	4.83
Conservative Portfolio - FC Wholesale Super	**-0.64**	**0.46**	**1.05**	**4.23**
Morningstar Benchmark	-0.27	1.18	2.06	4.86
MODERATELY CONSERVATIVE				
Moderately Conservative Portfolio - FC Wholesale Pension	**-1.35**	**0.03**	**1.33**	**5.03**
Moderately Conservative Portfolio - FC Wholesale Super	**-1.24**	**0.00**	**1.15**	**4.47**
Morningstar Benchmark	-0.89	0.32	0.92	4.28
BALANCED				
Balanced Portfolio - FC Wholesale Pension	**-1.83**	**-0.39**	**1.39**	**5.19**
Balanced Portfolio - FC Wholesale Super	**-1.66**	**-0.37**	**1.23**	**4.66**
Morningstar Benchmark	-1.70	-0.26	1.11	4.83
GROWTH				
Growth Portfolio - FC Wholesale Pension	**-2.52**	**-1.01**	**1.11**	**5.25**
Growth Portfolio - FC Wholesale Super	**-2.28**	**-0.92**	**1.00**	**4.78**
Morningstar Benchmark	-2.41	-1.09	0.51	4.65
BALANCED				
High Growth Portfolio - FC Wholesale Super	**-2.66**	**-1.24**	**1.01**	**5.02**
High Growth Portfolio - FC Wholesale Pension	**-2.95**	**-1.39**	**1.09**	**5.47**
Morningstar Benchmark	-3.27	-1.84	0.87	5.70

Portfolio changes PREVIOUS 12 MONTHS

INNOVA DYNAMIC ASSET ALLOCATION: INNOVA BALANCED (PAST 12 MONTHS)



TRADE	SUMMARY
15/08/2024 Global Quality (Sell) & Global Growth (Buy)	Our fundamental outlook for economic resilience and a stronger rebound in the U.S. market remains unchanged, prompting us to increase growth equity exposure in these portfolios. We implemented this adjustment 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 offers an opportunity for more consistent outperformance while increasing our overall growth exposure.
08/07/2024 Australian Index (Buy) & Australian Alpha (Sell)	We observed several cyclical headwinds in the domestic equity market, including persistent services inflation, recessionary signals from real GDP per capita, and declining forward earnings despite high prices. For these reasons, we preferred quality and defensive exposures domestically. To implement this strategy, we executed a manager switch to reduce exposure to the discretionary spending sector. However, to maintain a hedge against our base case for domestic equities (underweight in cyclicals and overweight in defensives), we allocated to the Australian Equity Index. This approach allowed us to retain cyclical sector exposure while reducing the portfolio's overall cost.
16/04/2024 Manager Switch (Global Equities)	A recent analysis of the Antipodes Global fund has found that the downside protection the fund offers is predominately due to reduced market exposure, rather than stock selection skill – something we can achieve through our own asset allocation. In addition, we did not get the alpha upside required to justify the management fee of the fund as performance was largely driven by market exposure and the Value factor – both things we can access elsewhere at a lower cost. The CFS Index Global Share is one we have allocated to in the past and offers full market exposure. The allocation to CFS Index Global Share will more effectively capture the equity risk premium whilst also lowering overall fees paid by clients.