



INNOVA
ASSET MANAGEMENT

QUARTER THREE 2025
CFS FIRSTCHOICE

— MARKET OUTLOOK REPORT

Key Takeaways

- Geopolitical flashpoints and trade tensions caused a heightened sense of volatility in US equities. Markets are still making sense of many variables including trade, AI domination, Israel-Iran conflict, and the President's "Big Beautiful Bill". Although the volatility caused a significant drawdown, risk sentiment was strong enough to produce a strong rally subsequently.
- Australian economy remains resilient as the RBA voted to pause in its latest Monetary Policy meeting. The unemployment rate remains historically low, and the AUD has strengthened in recent times, reflecting the confidence in Australian GDP forecasts, labour markets and government fiscal support.
- Given the rich valuations of US mega cap equities, our portfolios favour assets more resilient in this environment—short-duration equities, hard assets supported by nominal growth, quality small caps, global cyclicals, and S&P 500 Equal-Weighted exposure (mid-caps such as industrials/financials). We remain underweight USD-denominated assets, which remain highly sensitive to fiscal volatility.
- We still expect a 'soft landing': Our main scenario is for the global economy to slow down but not fall into recession. We're keeping investments diversified, with a tilt toward areas that look better value and can handle volatility.
- Focusing on value and balance: We're investing more in the UK, and emerging markets, plus smaller quality companies. We're keeping less in the expensive US tech giants, staying cautious on Australian banks, and avoiding property sectors that are too sensitive to interest rates.

What's happened in markets

This quarter was all about politics and global events. In April, new US tariffs on Chinese goods caused a quick sell-off in some of the world's most expensive shares — especially big US technology companies. Other markets, like the UK and Korea, were more stable and even saw gains.

By late June, the US and China reached a partial trade deal: steep tariffs stayed in place, but the US kept access to key Chinese materials. At the same time, President Trump's "Big Beautiful Bill" promised more tax cuts for households and businesses, which means more spending but also more national debt.

In mid-June, the outbreak of conflict between Israel and Iran sent oil prices up more than 20% in two weeks. This normally pushes investors into safer assets like the US dollar, but this time those assets didn't rally — a sign that investors are more worried about US debt than usual.

Here in Australia, the economy held up well despite global uncertainty. Low unemployment, steady wage growth, and strong commodity demand helped. The RBA paused rate cuts in June, wanting to be sure inflation is still coming down, but the outlook remains positive for further cuts. The strength in the Australian dollar reflects the fact the economy has held up well despite global uncertainty.

Bond markets were mixed: Australian bonds and credit performed well, while US bonds were choppy. The Australian dollar strengthened from last year's lows, helped by improved sentiment outside the US.

Innova house view

- **Australia:** Share prices here are starting to look more attractive after recent pullbacks. If the RBA cuts rates, it will be a big help to households and spending. Australian equities present an opportunity outside the large cap space where valuations are being dominated by the banks.
- **Global shares:** We're avoiding broad investments in expensive markets like the US big tech sector and focusing on specific regions and companies that offer better value and growth potential. We do believe that there is an argument for "American exceptionalism" where tariff policies empower American consumers and businesses by encouraging onshoring of manufacturing and production. Therefore, we want to be exposed to American stocks that would benefit from this regime.
- **Bonds and Credit:** We prefer Australian bonds and floating-rate credit over US government bonds, which are facing more uncertainty.
- **Big Picture:** Governments, especially in the US, are spending heavily — and that's now the main force shaping economies and markets. We're building portfolios that can adapt, stay diversified, and make the most of opportunities as they appear.

Potential scenarios

SOFT LANDING (BASE CASE)	SLOWER GROWTH	HIGHER INFLATION
- The world economy slows but avoids a major downturn. - Inflation continues to ease, though it won't go back to the very low levels we saw before COVID. - Our portfolios stay balanced, with investments in undervalued global markets and quality smaller companies.	If tariffs, higher borrowing costs, or political tensions cause people and businesses to cut back on spending, we'd expect safer investments like government bonds and more defensive shares to do better.	If government spending, higher oil prices, or tariffs keep prices elevated, we want to own assets that can handle that — like value shares, hard assets (e.g., silver), and investments that don't.

Portfolio positioning

ASSET CLASS	VIEW	CHANGE	RATIONALE
EQUITIES			
Emerging Market Equity	Overweight	-	We see potential in markets like India, Korea, and Brazil. These regions could benefit from a weaker US dollar, support from China's stimulus measures, and solid company-specific opportunities.
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 hence higher nominal growth.
Australian Equity	Neutral Weight	-	The local outlook has improved following interest rate cuts. Australia's mining sector could benefit if China increases infrastructure spending to meet its growth targets. We're still cautious about CBA's high valuations.
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 with less fiscal uncertainty.
Global Credit	Underweight	-	Spreads are tight in US and domestically we see the best opportunities.
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. Our US exposure is AUD hedged.
Global High Yield	Underweight	-	Still very tight spreads, though selectively there is opportunities within the space.
Cash	Underweight	-	
CURRENCY / COMMODITY			
AUDUSD	Neutral Weight	>	We've increased our hedging on global shares due to the US dollar being overvalued and facing fiscal volatility headwinds. While short-term volatility may persist, the currency tends to return to long-term averages over time.

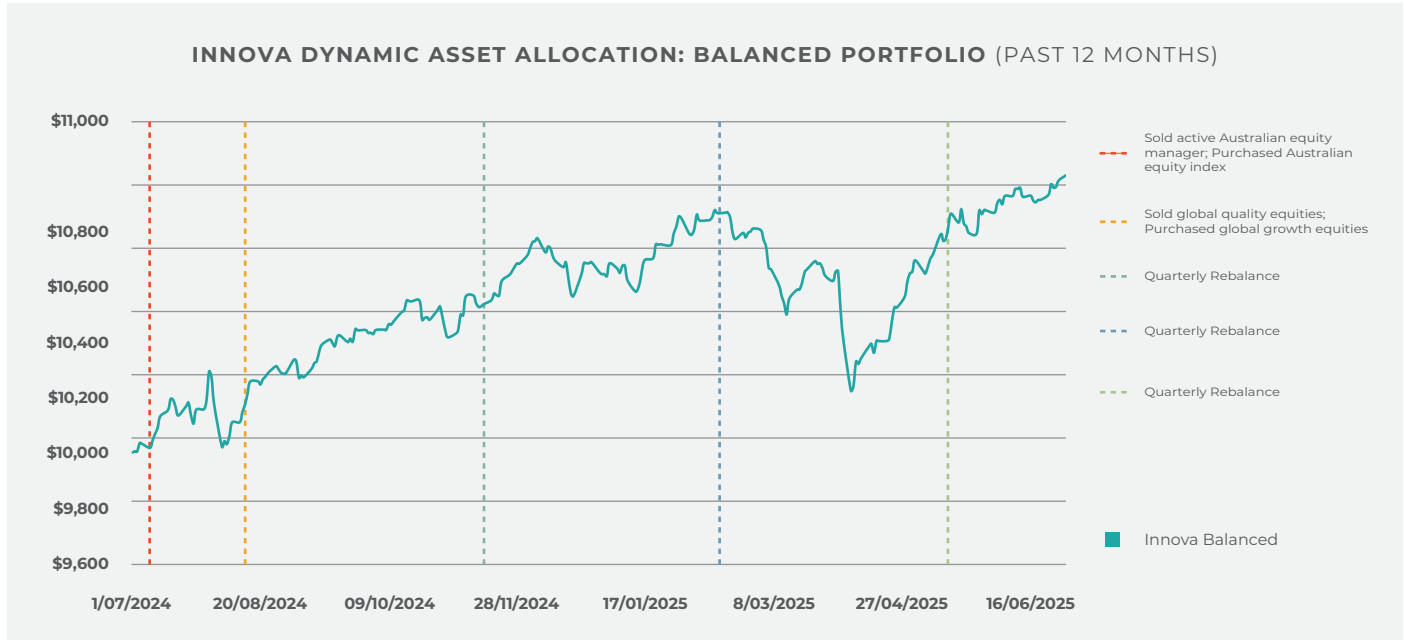
- We remain a more neutral weight to equities in general, with major underweights to the US mega caps and Australian banks. Within fixed income we now have a more balanced position between long duration fixed rate Government bonds and floating rate credit and are still investigating whether we should increase this duration position and reduce credit further.
- Value equities and relative value equity positions remain a key overweight. Globally, we are allocated to more cyclical sectors which should benefit from strong US nominal growth and soft cyclical global recovery. Domestically, we are still not overly optimistic about the economic outlook, though recent rate cuts have improved real disposable income and marginal retail and borrowing activity.

Performance

	1 MTH	3 MTH	6 MTH	1 YR
CONSERVATIVE				
Innova Active Conservative Portfolio - FirstChoice Wholesale Pension	0.58	2.23	2.80	7.01
Innova Active Conservative Portfolio - FirstChoice Wholesale Super	0.53	1.98	2.45	6.15
Australia Fund Multisector Conservative	0.75	2.33	3.32	6.99
MODERATELY CONSERVATIVE				
Innova Active Moderately Conservative Portfolio - FirstChoice Wholesale Pen	0.76	2.83	2.86	8.36
Innova Active Moderately Conservative Portfolio - FirstChoice Wholesale Sup	0.68	2.53	2.53	7.39
Australia Fund Multisector Moderate	1.04	3.06	3.40	7.71
BALANCED				
Innova Active Balanced Portfolio - FirstChoice Wholesale Pension	0.95	3.36	2.96	9.55
Innova Active Balanced Portfolio - FirstChoice Wholesale Super	0.85	3.00	2.62	8.49
Australia Fund Multisector Balanced	1.30	4.22	3.93	9.77
GROWTH				
Innova Active Growth Portfolio - FirstChoice Wholesale Pension	1.09	3.76	2.71	10.31
Innova Active Growth Portfolio - FirstChoice Wholesale Super	0.97	3.35	2.40	9.20
Australia Fund Multisector Growth	1.51	5.36	4.24	10.98
BALANCED				
Innova Active High Growth Portfolio - FirstChoice Wholesale Super	1.09	3.73	2.44	10.02
Innova Active High Growth Portfolio - FirstChoice Wholesale Pension	1.22	4.18	2.74	11.19
Australia Fund Multisector Aggressive	1.87	6.67	4.72	13.31

Portfolio changes PREVIOUS 12 MONTHS

The portfolio has deliberately focused on only the most compelling opportunities in markets, avoiding unnecessary trading. At present, it remains underweight growth, which provides significant scope to increase trading activity when attractive opportunities arise. As return expectations become more favourable, we will look to progressively increase the growth exposure over time.



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.
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.

Important Information

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