INNOVA ASSET MANAGEMENT

QUARTER THREE 2025

RISK DEFINED

— 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 choppier. 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			
Korean Equity	Overweight		We remain positive on Korean shares due the golden combination of cheap valuations and the strongest relative momentum. Policy reform should significantly improve shareholder outcomes and corporate governance. Also benefits from AI tailwinds via large memory chip exposure - heavily involved in the global AI supply chain.
UK Equity	Overweight	-	UK shares are attractively priced and exhibit defensive qualities. Strong balance sheets and an increase in buy backs, as well as low foreign flows. 75% of earnings come from overseas, and the UK's improving political stability is also a positive sign.
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.
Quality Small cap Equity	Overweight	-	Smaller companies with strong pricing power tend to perform well when interest rates are slightly higher, and the economy avoids recession. We favour quality businesses in this space as central banks begin to reduce rates.
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.
Japanese Equity	Neutral Weight	-	After a strong run, Japanese shares have corrected closer to their long-term average prices. We are watching this region for selective opportunities and have a meaningful exposure via international value.
European Equity	Neutral Weight	-	Optimism has returned to Europe, partly due to government spending, including in areas like German defence. ECB rate cuts have also been consistent, supporting cyclical sector that were undervalued. Valuations are not cheap however.
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.
Gold	Neutral Weight	-	We have divested from Gold Miners and into Silver which is trading much cheaper than gold and the gold/silver ratio is at percentile levels which have historically predicted relative outperformance for silver.

- 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.
- VLUE, QSML, UK equities, via the FTSE100 ETF, and QUS continue to demonstrate outsized forecast returns and superior earnings yields based on our systematic outputs.
- Major changes in the quarter have been increasing out hedging ratio within global equities and REITs to take advantage of the record high USD valuations and headwinds that it may face during a turbulent political regime. Our hedging ratio is closer to 50/50 now, a level we are more comfortable as USD valuations were stretched.
- We also shifted our Gold Miners position to Silver, taking profits from the excellent run and utilising silver as a gold bullion proxy at much cheaper valuations. We did extensive empirical analysis on the Gold/Silver ratio, finding that at current levels, there tends to be meaningful mean reversion at these levels which lead to significant excess returns for silver (primarily driven by declines in gold and not surges in silver)

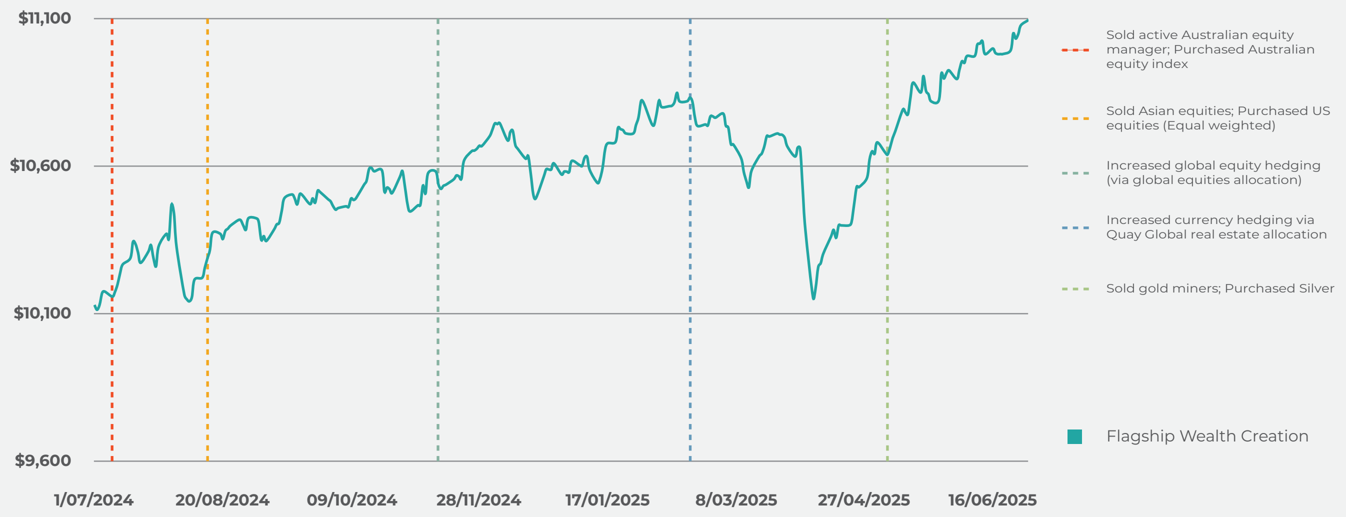
Recent portfolio changes

TRADE	SUMMARY
06/05/2025 Precious Metals (Switch) & Global Equities (Buy)	The gold-to-silver ratio has recently reached historically high levels, an indication that silver may be undervalued relative to gold. In past cycles, this has often led to stronger silver performance as the gap between the two narrows. This time, silver has lagged during gold's rally, which is unusual and suggests there may be room for it to catch up. Historical data also shows that when this ratio is at current extremes, gold returns often turn negative, while silver tends to hold up better and offer stronger upside potential. Given these signals, exposure to gold miners has been trimmed and switched into physical silver via the ETPMAG ETF. Silver remains supported by similar macro themes as gold—particularly its role as a store of value in uncertain environments—while offering more attractive return potential from its current levels. A small portion of the proceeds has also been reallocated to global equities to maintain portfolio balance after the gold miners position had grown materially in size.

Performance

	1 MTH	3 MTH	6 MTH	1 YR	3YR	5YR
CONSERVATIVE/LOW RISK BUCKET						
Hub24 Flagship - Preservation	**1.13**	**2.92**	**4.09**	**7.48**	**5.82**	**4.17**
HUB24 Fundamental Preservation	**1.22**	**3.35**	**4.87**	**8.57**	**6.31**	**4.07**
Target Cash Rate +1.5%	0.44	1.39	2.84	5.95	5.50	3.95
BALANCED/MEDIUM RISK BUCKET						
Hub24 Flagship - Wealth Creation	**1.57**	**4.52**	**4.98**	**9.33**	**8.61**	**7.94**
HUB24 Fundamental Wealth Creation	**1.59**	**5.03**	**6.15**	**11.35**	**9.62**	**7.62**
Target Cash Rate +3%	0.57	1.76	3.59	7.51	7.06	5.48
Hub24 Flagship - Aspiration	**1.85**	**5.27**	**5.49**	**10.61**	**9.66**	**9.58**
HUB24 Fundamental Aspiration	**1.94**	**6.05**	**6.99**	**13.24**	**11.29**	**9.51**
Target Cash Rate +5%	0.72	2.25	4.59	9.60	9.14	7.53

Portfolio changes PREVIOUS 12 MONTHS



TRADE	SUMMARY
18/02/2025 Increasing Currency Hedging	The USD has rallied strongly and now appears overvalued. While overvalued currencies can stay elevated, further downside risk to the AUD seems limited. Accordingly, we've reduced unhedged exposure, bringing portfolios to a more balanced AUD/USD split. Near-term headwinds for the AUD include U.S. tariffs, weaker Chinese growth, lower local interest rates, and soft GDP — but much of this is likely priced in, with the AUD now near GFC and COVID lows. Over time, a reversion toward its long-term average is more likely than further decline. By switching to a hedged strategy, portfolios can benefit from any AUD strength and avoid underperformance from unhedged positions.
12/11/2024 Increase Global Equity Hedging	The USD has been in a strong uptrend and is now trading at an overvalued level. Although overvalued assets can remain so for extended periods of time, the potential downside for the AUD appears limited, reducing the need for large unhedged positions in portfolios. Following this trade, portfolios will still be mostly unhedged but will begin the transition to balancing hedged/unhedged position. In terms of monetary policy, the Federal Reserve is continuing its rate-cutting cycle, while the RBA remains hawkish. Australia's trimmed mean measure of inflation remains above its band, supported by a strong labour market, population growth, and fiscal expansion—factors fuelling inflationary pressures. Therefore, the RBA may not have as much room to cut. A lower interest rate differential, which could favour the AUD, may even lend some support to the currency. To execute this trade, we will be using the global equites portion of the portfolios to upweight our hedging.
15/08/2024 Asian Equities (Sell) & US Equities (Buy)	We previously maintained a significant underweight position in US equities and an overweight position in Asia. However, given our base case of economic resilience and anticipation of a rebound in the US market, it was prudent to increase our allocation to US equities. We achieved this by investing in the equal-weighted index, thereby avoiding additional exposure to the costly US mega-cap stocks. This reallocation was funded by reducing our overweight position in Asia. Investing in the equal-weighted index allowed us to capitalise on the decline in US equity prices and the increased valuation gap relative to the mega caps.
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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