Ausbil Balanced Fund

Quarterly Investment Report

December 2023

Ausbil Investment
Management Limited
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Strength. Wisdom. Agility.

CELEBRATING 25 YEARS IN FUNDS MANAGEMENT

Economic Review

Economic Review

The month of December saw further acceleration in the 'risk-on' sentiment for global investors as financial conditions loosened. The euphoria was driven by the combination of factors, including the US Federal Reserve (Fed) pivoting to commence an easing cycle from 2024 onwards; and a US soft landing that is increasingly coming into full view, despite this outlook being much maligned by consensus throughout the year. The shift was driven by the slowing momentum in core inflation measures (based on a six-month annualised pace). We have core consumer price inflation running at 2.9% and the Fed's preferred core PCE (personal consumption expenditure) at 1.9% in November. As Chair Powell pointed out, "the real rate is now falling and that is part of the process of moving from a restrictive policy."

The Fed's updated 3-year horizon forecasts have the GDP growth rate back at trend, the unemployment rate holding onto 50-year lows, and inflation measures around target levels. Forecasts include 75 basis points (bps) in rate cuts for 2024, 100bps for 2025 and a further 75bps for 2026 – overall, 250bps in total. Surprisingly, the market's expectations have galloped several lengths ahead, both in the timing and in the magnitude of expected rate cuts. In response, there has been a concerted effort by Fed voting members to rein in and temper pricing through jawboning, underscoring the need for caution. Williams of the New York Fed said, "I just think it's just premature to be even thinking about that … We aren't really talking about rate cuts right now… as Chair Powell said, the question is: Have we gotten monetary policy to a sufficiently restrictive stance in order to ensure that inflation comes back down to 2%? That's the question in front of us."

Global equity returns outperformed for the second consecutive month, with the MSCI World Index for developed markets up 4.8%, the S&P 500 up 4.4% and the S&P/ASX 200 far better, up 7.1%. The Brent crude oil price declined 4.4% to US$77 per barrel (down from US$80.6), and spot gold rose 1.3% to US$2,063 per ounce (up from US$2,037). The US 10-year bond yield closed sharply lower to 3.88%, down from 4.33%. The embedded bond risk premium, as defined by the Fed's measure of the 10-year term premia, collapsed to negative 44bps (down from being positive 7bps). The 2/10yr inverted yield curve steepened to negative 37bps (up from negative 36bps), corporate high yield credit default spreads continued to be well bid, closing lower at 356bps (down from 402bps), 10-year inflation-protected real yields were lower at 1.71% (down from 2.09%), and the US dollar index depreciated 2.1% to close at 101.3 (down from 103.5). The Australian 10-year nominal bond yield followed the US lead to close lower at 3.96% (down from 4.41%), the 2/10 yield curve flattened to 24bps (down from 31bps), and the 10yr bond spread relative to the US 10yr was steady at 8bps over (same as prior month). The Australian dollar appreciated by 3.1% to close at US68.1 cents (up from US66.1), and the trade-weighted index appreciated 1.8% to 62.6 (up from 61.5).

Like the US, an atmosphere of excessive rate cut expectations is also prevalent across markets in the United Kingdom and Europe, despite the Bank of England and the European Central Bank maintaining their inflation vigilance. Bank of England Governor Bailey said they will not cut rates for the "foreseeable future" as the second half of the inflation battle will be "hard work". The European Central Bank paused rates at 4%, shifting the narrative to how long they should be maintained at these sufficiently restrictive levels. The Governing Council and President Lagarde are leaning against the current market expectation for cuts starting in the March quarter of 2024. ECB member Schnabel said, "the disinflationary process on underlying inflation has only recently gained momentum. We now need to see whether this is sustained." The ECB also announced an earlier balance sheet runoff of its €1.7 trillion in bond holdings from the PEPP (Pandemic Emergency Purchase Programme). PEPP assets will now reduce reinvestment of maturing assets in 2H 2024 by €7.5 billion per month on average, and discontinue reinvestment at the end of 2024.

The Bank of Canada extended their rate pause at 5% since July, reiterating their preparedness to raise rates to stem inflation if needed. The Bank of Japan left policy unchanged despite flagging weeks earlier a possible exit from easy policy settings on yield curve control and negative cash rates.

The Reserve Bank of Australia paused the cash rate at 4.35%, whilst retaining a tightening bias given overseas experience showing that "services price inflation has remained persistent and the same could occur in Australia." Importantly, the Board is monitoring inflation expectations to ensure that they do not "drift away from the inflation target."

Economic Review

China’s Central Economic Work Conference (CEWC) announced that policymakers have prioritised growth for 2024 to help stabilise expectations, growth and employment, before making larger transformative changes to the economy. Two key new phrases were introduced, focused on “pursuing stability through growth”, and “building the new before abolishing the old.” The CEWC called for better policy co-ordination and consistency by incorporating non-economic policy measures into the assessment; proactive fiscal policy to be “appropriately strengthened” and made more effective with an optimised structure of fiscal spending; coordinating local debt resolution and economic development; with prudent monetary policy to be “flexible, appropriate, precise and effective.”

On the data front, US real GDP for the September quarter grew at an unsustainable 4.9% quarter annualised rate, but cumulative policy tightening should see the quarterly growth profile slow to a below trend pace into 2024. The tight labour market is moving closer to balance with gains in supply through rising participation rates and a slowing in demand for the number of job openings.

Australia is overhauling the temporary migration system to slow student inflow, reduce ‘visa hopping’ and increase skilled migration. The Federal governments mid-year economic and fiscal outlook (MYEFO) is forecasting net overseas migration to fall to 375,000 people in 2023-24 and 250,000 in 2024-25, which is regarded as the ‘normal’ level. The MYEFO also revealed ongoing substantial improvements in the budget deficit owing to stronger than expected tax receipts and commodity exports (A$65bn over the 4 years to 2026/27). The RBA and the Federal Government updated the Statement on the Conduct of Monetary Policy. Key changes included, firstly, the move to a more precise inflation target of 2.5% from the 2-3% range, however the time frame is not defined. They noted that “inflation is expected to return to the midpoint of the target. The appropriate timeframe for this depends on economic circumstances and should, where necessary, balance the price stability and full employment objectives of monetary policy.” Secondly, proposed changes look to redefining the full employment objective to be”…sustained full employment, which is the current maximum level of employment that is consistent with low and stable inflation.”

Global Economic Outlook

Global Economic Outlook

On geopolitics, the developments of shipping attacks by Iranian backed Houthis in the Red Sea, and between Israel and Hamas in the Middle East are concerning to all. In the context of Russia's invasion of Ukraine, and ongoing political tensions with China, the world is now in a state of heightened tension and uncertainty. The Middle East could worsen with neighbouring countries drawn into the conflict, and a risk that the United States could become involved. Conflict in Ukraine, Putin's list of threats, and the deployment of tactical nuclear weapons to Belarus all heighten the risk of destabilisation and increase the potential for a broadening of the conflict with neighbouring NATO members. The confluence of risks from both wars could easily reignite inflationary price shocks in energy, metals and food. In this environment, there is a significant risk of further oil price inflation, placing upward pressure on interest rates. There is also the risk of further drag on economic growth, which will be a concern for markets. In summary, the current state of play is best summarised by the quote from former US Defence Secretary, Donald Rumsfeld, that there are "known unknowns" and "unknown unknowns" which are contributing to the fog of war, which is currently, the primary risk to Ausbil's macro-outlook.

While there is much geopolitical risk, including numerous upcoming government elections, we still see the macroeconomic settings returning to more normal levels. Our early contrarian 'soft landing' outlook for the US is increasingly coming into full view, and we believe it is achievable. We see the extended pause in global cash rates ultimately leading to the commencement of modest rate cuts in 2024 on falling inflation. Whilst authorities are in a risk management stance, their monetary response function has now evolved to simply "assess the inflation dynamics and reduce rates to offset the impact from rising real rates."

The structural long-run themes of decarbonisation and slowing globalisation will be commodity demand intensive and will underpin real activity. Global GDP growth has been revised higher as it is on a clearer upward path towards to 3.2% in 2024 on a better performing US, as illustrated in Table 1.

Table 1: Global growth – on an upward path to 3%

Real GDP % year average November 2023	10 yr. average 2010 to 2019 %	Re-opening Actual 2022 %	Official Sector Consensus 2023 (f) %	Official Sector Consensus 2024 (f) %	Ausbil 2023 (f) %	Ausbil 2024 (f) %
United States	2.3	2.1	2.0	1.5	2.0	1.7
Japan	1.2	1.0	1.5	1.0	1.3	1.1
Eurozone	1.4	3.4	0.7	1.1	0.7	1.4
China	7.7	3.0	5.1	4.6	5.1	4.8
India	7.0	7.2	6.2	6.2	5.9	6.5
Australia	2.6	3.7	1.4	1.5	2.1	1.75
Global GDP	3.7	3.4	3.0	3.0	3.0	3.2

Source: Ausbil, FactSet.

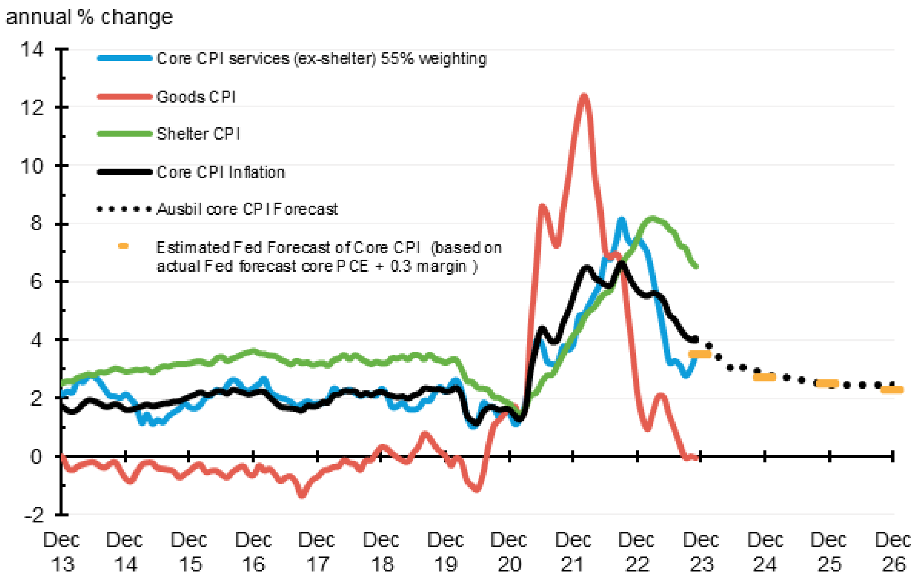
Global Economic Outlook

The Asia-Pacific growth engine, particularly India and China, is expected to outpace the US and a weak Europe. US growth at 1.7% in 2024. The US growth outlook is driven by a resilient labour market remaining below full employment levels, and underlying strength in the consumer from real wages growth and the drawdown in excess savings. Europe's shallow recession risk has resurfaced from a weaker Germany, but that may prove short lived given that China's politburo announced targeted stimulus measures since August 2023 should sustain the domestic recovery; in particular, expanding the central budget deficit by an additional 0.8% to 3.8% of GDP in order to meet China's growth target of 5%. This is to be implemented through an infrastructure stimulus package funded by at least 1 trillion yuan (US$137 billion) of additional sovereign debt.

Inflation is falling, and the forecast trajectory is for a return to above central bank target levels out to 2025. Core inflation dynamics are switching, and we see persistent sticky services (ex-housing) inflation, lower housing inflation to a lesser degree and upside risk from goods inflation. Furthermore, the September quarter 2023 surge in energy prices is a constant reminder of the risk this presents to the outlook from second-round impacts bleeding into the core inflation measures. There is also the growing likelihood that inflation may decline faster than forecast, which would open the door to earlier cuts to offset the impact from rising real rates, and thereby provide ongoing support to economic growth.

Chair Powell has decomposed US core inflation into three sector categories: core goods; shelter; and core services, excluding shelter. As service inflation is intricately linked to the labour market, an improving inflation profile requires correcting the labour imbalance and slowing wage growth from a 4.5% pace towards 3.5%, based on the assumption that labour productivity growth averages 1.5%pa, similar to rates experienced back in 2018-19.

Chart 1: Three core measures of consumer price inflation



Source: Ausbil 2024.

Australian Economic Outlook

Australian Economic Outlook

The Australian economy performed exceptionally well in 2023 despite facing the multiple headwinds of geopolitical uncertainties, rising global bond yields, higher mortgage rates and ongoing cost of living pressures. We continue to forecast a favourable domestic outlook for 2024. This is based on our unique geographic exposure to the faster growth engines of the Asia-pacific region, together with an improving global environment supported by cuts in nominal rates on falling inflation.

Australia continues to benefit as a net exporter of commodities, driven by the ongoing cyclical rise in resources demand, and the underlying long-term structural trends, including decarbonisation, which are commodity demand intensive. In addition, Australia will also benefit from China's politburo announcing additional targeted stimulus measures since August in supporting domestic activity and sand bagging the contagion risk from a depressed housing sector. There is also increasing speculation of the likelihood of another US$137 billion in direct credit funding from the Peoples Bank of China, targeting the housing sector in the lower tiered cities and western regions, which will offer low-cost financing for urban village renovation and affordable housing programs. This should result in an injection of money in phases into public programs via policy banks and via options including the Pledged Supplemental Lending Facility.

Australia's GDP growth is forecast by Ausbil at 1.75% in 2024, but still sub-trend, with the drag on activity, primarily coming through the household consumption channel. The labour market remains resilient and we are forecasting a modest uptick in unemployment to 4.0%, but with the economy holding on to broad-based gains. An outcome that will see the unemployment rate remaining below the NAIRU (natural rate of unemployment) estimates of Treasury and the Reserve Bank of Australia (RBA) in the range of 4.25% to 4.50%.

Overall, activity will be supported by the terms of trade, full employment, a reducing savings rate and the gradual rundown in the stock of excess savings. Based on the latest Q3 national accounts, private households currently have A$245 billion in excess savings (representing 16.4% of annual nominal gross household disposable income), the peak was A$294 billion in Q3'2022 (equivalent to a 20.1% share). Of the current excess savings amount, A$138 billion is sitting in mortgage offset and redraw accounts. We estimate the savings drawdown rate at A$15 billion per quarter, up from A$10 billion, is supporting subdued household consumption of up to 0.3% per quarter and mortgage repayments. Since Dec 2022, the cumulative drawdown in excess savings stands at A$49 billion. That said, as the situation is fluid, we are watching the data very closely for any signs of deterioration, or any consumer stress that emerges. Meanwhile, the positive terms of trade, growing income tax receipts and lesser outlays has seen fiscal policy move dramatically from cyclical deficit into surplus, which is expected to continue over the medium term.

Allowing for the Governments overhaul of the temporary migration strategy, underlying population growth and net migration back at more normal levels will continue to be supportive of Australia's economic growth. Labour supply will increase the participation rate, and the employment-to-population ratio should remain around record highs. The ratio of the number of unemployed persons per job vacancy is currently 1.4:1, compared to 3:1 prior to the pandemic.

We are forecasting a gradual moderation in underlying domestic inflation over 2024 to 3.4%, still above the upper central bank target level. The moderation is driven by ongoing supply-side improvements against an expected pick-up in nominal wages growth. We see real wages growing in the June quarter 2024, with headline CPI at 4.0%, and the wage price index at 4.4%. However, persistent higher wages and resilient employment outcomes will see the RBA biased to raising interest rates.

Australian Economic Outlook

Structural demand for resources will underpin the Australian dollar with the AUD expected to appreciate into the range of US70 cents, and the trade weighted basket trending higher. The RBA policy decisions are subject to data from meeting to meeting, especially noting the risk that "services price inflation has been surprisingly persistent overseas and the same could occur in Australia." We are forecasting the cash rate to remain in restrictive territory at these levels for some time, with the near-term risk that the RBA's low tolerance to any inflation upside surprises could trigger another rate hike. This is based on our view that the real cash rate should be in the range of 1.5% to 2.0%, bringing it closer to the US real cash rate that is currently in the range at 2.0% to 2.5%. This should allow companies and consumers alike to readjust to a more stabilised policy environment. Meanwhile, the RBA will be monitoring the global economy, household spending, and wage and price-setting behaviour. In summary, repeating what we said for 2023, we do not see Australia entering a recession in 2024, a view we have held for some time, and consensus is increasingly adopting a similar view.

Jim Chronis

Chief Economist, Associate Director

As Ausbil's Chief Economist, Jim is responsible for macroeconomic research and strategy. As Associate Director – Debt and Diversifieds, Jim manages the Ausbil Balanced Fund cash and fixed interest mandates. Jim holds Bachelor of Laws and Bachelor of Economics (Honours) degrees from the University of Sydney.

Equity Market Review

Investment Market Review

Table 2: Key benchmark returns by asset class - total return

Asset Classes	3 months %	12 months %
Australian Equities	8.19	11.07
Australian Bonds (UBSA Composite Bond Index)	3.79	5.06
Australian Property - Direct Property	2.80	12.90
Australian Property - REITS	16.56	17.59
Global Equities (benchmark)	5.17	20.52
Cash	1.06	3.89

Equity Market Review

Markets staged a rebound in the December quarter as inflation figures brought forward the possibility of rate cuts, commencing in the US in the first half of calendar 2024, with a quarterly return of +8.4% for the S&P/ASX 300 Accumulation Index, bringing the trailing market 1-year return to +12.1%.

The RBA tightened rates across 2023 by a total 125bps, raising four times by a total of 100bps across 5 meetings in the first half of the calendar year, and only once by 25bps in the second half across 6 meetings. The other 300bps in rate increases from the pandemic low of 0.1% occurred across calendar 2022, with the cash rate closing out 2023 at 4.35%.

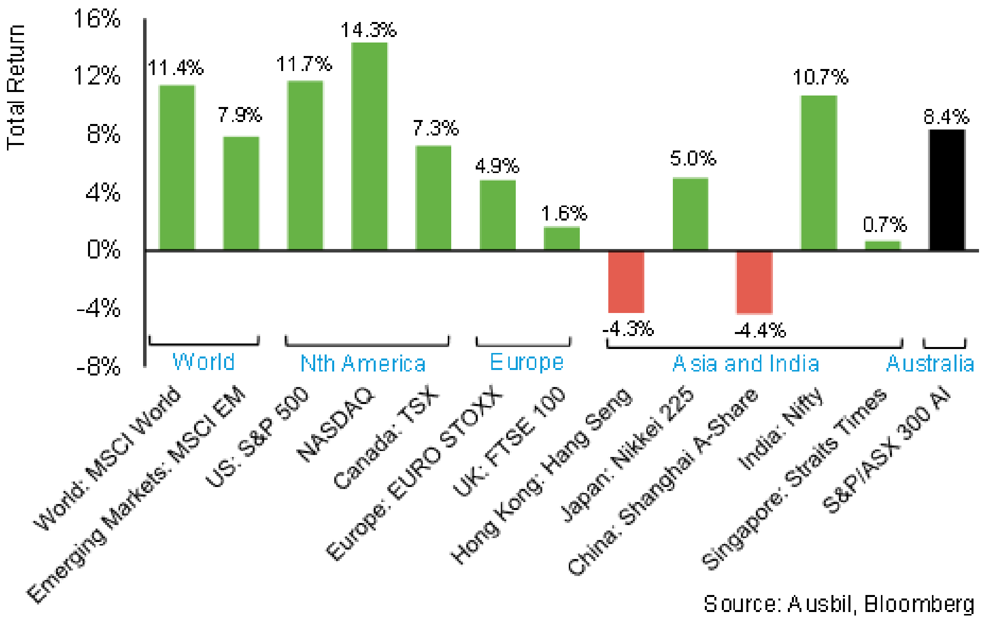
As a result of monetary policy normalisation, while the economy remained near full employment, economic growth had slowed to below trend. As Ausbil has argued across 2023, persistently low unemployment, demand for Australian resources, and significant excess savings in the system helped soften the rapid normalisation of interest rates, and the impact of persistent higher inflation on consumers.

Though markets were significantly impacted by the rising 10-year yield in 2022 and early 2023, and slowing economic growth, they responded positively to the slowing of rate rises towards the end of 2023.

Globally, every major market except for Hong Kong and China rebounded in the quarter on a better inflation outlook, with developed markets (MSCI World) outperforming emerging markets (MSCI EM), and Nasdaq beating all markets on a resurgent technology sector, as illustrated in Chart 2.

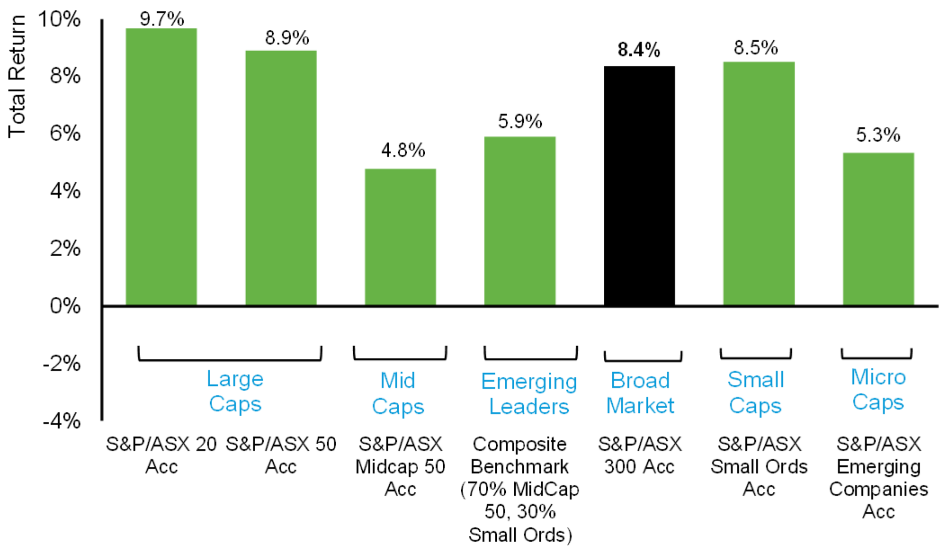
Equity Market Review

Chart 2: World equity market returns – December Quarter 2023



The December quarter rebound was felt across all segments of the market, with the largest companies delivering the best results, and mid and micro-cap stocks underperforming the broad market index, as shown in Chart 3.

Chart 3: Domestic returns by segment – December Quarter 2023

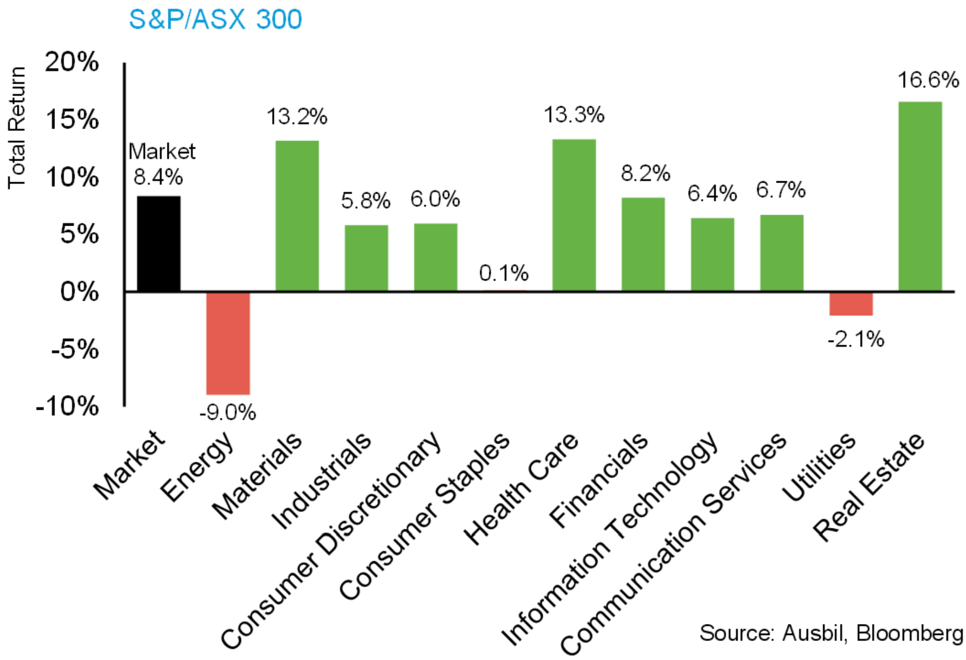


Source: Ausbil, FactSet

Equity Market Review

At a sector level, the positive sentiment was also reflected across all sectors other than Utilities and Energy, as shown in Chart 4.

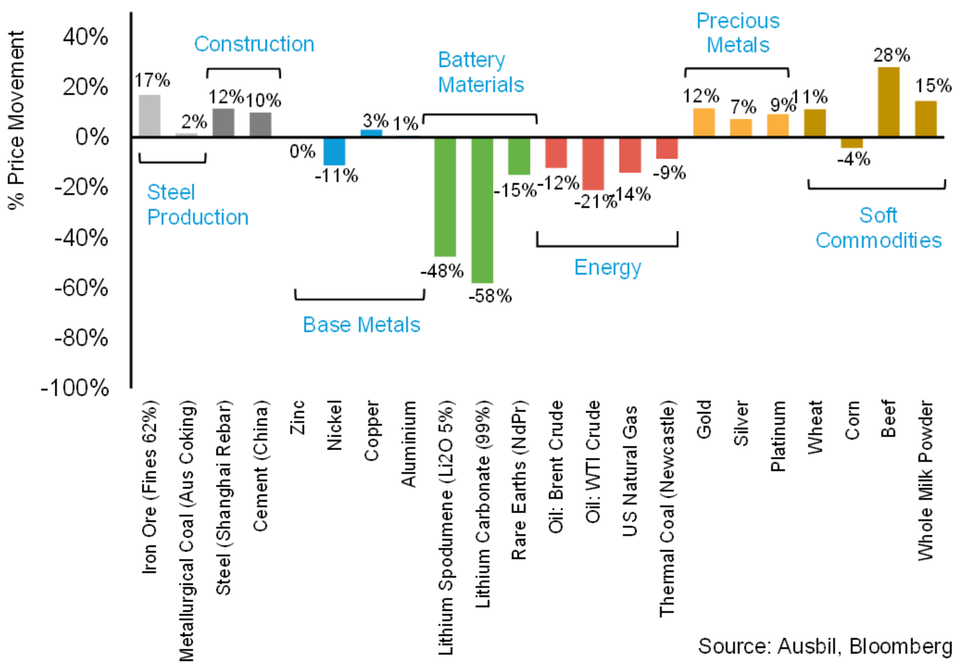
Chart 4: Sector returns – December Quarter 2023



Source: Ausbil, Bloomberg

Commodities ended a difficult year battling the overall slowing of the economic cycle that was induced by two years of hawkish monetary tightening. China infrastructure stimulus announcements in the quarter helped support the market, but was not enough to restore momentum, despite key segments of the market showing an ongoing demand overhang from underinvestment in production.

Chart 5: Commodity markets – December Quarter 2023



Source: Ausbil, Bloomberg

Equity Market Review

Ausbil remains focused on the key thematics that are driving long-term earnings growth, particularly where imbalances see demand exceeding supply on a fundamental basis for some time. We like critical and base metals for the long rotation from fossil fuels to renewables in the great decarbonisation, and the electrification-of-things, with the steady switch from combustion and fossil fuel power to renewable electricity generation. This is a long game which requires a significant amount of investment. Service companies associated with the cap-ex investment needed for this energy transition are also attractive.

In the December quarter, the AUD/USD appreciated by 5.9%, closing the month at US$0.6812. In fixed income markets, US 10-year Treasury yields closed at 3.9% (down from 4.6%) and Australian 10-year Government Bond yields closed the month at 4.0% (down from 4.9%). In credit markets, investment grade credit spreads fell to 57 bps from 74bps and high yield spreads fell to 356 bps from 480bps over the quarter.

Fixed Interest and Cash Rates

Fixed Interest and Cash Rates

It was the tale of two halves during the December quarter. At first, we saw global 10-year bond yields peak over 5% early in October, before reversing course to aggressively decline into quarter end and finish at the same level from a year ago. The move was driven by cash rates having peaked, falling inflation and the Federal Reserve pivoting for rate cuts to offset rising real rates in 2024.

For the quarter, the US 10-year nominal bond yield rallied to close at 3.88% (down from 4.57%), the 2/10yr inverted yield curve flattened to negative 37 basis points (from negative 48bps), corporate high yield credit default swap spread narrowed to 356bps (down from 481bps), and 10-year inflation protected real yields fell to 1.71% (down from 2.23%). The embedded bond risk premium, as defined by the Fed's measure of the 10-year term premia, collapsed to negative 44bps (down from being positive 16bps). The US dollar index depreciated 4.6%. The Australian 10-year nominal bond yield fell to close at 3.96% (down from 4.49%), the 2/10 yield curve flattened to 24ps (from being 39bps), and the 10yr bond spread relative to the US 10yr Treasury closing over at 8bps (from being under at positive 9bps). The dollar appreciated to US68.1 cents from US64.4, and the trade-weighted index appreciated by 2.5% to 62.6 (up from 61.1).

US Federal Reserve monetary policy pivoted to forecast rate cuts on falling inflation. Commencing in 2024 there are 75bps in cuts, 100bps in 2025 and a further 75bps in 2026 – overall, 250bps in total. Chair Powell stated that the "real rate is now falling and that is part of the process of moving from a restrictive policy." The Fed's balance sheet reduction remains 'an important part' of its monetary tool kit, where quantitative tightening run-off could "continue for some time, even after the Committee begins to reduce the target range for the Federal Funds Rate." The Fed's updated 3-year horizon forecasts have the GDP growth rate back at trend, the unemployment rate holding onto 50-year lows, and inflation measures down around target levels.

The European Central Bank paused rates at 4%, shifting the narrative to how long they should be maintained at these sufficiently restrictive levels. The Governing Council and President Lagarde are leaning against the current market expectation for cuts starting in the March quarter of 2024. ECB member Schnabel said, "the disinflationary process on underlying inflation has only recently gained momentum. We now need to see whether this is sustained." The ECB also announced an earlier balance sheet run-off of its €1.7 trillion in bond holdings from the PEPP (Pandemic Emergency Purchase Programme). PEPP assets will now reduce reinvestment of maturing assets in 2H 2024 by €7.5 billion per month on average and discontinue reinvestment at the end of 2024.

The Bank of England left policy on hold at 5.25% with a tightening bias. Governor Bailey said they will not cut rates for the "foreseeable future" as the second-half of the inflation battle will be "hard work". The Bank of Japan tweaked its yield curve control policy by relaxing the language on hard-cap limits, stating that the 1% upper range on the 10-year yield is a reference level only for its "nimble" market operations. The Bank of Canada extended their rate pause at 5%, which has been on hold since July 2023, reiterating their preparedness to raise rates to stem inflation if needed. The Reserve Bank of NZ extended its pause at 5.5%, highlighting that rates will be restrictive, "for a more sustained period of time."

The Reserve Bank of Australia hiked by 25bps to 4.35% after pausing in July. The statement retained a tightening bias and emphasised that the Board is monitoring inflation expectations to ensure that they do not "drift away from the inflation target." Governor Bullock sees inflation as, "increasingly homegrown and demand driven," warranting a "more substantial monetary policy response," as it will take a longer period to come back down to target. This was echoed in November's Statement on Monetary Policy which featured significant upgrades to GDP growth and inflation, with the unemployment rate materially lowered across the entire forecast horizon out to year-end 2025.

Fixed Interest and Cash Rates

On the data front, US core inflation showed core goods deflating, core shelter prices moderating, and core services (excluding shelter) decelerating. Activity in Q3 saw GDP re-accelerated to an unsustainable annualised rate of 4.9% on strong consumer spending, inventory rebuild and government sector growth. However cumulative policy tightening should see the quarterly growth profile slow to a below trend pace into 2024. The tight labour market is moving closer to balance with gains in supply through rising participation rates and a slowing in demand for the number of job openings. Sustained improvements in both business and sentiment surveys are signalling a trough in weak German activity and an economy that appears to be stabilising. Australia's record population growth is being absorbed by a resilient labour force and an unemployment rate in the range of 3.5% to 3.9%. Nominal wages accelerated in line with RBA expectations to an annual rate of 4.0%. Q3 CPI inflation reaccelerated, and GDP growth has performed reasonably well, running at an annual rate of 2.1%, despite the headwinds of uncertainties confronting the economy through the year. In other news, tariffs on Australian wine worth A$1.2 billion will be reviewed by Chinese authorities over an expedited five-month period. The Federal Government is overhauling the temporary migration system to slow student inflow, reduce 'visa hopping' and increase skilled migration. The Federal Government's mid-year economic and fiscal outlook (MYEFO) is forecasting net overseas migration to fall to 375,000 people in 2023-24 and 250,000 in 2024-25, which is regarded as the normal level.

Fund Review

Fund Review

The Balanced Fund outperformed its benchmark index for the December quarter 2023, returning +7.39% (gross of fees) versus the benchmark of +6.28%. Over the past 12-months, the Balanced Fund slightly under-performed returning +12.24% (gross of fees) versus the benchmark of +12.65%.

October saw asset markets underperform for a third consecutive month, driven by the outbreak of war between Israel and Hamas in Gaza, and the sustained rise in long bond yields. China expanded its Central budget deficit by an additional 0.8% to 3.8% of GDP for 2023 to meet their growth rate target of 5%. China's economic support was implemented by announcing an infrastructure stimulus package to be funded by at least 1 trillion yuan (US$137 billion) of additional sovereign debt for spending on infrastructure projects.

November saw investors aggressively pivot to 'risk-on' mode, fuelling a spectacular rebound across most asset classes (except oil) on optimism of a soft landing and a Federal Reserve that is done hiking. Long bond yields declined sharply. US and European rate cuts have been priced-in for calendar 2024. The move was driven by moderating inflation, softening employment and slowing wages growth. Adding to investor sentiment was the announcement that the US Treasury will be reducing its bond borrowings for this December quarter. Ratings agency Moody's lowered its credit outlook on US government debt to 'negative' from 'stable', pointing to the cost of rising interest rates and political gridlock. Chinese authorities announced further property support, allowing banks to offer unsecured short-term loans or working capital loans to qualified developers. Bloomberg also reported on the increasing likelihood of an additional 1 trillion yuan (US$137 billion) in direct credit funding from the Peoples Bank of China, targeting the housing sector in the lower-tiered cities and urban regions.

December saw further acceleration in the 'risk-on' sentiment for global investors as financial conditions loosened. The euphoria was driven by the combination of factors, including the US Federal Reserve pivoting to commence an easing cycle from 2024 onwards; and a US soft landing that is increasingly coming into full view, despite this outlook being much maligned by consensus throughout the year. The shift was driven by the slowing momentum in core inflation measures (based on a six-month annualised pace), core consumer price inflation running at 2.9% and the Fed's preferred core PCE (personal consumption expenditure) at 1.9% in November. As Chair Powell pointed out, the "real rate is now falling and that is part of the process of moving from a restrictive policy."

On geopolitics Ukraine/Russia tension increased a notch as NATO Secretary General Stoltenberg cautioned that any deliberate damage to the alliance's critical infrastructure would warrant a response after an undersea gas pipeline was ruptured in a suspected act of sabotage in Finland. The war between Israel and Hamas saw a short truce, allowing the exchange of hostages and prisoners. Presidents Biden and Xi Jinping concluded their APEC meeting announcing that they had agreed to restore military communications and would cooperate on areas such as artificial intelligence, climate change and curbing fentanyl supply. Separately, Xi Jinping declared the relationship with Australia to be at a "new starting point," and that both nations should expand their strategic partnership. In Australia, a significant majority of Australians voted against a change to the constitution that would establish an Aboriginal and Torres Strait Islander voice. The vote was lost on the national count and in the six states.

Strategy and Outlook

Strategy and Outlook

The Balanced Fund strategy will maintain its current asset class positioning.

While there is much geopolitical risk, we still see the macroeconomic settings returning to more normal levels. Our very early contrarian 'soft landing' outlook for the US is increasingly coming into full view and achievable. Global GDP growth is on a clearer upward path towards 3.2% on a much better performing US. We see the extended pause in global cash rates ultimately leading to the commencement of modest rate cuts in 2024 on falling inflation. There is also the growing likelihood that inflation may decline faster than forecast, which would open the door to earlier cuts to offset the impact from rising real rates and thereby provide ongoing support for economic growth. Whilst monetary authorities are in a risk management stance, their response function is succinctly expressed as to "assess the inflation dynamics and reduce rates to offset the impact from rising real rates."

The Australian economy has performed exceptionally well, and for 2024 GDP growth is forecast at a sub-trend pace of 1.75%. This is based on our unique geographic exposure to the faster growth engines of the Asia-pacific region, together with an improving global environment supported by cuts in nominal rates on falling inflation. We continue to benefit as a net exporter of commodities, driven by the cyclical pick-up in resources demand, and the underlying long-term structural trends like decarbonisation that are commodity demand intensive. Australia will also gain from China's politburo announcing targeted measures since August in supporting domestic activity and sandbagging the contagion risk from a depressed housing sector. Here, overall, activity will be supported by the terms of trade, full employment, a reducing savings rate and the rundown in the stock of A$245 billion in excess savings. That said, as the situation is fluid, we are watching the data very closely for any signs of deterioration, or any consumer stress that emerges. We are forecasting the cash rate remaining in restrictive territory at these levels for some time in 2024, with the near-term risk that the RBA's low tolerance to inflation upside surprises may trigger another rate hike to anchor inflation expectations. In summary, repeating what we said last year, we do not see Australia entering a recession in 2024, a view we have held for some time, and one that consensus is increasingly adopting.

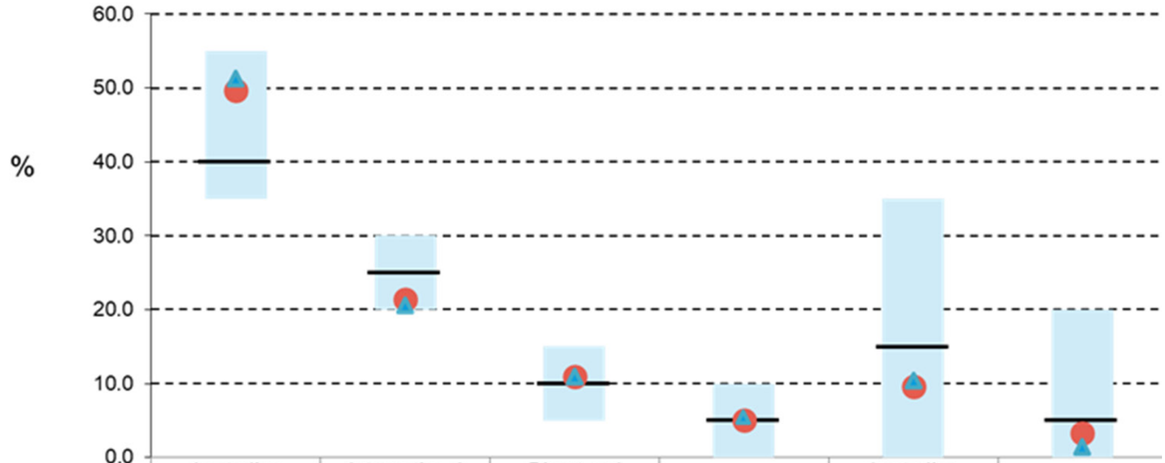
Fund Overview

Fund Return

Period	Fund Return % Gross	Fund Return % Net	Bench-mark* %	Out/Under performance % Gross	Out/Under performance % Net
1 month	5.72	5.67	4.55	1.17	1.12
3 months	7.39	7.18	6.28	1.11	0.90
6 months	5.86	5.41	5.81	0.05	-0.40
1 year	12.24	11.28	12.65	-0.41	-1.37
2 years pa	1.84	0.94	2.99	-1.15	-2.05
3 years pa	8.52	7.57	6.99	1.53	0.58
5 years pa	10.86	9.89	8.90	1.96	0.99
7 years pa	9.37	8.40	7.75	1.62	0.66
10 years pa	9.16	8.20	7.74	1.43	0.46
15 years pa	9.99	9.02	8.08	1.91	0.93
20 years pa	9.42	8.54	7.61	1.81	0.93
25 years pa	8.76	7.86	6.92	1.84	0.94
Since inception pa Date: July 1997	8.97	8.06	7.16	1.81	0.90

* The benchmark returns represent the neutral strategic asset allocation return.

Asset Allocation



	Australian equities	International equities	Direct and listed property	Alternatives	Australian fixed interest	Cash
Maximum range (%)	55.0	30.0	15.0	10.0	35.0	20.0
– Benchmark (%)	40.0	25.0	10.0	5.0	15.0	5.0
Minimum range (%)	35.0	20.0	5.0	0.0	0.0	0.0
● Current (%)	49.66	21.44	10.90	5.06	9.56	3.37
▲ Year ago (%)	51.27	20.65	10.98	5.32	10.38	1.40

Notes:
•1) As at 31 December 2023, hedged currency exposure amounts to 18.1%. This is made up of International shares 13.1% and Global Infrastructure 5.1%.
•2) As at 31 December 2023, the Australian Fixed Interest portfolio modified duration is 4.78 years compared to the benchmark index of 5.06 years.

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