PRINCIPIA

INVESTMENT CONSULTANTS

Quarterly Market Report

June 30, 2024

Holding Pattern

The last financial year has seen excellent returns for investors, with the Australian market returning 12.1% and international markets up 19.9%. But it has not been a smooth journey, and recently markets seem to be in a holding pattern waiting for economic skies to clear. Around the world asset classes have pulled back in the June quarter, apart from a very narrow rally in a handful of US tech stocks associated with AI applications.

Over the June quarter both the RBA and the Federal Reserve have kept respective interest rates on hold, but the message from the two central banks has been quite different. In the US inflation continues to fall more in line with expectations, and in their last meeting the Feds confirmed that they expected a single rate cut for 2024 but foresee four reductions instead of three in 2025.

However when the RBA announced they were keeping rates on hold the message was far more hawkish, and upward revisions to the inflation forecast were greater than anticipated. To cap off the quarter, by the end of June Australia’s inflation had accelerated faster than expected for a third straight month, sending bond yields and the AUD higher as traders increased bets that the RBA will resume raising interest rates at its next meeting.

But the subdued performance in the quarter is not just in the Australian market, nor is it all due to changing inflation expectations. There has been a broad pull-back in equities across the world in the last quarter. Except for the US, other markets have seen a retreat from their highs back at the end of March.

The US markets appear to be doing better than its economy suggests, but this is a very narrow rally driven by a handful of stocks involved with AI applications. NVIDIA – which is around 7% of the broad US market – is up 190% for the 12 month period. While this outperformance has not been without significant earnings growth, the question for investors might be when and how much of the benefits of AI will flow into positive economic returns for the broader economy.

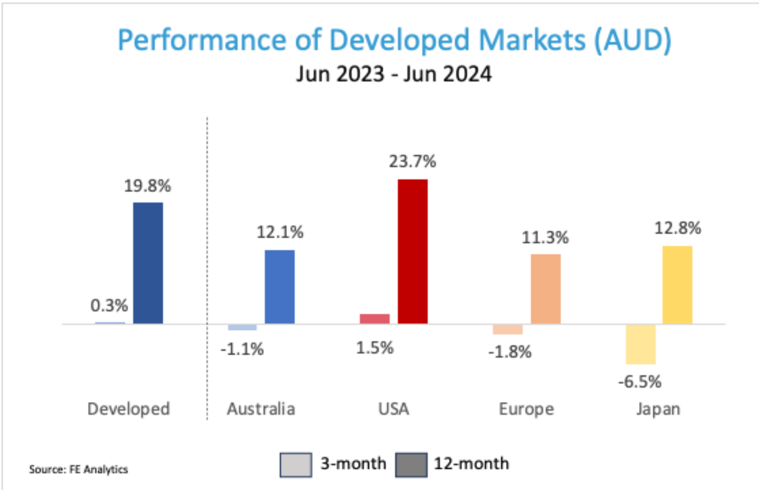
Equity and Bond Market Overview

ASX HAS A GOOD FINANCIAL YEAR, BUT SLOW QUARTER

In Australia the ASX 200 index has returned 12.1% over the course of the year, supported by the performance of the banks. However it has been a flat quarter as the materials sector is negative due to the price drop in iron ore as demand from China remains weak, and investors are cautious as inflation remains sticky.

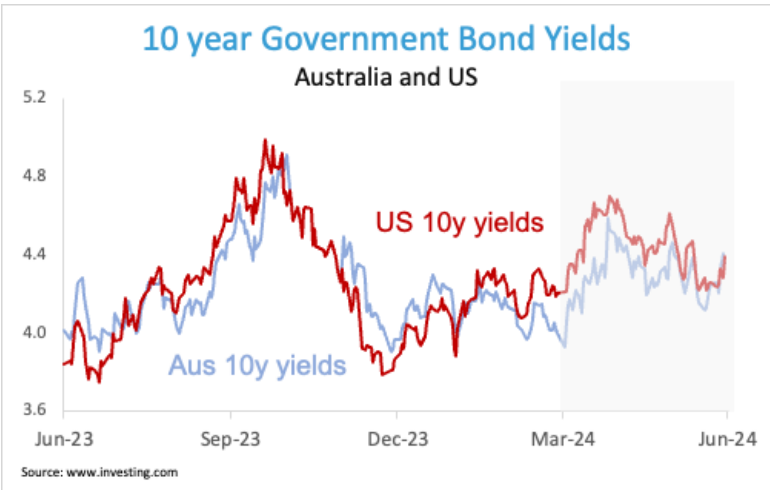
A SIMILAR STORY IN DEVELOPED MARKETS

The story is much the same in developed markets in which the MSCI World Index has returned approximately 20% for the year, but the second quarter has been flat amidst a more cautious mood. While the US market continues to reach new highs, other major markets have pulled back with Japan returning -6.5% (in AUD) in the quarter.



BOND YIELDS VOLATILE EVEN AS INFLATION SLOWS

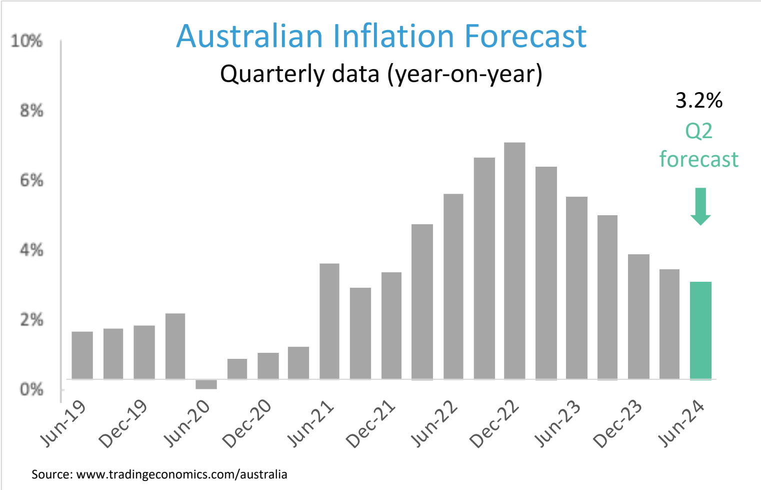
10-year government bond yields in Australia and the US remain volatile, although throughout the quarter the trend has been for yields to start coming down as inflation continues to decline, albeit slower than the market had anticipated at the start of the year. The bond market continues to assess the timing of rate cuts.



Economic Review and Forecasts

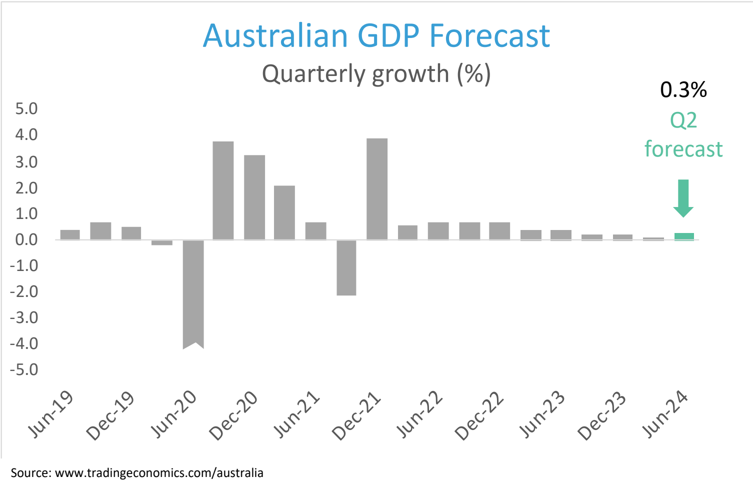
INFLATION CONTINUES TO FALL BUT REMAINS ABOVE TARGET.

Inflation has been falling since the end of 2022, and the inflation rate in Australia is expected be 3.2% for the June quarter. While cost pressures have eased, the RBA have recently warned that upside risks to inflation remain, noting recent strength in CPI, household consumption and service inflation numbers.



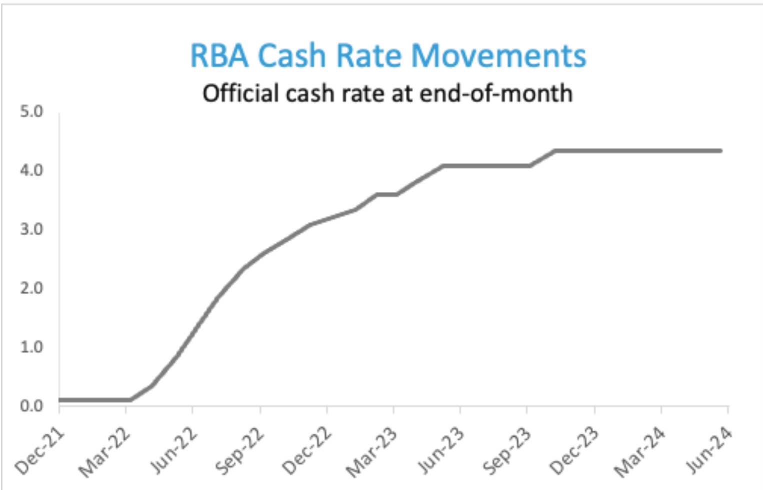
AUSTRALIA REMAINS ON TRACK FOR A SOFT LANDING.

The Gross Domestic Product (GDP) in Australia expanded 0.10% in the March quarter of 2024 and is forecast to be a slightly better 0.3% in the June quarter. The soft GDP growth rate is mainly due to subdued domestic demand, as rising mortgage and cost of living expenses have curbed spending.



INTEREST RATES ON HOLD, BUT HIGHER RATES A POSSIBILITY

The RBA remains in a wait and see mode as inflation remains sticky. The Board reiterated that the path of interest rates will depend upon the data and the evolving assessment of risks, as it waits for the past 13 rate increases to filter through the economy and reduce pressure on prices. The RBA has not ruled out lifting the cash rate again.



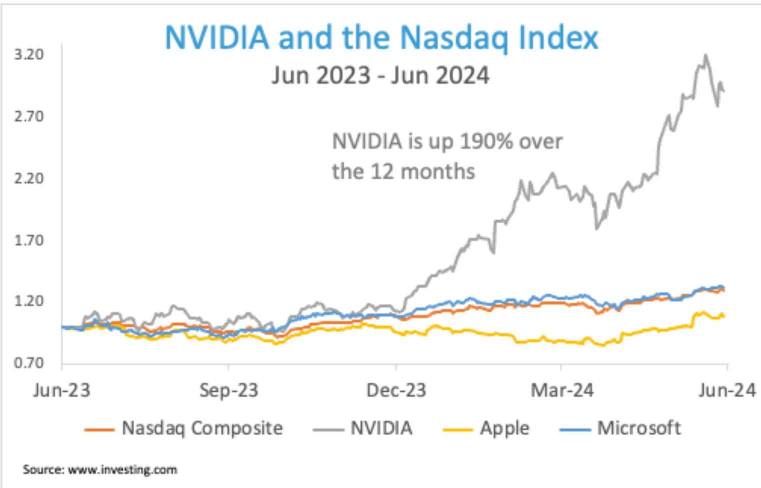
Market Returns to 30 June 2024

Asset Class	3 Months	1 Year	3 Year	5 Year	10 Year
Cash	1.1%	4.4%	2.4%	1.6%	1.9%
Australian Bonds	-0.8%	3.7%	-2.1%	-0.6%	2.2%
Global Bonds	0.0%	2.9%	-2.7%	-0.7%	2.1%
Australian Equity	-1.1%	12.1%	6.4%	7.3%	8.1%
Developed Markets	0.3%	19.9%	11.2%	13.0%	13.1%
Developed Markets (hedged)	3.4%	20.7%	7.2%	11.2%	10.3%
Emerging Markets	2.6%	12.2%	-1.3%	4.1%	6.4%
Australian REITS	-5.6%	24.7%	5.7%	4.4%	8.9%
Global REITs	-5.6%	4.3%	-0.7%	1.4%	7.6%

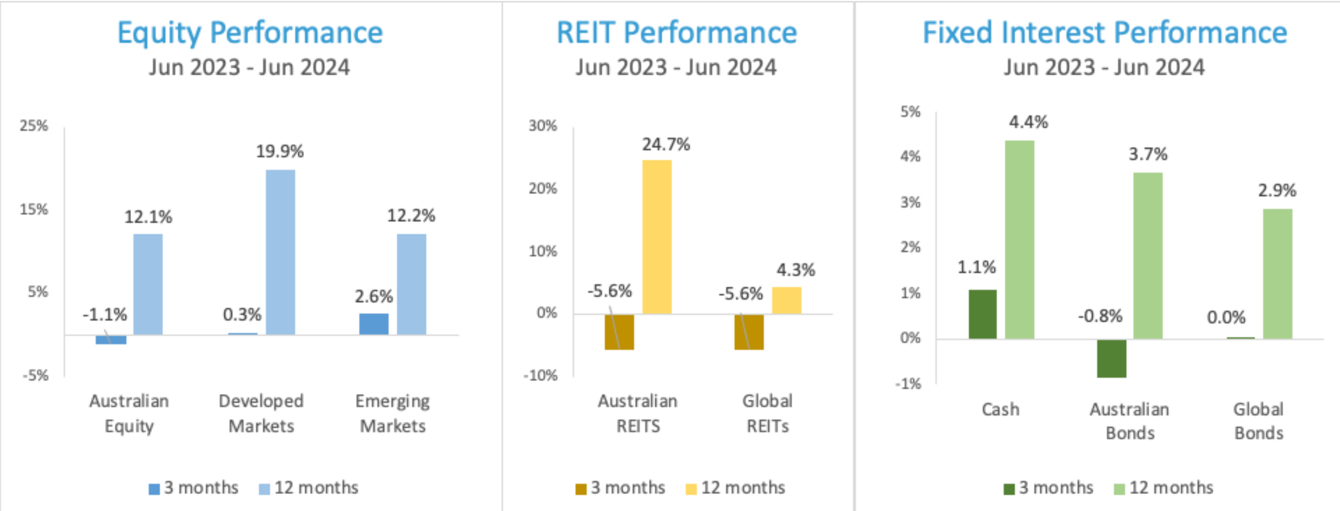
- Yields remain volatile as traders continue to weigh expectations for central banks to start cutting interest rates. However inflation remains sticky, keeping rates higher for longer which in turn is keeping the returns from bonds subdued.
- The Australian share market is up 12.1% for the financial year mainly driven by the strong performance of the big banks. The last quarter has been flat for the market.
- Global stock markets have had a much stronger year and are up 19.9% for the last 12 months. The driver of returns remains the tech sector in the US, and particularly those companies associated with AI.
- High US interest rates has seen a strong US dollar against other major currencies. As the AUD/USD exchange rate has climbed during the quarter the hedged MSCI World index has outperformed the unhedged index.
- Emerging Markets continue to lag developed markets, mainly due to the poor performance of the Chinese stock market which accounts for 30% of the EM index.
- Australian REITs outperformed the local equity market in the quarter and over the year, although it was the reverse when looking at global REITs against global equities.

NVIDIA LEAVES TECH (AND THE REST OF THE MARKET) BEHIND

The US tech sector has been driving the performance of the US market since the start of the pandemic. But the rally has become concentrated around those stocks associated with AI. Three stocks - NVIDIA, Microsoft and Apple – make up 30% of the Nasdaq index. NVIDIA is up 190% over the last 12 months, leaving the rest of the market in its wake.



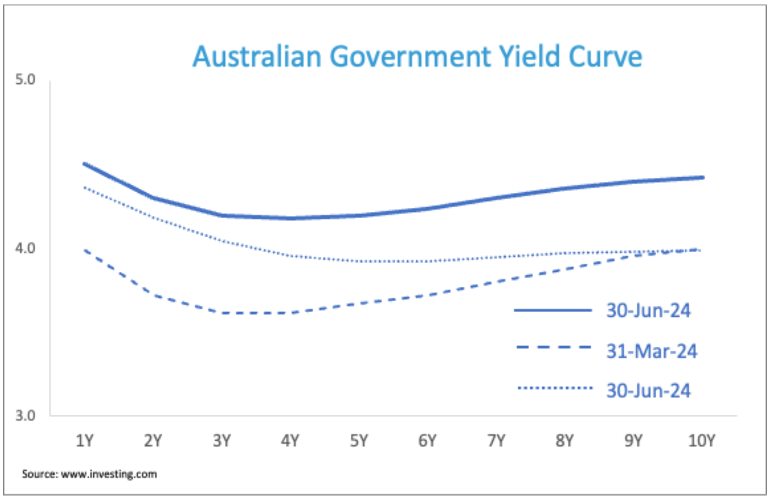
Market Returns (Chart)



Yield Curves

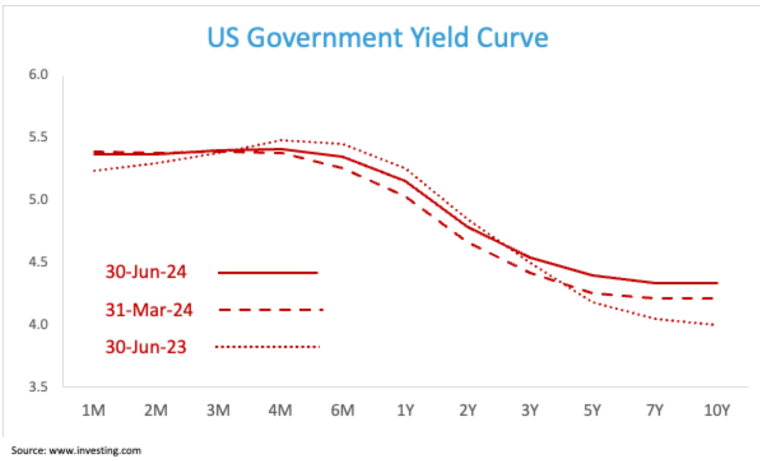
AUSTRALIA

While the RBA has kept its cash rate at 4.35% for the last 8 months, the Australian yield curve is now reflecting an expectation that rates may go higher. The RBA has never ruled out lifting the cash rate again, and the recent acceleration in the monthly inflation has resulted in an upward shift in the yield curve and sent the currency higher.



UNITED STATES

There is little change in the US yield curve from where it was 3 months ago, reflecting the markets continuing expectation that interest rate cuts from the Federal Reserve won't start until later this year. However, the Feds have reiterated that they will proceed cautiously as it decides when to begin cutting rates.



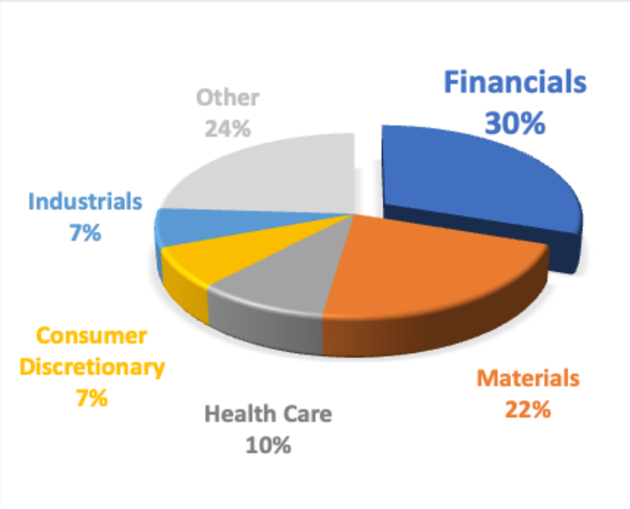
Sector Performance

AUSTRALIA

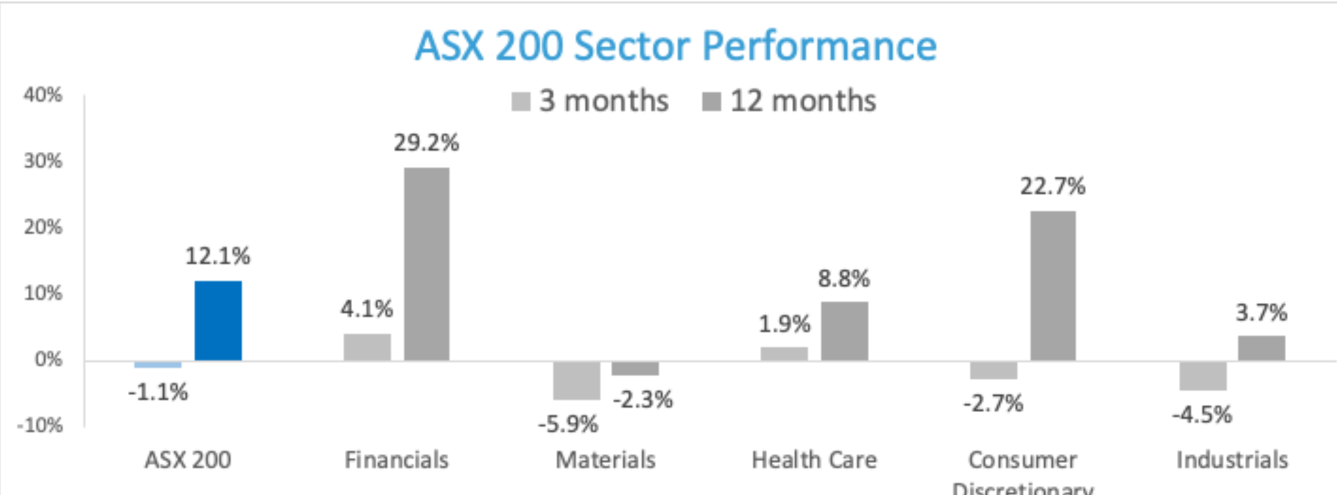
Financials and Consumer Discretionary stocks have performed strongly over the last 12 months year, leading the overall performance of the ASX 200 Index. However, the Materials sector – dominated by the big miners – has been negative in the quarter amidst falling iron ore and nickel prices. In the last quarter Discretionary stocks are also negative which indicates cost of living pressures are now impacting retail spending.

Sector	3 months	12 months
ASX 200	-1.1%	12.1%
Communication Services	-4.9%	0.9%
Consumer Discretionary	-2.7%	22.7%
Consumer Staple	0.2%	-3.7%
Energy	-6.8%	-1.8%
Financials	4.1%	29.2%
Health Care	1.9%	8.8%
Industrials	-4.5%	3.7%
Information Technology	2.9%	28.4%
Materials	-5.9%	-2.3%
Real Estate	-6.3%	20.3%
Utilities	13.3%	12.5%

Five sectors make up approximately 75% of the market, with the two largest constituting more than 50%. The bottom chart shows the 12-month performance of the five largest sectors.



Sector	Weight	Cummulative
Financials	30.3%	30.3%
Materials	22.0%	52.3%
Health Care	9.6%	61.9%
Consumer Disc	7.3%	69.2%
Real Estate	6.9%	76.1%
Industrials	6.8%	82.9%
Energy	5.0%	87.9%
Consumer Staples	4.1%	92.0%
Communiation Services	3.8%	95.8%
Information Technology	2.9%	98.7%
Utilities	1.3%	100.0%



Source: FE Analytics

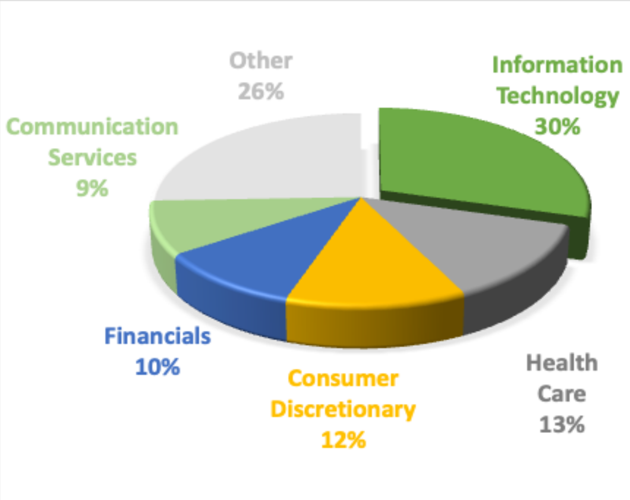
Sector Performance

UNITED STATES

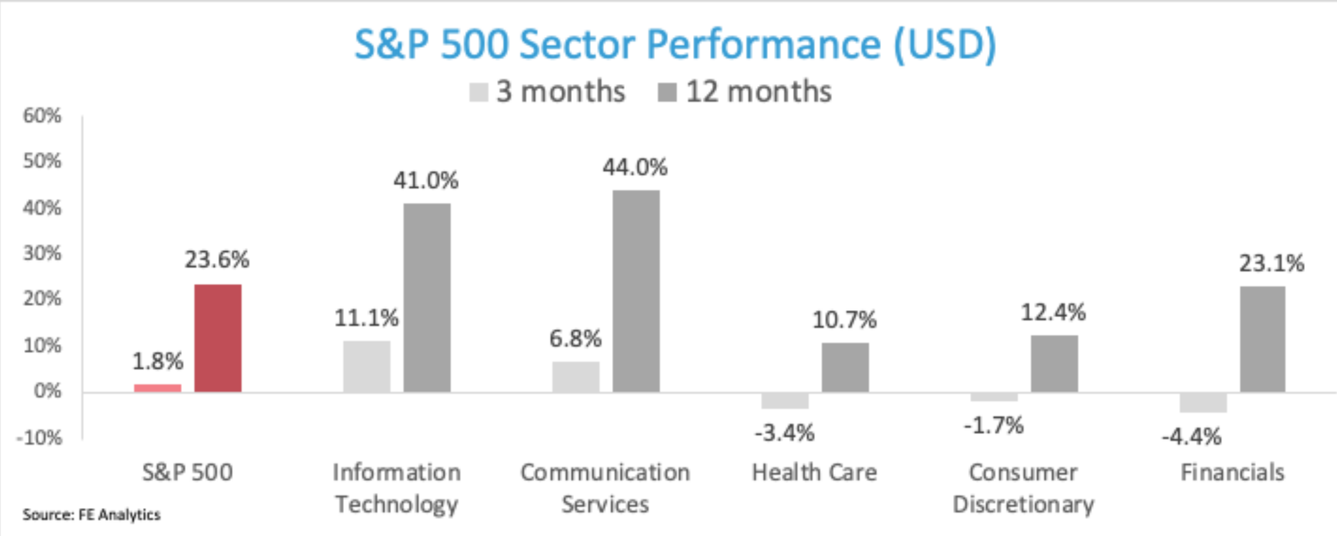
The US Tech sector (Information Technology and Communications stocks) have had exceptional 12 month returns as the large Nasdaq stocks continue to benefit from enthusiasm for AI. However a correction in NVIDIA's share price in the last days of the quarter may indicate the inflated prices are not sustainable. Consumer Discretionary stocks are flat for the June quarter, indicating a tough time ahead for the retail sector.

Sector	3 months	12 months
S&P 500	1.8%	23.6%
Communication Services	6.8%	44.0%
Consumer Discretionary	-1.7%	12.4%
Consumer Staple	-1.2%	6.9%
Energy	-4.9%	14.3%
Financials	-4.4%	23.1%
Health Care	-3.4%	10.7%
Industrials	-5.3%	14.6%
Information Technology	11.1%	41.0%
Materials	-6.8%	7.7%
Real Estate	-4.5%	4.1%
Utilities	2.0%	6.3%

Five sectors make up approximately 75% of the US market, with Tech companies constituting around 40%. The bottom chart shows the 12-month performance of the five largest sectors.



Sector	Weight	Cummulative
Information Technology	29.6%	29.6%
Financials	13.2%	42.8%
Health Care	12.4%	55.2%
Consumer Discretionary	10.3%	65.5%
Communication Services	9.0%	74.5%
Industrials	8.8%	83.3%
Consumer Staples	6.0%	89.3%
Energy	3.9%	93.2%
Materials	2.4%	95.6%
Real Estate	2.3%	97.9%
Utilities	2.1%	100.0%



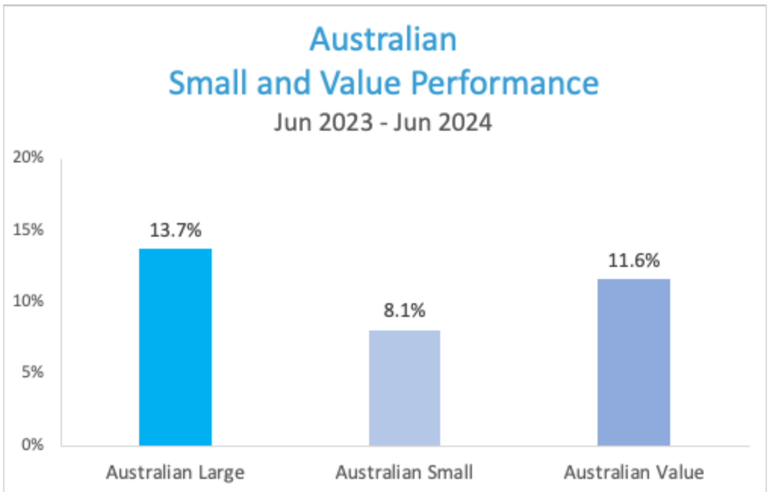
Equity Factors - Small and Value Premiums

Asset Class	3 Months	1 Year	3 Year	5 Year	10 Year
Australian Large	-0.7%	13.7%	7.4%	7.5%	8.0%
Australian Growth	0.4%	15.6%	6.1%	6.5%	8.9%
Australian Small	-3.3%	8.1%	1.9%	6.8%	7.9%
Australian Value	-1.9%	11.6%	8.5%	7.7%	6.6%
Global Large	0.3%	19.9%	11.2%	13.0%	13.1%
Global Growth	4.0%	26.2%	11.8%	16.6%	16.3%
Global Small	-5.1%	8.8%	2.7%	8.0%	10.1%
Global Value	-3.5%	13.6%	9.8%	8.6%	9.6%

Source: FE Analytics. See below for MSCI indices used to define Large, Small, Value and Growth.
Note that the MSCI Australia indices will be different to the S&P/ASX 200 and S&P/ASX Small Ordinaries indices.

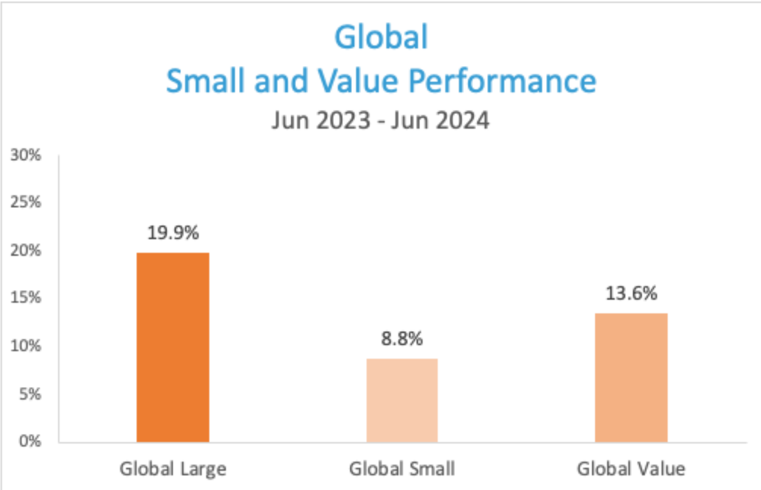
AUSTRALIAN FACTORS

Factors are very volatile over short time periods. Looking over the course of the last 12 months, Australian value stocks have underperformed growth stocks, mainly due to the performance of the higher P/E banks (CBA and NAB). Smaller companies continue to underperform large companies, particularly in the risk-off environment of the last quarter.



GLOBAL FACTORS

The global markets are dominated by the US, which accounts for approximately 70% of the MSCI World Index. The biggest driver of US returns in the last few years has been the large growth tech stocks, resulting in value and small cap stocks underperforming the broader market. However, the MSCI World ex-USA index has delivered a value premium over the last 12 months.



MSCI Australia TR
MSCI Australia Small Cap TR
MSCI Australia Value TR
MSCI Australia Growth TR

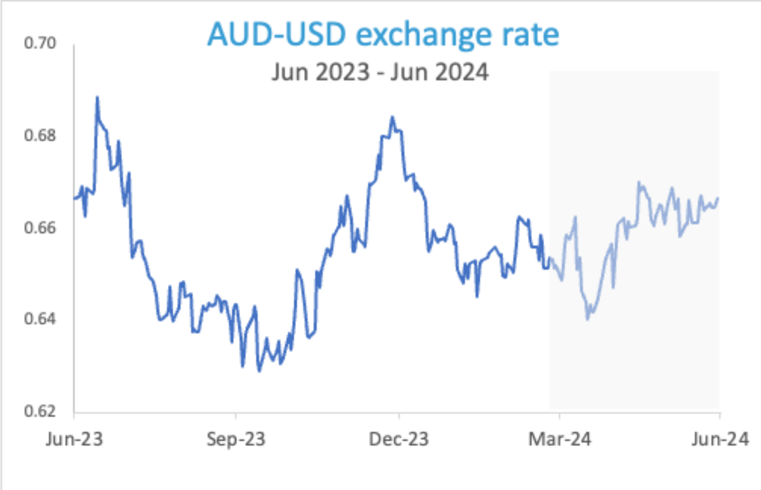
MSCI World ex Australia Index (ATR, AUD)
MSCI World ex Australia Small Cap Index (ATR., AUD)
MSCI World ex Australia Value Index (ATR, AUD)
MSCI World ex Australia Growth Index (ATR, AUD)

Currency and Commodities

EXCHANGE RATE

The Australian dollar is up 2.4% in the quarter, as the differential between Australia and US 10 year bond yields has decreased.

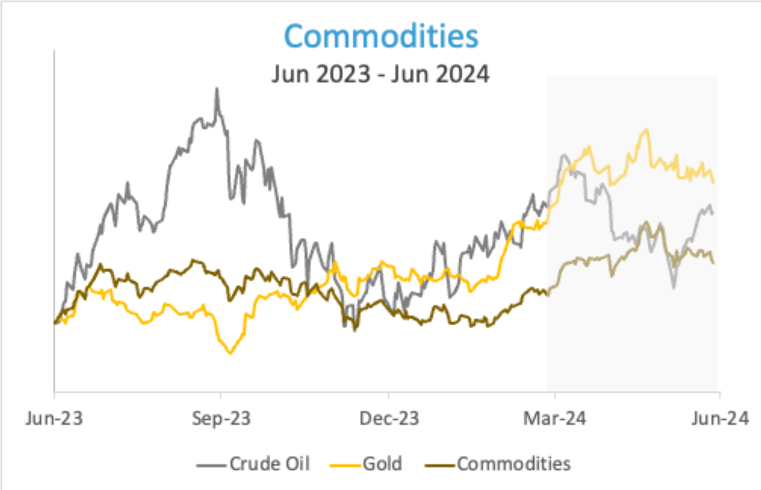
The RBA will trail the US in shifting to an easing cycle as domestic inflation remains stubborn, and the recent acceleration in inflation has pushed the AUD higher on an expectation that the RBA may raise rates.



COMMODITIES, OIL AND GOLD

The Commodity index is up 9% over the last 12 months, buoyed by oil and gold which together make up approximately 30% of the index.

Gold is up 22% over the last 12 months, buoyed by increased expectations of monetary easing and continuing geopolitical tensions. Oil prices continue to track higher on renewed tensions in the Middle East and the Russia-Ukraine conflict.



Source: www.investing.com

Dr Steve Garth
Principia Investment Consultants
July 2024