Quarterly Newsletter | December 2023

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Giving you the edge to achieve a positive future

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Bond, share and property markets have moved up in expectation of lower interest rates in 2024.

GLOBAL OVERVIEW

Both share and bond market prices continued to rise in the December quarter, capping a solid year for investment markets. The moves were driven by the combination of evidence that inflation was easing, comments by the Chairman of the US Central Bank that interest rates were likely to fall in 2024 and economic data that remained fundamentally robust. This resulted in a near consensus view that a soft landing is in place with rate cuts in the US now expected in March and Australia is likely to follow with interest rate reductions in the second half of the year. This seems optimistic, as discussed below. The Australian 10-year bond yield decreased from 4.4% to 4% during the month on comments by the Reserve bank of Australia that higher interest rates were working to slow the economy. That's just part of the story.

Market analysts interpreted the comments that a further increase in monetary policy was not required and in fact the next likely move by the central bank would be to cut rates. The Australian bond market returned 3.80% over the quarter to be 5.3% higher over the year. The S&P/ASX 200 Accumulation Index increased 7.26% in December closing on its highs for the year and delivered a return of 12.4% for 2023. The fall in bond yields saw a continued rotation to the more interest rate-sensitive parts of the stock market, with real estate investment trusts REITs (+11.4%) the best performing sector. Within the Australian share market, Healthcare (+9.1%) also performed strongly with several large stocks recovering from oversold positions. The smaller end of the Australian share market which has struggled all year, also increased strongly in December with the S&P/ASX Small Ordinaries Index rising 7.2%, to post a positive return of 7.8% for the year and a rise of 15% from the low point in late October.

International shares as represented by the Morgan Stanley Capital Index (MSCI), returned 1.8% in December held back by the rise in the Australian dollar particularly against the US dollar as the US share market makes up most of this index. Over the year ending December 2023, the MSCI increased a very healthy 23.2% thanks to the rise in just a handful of companies in the US including Apple, Alphabet

Emmanuel Calligeris
Chairman of the CARE Investment Committee

Inc., Nvidia, Meta, Tesla, Microsoft and Amazon. Collectively known as the "Magnificent 7." The US share market itself was strong with the Nasdaq Composite, a broad market index that is heavily weighted towards the technology sector, increased by 7.6% over the quarter in local currency. The rise followed economic data that suggested a more benign inflation outlook is likely and to that end comments from US Federal Reserve Chairman Powell that we are likely at the peak of the interest rate cycle. The Fed has projected that rates will fall in line with the core PCE (personal consumption expenditure) inflation from 3.2% to 2.4% in 2024. The market has taken this a step further in its expectations and is now pricing a 70% chance of the first rate cut at the central bank's March meeting and led bond markets to price in close to 1.50% of interest rate reductions over the course of the year.

The influence of the Magnificent 7 on stock markets in 2023 was nothing short of profound. There were many reasons for why the "Magnificent 7" performed so strongly including strong underlying fundamentals, strong profits, beneficiaries of the artificial intelligence (AI) boom, apparent immunity from inflation and vagaries of interest rates, but there is no denying it was very narrow and concentrated in these mega-cap names. We must remember that no tree grows to the sky. These companies have experienced strong profit growth but profit growth will eventually slow to a more normal pace.

In Europe, our previous report highlighted the sluggishness of the manufacturing economies and in particular - Germany. The ECB will pivot to an interest rate easing stance despite the economic data becoming less bad. Investors appear to be expecting rate cuts to ease the headwind from restrictive monetary policy. However, consumer inflation expectations also increased, after having declined in the prior three months. This is the first batch of important data in the run-up to the January ECB meeting. The bad news is that a lasting disinflation trend cannot be taken for granted yet. At the same time, the improving economic situation does not require an early interest rate cut. Data still seems geared towards a wait-and-see position at least until the second quarter.

China's policy meeting was disappointing in that there were no strong policy signals, however the background message appears to be that fiscal stimulus will continue to be used to prop up growth. Although annual growth recorded 5.2%, it underwhelmed expectations. Other data releases reveal that the economy continues to face potent headwinds. The GDP deflator – the broadest measure of inflation - declined 1.5% over the year corroborating the signal from falling producer and consumer prices. The property market is deteriorating with the contraction in new home prices and residential property sales deepening. The property slump and deflationary forces are weighing down on consumer sentiment. The 7.4% year-on year expansion in retail sales in December fell below an 8% forecast. The bottom line from the economic data released in January is that the outlook remains gloomy. The current policy stance is not accommodative enough to produce a cyclical recovery.

The Genuine Edge portfolio returned 4.1% over the quarter, culminating in a 14.6% increase over the year. Investments in Robotics / Automation (+8.7%) and International Small Companies (+7.0%) were among the two biggest contributors to portfolio returns over the quarter. The Indian Equity Strategy, with a modest 2.2% increase, and Global Healthcare, which decreased by 1.1%, detracted from our relative performance.

Security positions were closely monitored and were carefully reviewed by all our committee members throughout the period, particularly with any overweight or underweight positions. During the December quarter, security weightings of were well within our policy range. As such, the Investment Committee did not need to rebalance the portfolios over the quarter.

The Robotics/Automation ETF rebounded strongly in the December quarter, bringing its 1-year return to +23%. The investment aims at providing investors with exposures to selected market and technology leaders across 2 groups (i.e. Technology and Applications) and 11 subsectors, covering the entire value chain of robotics, automation, artificial intelligence. The "Technology" group captures the critical intelligent systems that interact with the human world, including actuation, sensing, computing, and integration. The "Applications" group refers to specific and evolving areas of industry and society where this technology is deployed, including food and agriculture, 3D printing, security, healthcare, material handling, manufacturing, energy, and consumer products. Over the quarter, the top two performing subsectors were Business Process Automation (+25%), led by Dassault Systems (+30.8%), ServiceNow (+26.4%), PTC (+23.5%) and Autodesk (+17.7%). This was followed by Sensing (+20.2%), led by Koh Young (+41%), Hexagon (+39.6%), Samsara (+33.4%) and Keyence (+18.5%). ServiceNow is a U.S. company that specialises in cloud computing platforms, helping businesses to define, manage and automate their digital workflows. The introduction of its newly launched AI-powered tool for workflow enhancement aligns well with the current market demands and technological trends, which could continue to drive their future growth. Koh Young is a South Korean company specialising in 3D measurement and inspection equipment that are used in the production of electronic assemblies. The company's growth is significantly driven by the increasing need for precision in manufacturing, particularly in the electronics sector. The Manufacturing and Industrial Automation sector lagged over the quarter. This sector, which still depends heavily on the industrial market in China, faced slower-than-expected growth. The first half of the year was particularly challenging, marked by consecutive months of contraction. This trend indicates a shift in the sector's dynamics, with a growing need to diversify and expand beyond the Chinese market to maintain growth momentum globally.

The Indian Equity Fund returned +17.9% over 2023, outperforming the broad emerging market benchmark by +8.7%. Indian equities ended the quarter in positive territory, with sectors like real estate, utilities, and industrials advancing the most. In light of this, not owning certain utilities names, including some Adani Group companies, and not holding stocks that come under Fund's exclusion policy list, along with an overweight stance in financials weighed on returns. Holdings in KEC International and Marico were among the biggest detractors from portfolio performance. KEC International is India's second largest manufacturer of electric power transmission towers and also one of the largest Power transmission, Engineering, Procurement and Construction companies in the world. Its short-term performance was negatively impacted by the subdued growth in its railways segment, a key business area. Nevertheless, the substantial growth in its diversified segments like cables, solar, civil, and smart infrastructure is expected to fully compensate for the slowdown in the railways segment and drive overall growth. Marico, specialises in beauty and wellness products and particularly known for its hair oil brands like Parachute, faces market saturation in its core categories, limiting the scope for volume growth. However, its market-leading status and strong focus on innovation are expected to help Marico sustain and grow its market presence. The holding in HCL Technology posted gains as it reported revenue growth in line with expectations for the quarter. The company is performing well when compared to its industry peers, especially in aspects such as deal bookings, prospects for near-term growth, and the robustness of its managed services offerings. The exposure to Fortis Healthcare also enhanced relative returns, as it has been actively expanding its presence, both in terms of geographical reach and service offerings. The increasing demand for quality healthcare services in India, partly due to a growing middle class and heightened health awareness, is expected to play into Fortis's strengths.

The performance of the Healthcare ETF (IXJ) remained subdued, finishing the year just +2% higher. The sector had a relatively muted year, especially when compared to the returns from the Information Technology and Communication sectors. The pursuit of AI-related investments indeed weighed on sector performance, as investors favoured high-profile technology stocks over healthcare companies. Eli Lilly (+59.9%) and Novo Nordisk (+54.7%) are the two biggest contributors to Fund returns in 2023, continuing to gain traction thanks to their early success in the development of anti-obesity drugs. These new varieties of diabetes and weight loss drugs, however, led to increased market volatility as some medical device companies were sold off heavily on the basis that their devices and services would become outdated in the future. The rest of sector has yet to gain moment, in part due to the approaching general election in the U.S. The healthcare sector typically underperforms the broader market in general election years, as presidential candidates pledge to reform drug prices or health

insurance, creating additional uncertainties for the sector. Companies that held back the performance over the quarter included Pfizer (-16.8%), Bristol-Myers Squibb (-15.5%) and Johnson & Johnson (-4.1%). Corporate activity will likely be an ongoing feature of the sector, as large, established pharmaceutical companies acquire high quality businesses for new growth opportunities at attractive valuations. With the interest rate environment becoming less restrictive in 2024, activities from smaller biotech companies are expected to pick up as well. With valuations across the broad healthcare sector remains relatively attractive, we may start to see some stronger support to Fund performance in 2024.

The International Small Companies ETF returned +7.0% over the quarter, to be 14.9% higher over the last 12 months to December. It was yet another challenging year for small companies as higher bond yields acted as a notable headwind to sector performance. As bond yields rise, the discount rate used in such valuation process may also increase, which can lower the present value of expected future cash flows and potentially lead to lower stock prices. Higher bond yields could also result in increased borrowing costs for companies, especially for smaller businesses which often have fewer dominant positions within their industries, lower profit margins, and less pricing power to offset rising costs. Thanks to a substantial fall in bond yields towards the end of 2023, smaller companies finished the year with stronger momentum. Over the quarter, weakness in the Energy sector (-9.3%) was among the biggest detractors from Fund performance. The fall in oil prices from roughly US$90 to US$75, with other key commodities such as natural gas and coal also experiencing similar declines, weighed on sector returns. On the positive side, Financial Services (+10.7%) and Real Estate (+9.4%) emerged as the biggest contributors to performance. The recovery was primarily underpinned by improved investor sentiment, fuelled by expectations of rate reductions in 2024 particularly in the U.S. (being 63% of the Fund). This anticipation of a more accommodative monetary policy typically bolsters sectors that are more sensitive to interest rate changes. Despite a turbulent start to the year for the U.S. banking system in 2023, the economy experienced better-than-expected growth. Additionally, a property market that proved surprisingly resilient also helped to offset concerns about tightening financial conditions.

As mentioned above, bond, share and property markets have moved up in expectation of lower interest rates in 2024. Although we are close to if not at the end of the interest rate tightening cycle in the US, Europe and potentially Australia, with further stimulus required in China, the path of reductions looks optimistic. Strong growth and low inflation with full employment equals economic Utopia. However, when an economy reaches full employment as is the case in Australia today, the central bank needs to calibrate monetary policy almost perfectly to keep it there. If it does not cut rates fast enough, unemployment will increase; if it cuts rates too fast, inflation will rise. Against the backdrop of the current unsettled geopolitics, central banks are navigating a very narrow runway.

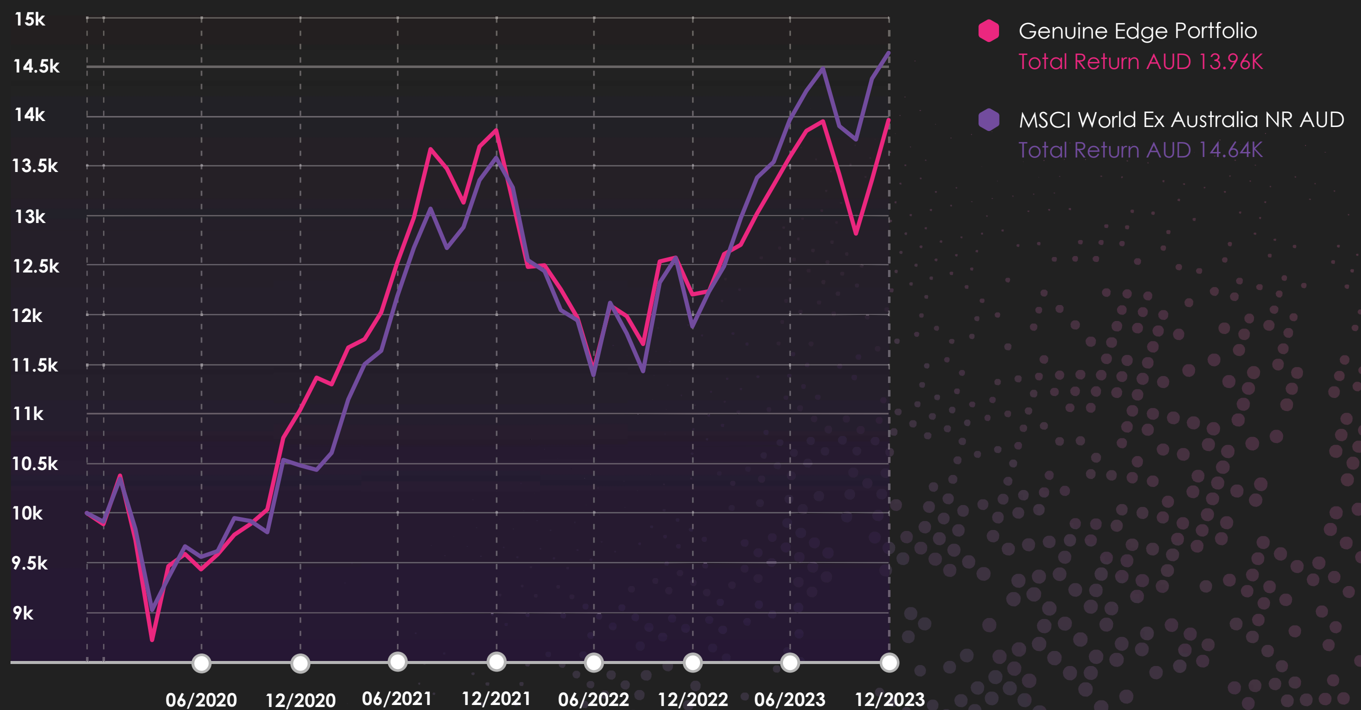
RETURNS

31ST DECEMBER 2023

1 Month	3 Months	6 Months	1 year	3 years
4.51	4.07	2.75	14.59	8.23

* Returns are based on model portfolios assuming benchmark allocation. The numbers are before tax, adviser fees or platform fees but are net of the CARE Investment Management fees.

GROWTH OF $10,000 OVER 5 YEARS



Time Period: 1/12/2019 to 31/12/2023
Source Morningstar Direct

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INVESTMENT COMMITTEE

Emmanuel Calligeris
BEc MBus (Finance)

Emmanuel is Chairman of the CARE Investment Committee. Emmanuel holds a degree in economics and worked as the Chief Investment Officer for OnePath Investments (the investment arm of ANZ Bank) for over 20 years where he was responsible for $13 Billion of funds under management.

Grahame Evans
GAICD DipSM MBA

Grahame is the risk and compliance member of the CARE Investment Committee. Grahame brings over 35 years of financial service industry experience.

Dr. Mark Brimble
BCom(Hons) PhD CPA FFin

Mark is an independent member of the CARE Investment Committee. Mark holds a doctorate in capital markets and is keenly interested in investor behaviour.

Rob McGregor
SIA (Aff) ADFP

Rob was a founder of GPS Wealth, developed the CARE Investment Philosophy over the last 15 years and successfully managed $100m in clients' funds during the GFC.

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