

Sterling Clime Balanced Portfolio (SR0011)

Investment Summary
October 2024



Praemium (SMA)

Market & Economic Commentary

Markets marked time over October, with the consequential US election over-shadowing the investment environment. The one asset class which moved decisively over the month was the bond market, with US 10-year Treasuries rising from approximately 3.81% at the end of September to around 4.28% at the end of October, reflecting increased concern about risks from fiscal deficits, election promises, and increased uncertainty. Hopefully, a peaceful and clear outcome to the US election will see some reversal in November.

In the US, sharemarket indexes ended October mixed to lower, with the benchmark S&P 500 down -0.99%, the Dow Jones down -1.34% for the month, while Nasdaq rose 1.03%. Other global markets were lower: Germany's DAX was down -1.28%, the French CAC fell -3.74%, Britain's FTSE was down -1.54%, and Japan's Nikkei was also lower. China's key index fell almost 8%, giving back some of the previous month's gains.

The ASX 200 fell -1.33%, with the 5% fall in Resources a key drag. Gold was the best performing sector, as central bank buying, and geopolitical tensions continue to support the gold price. Consumer Staples was a laggard, largely driven by weak earnings guidance from Woolworths.

Banks returned to strength, partly reversing the rotation to mining that occurred in late September. As we head into their reporting season, banks are still one of the rare parts of the market seeing consensus earnings upgrades as Reserve Bank of Australia (RBA) rate cut expectations are pushed back and bad debts remain low. Banks have risen substantially over the last 12 months and are now priced well above their long-term average valuations.

The ASX 200 is up 20% over the last year. Valuations for Australian stocks are stretched, with the forward Price Earnings ratio (PE) around 18.2x versus a long term average around 14.5x.

As noted above, US and global bonds ended the month with yields sharply higher. Global bond yields had been in a downward trend on the back of softening economic data, with markets enjoying lower inflation readings and rate cutting policies amongst most developed economy central banks. But that trade reversed during October, with anxiety over the US deficit outlook and amidst election uncertainty.

The AUD fell against the USD, reflecting USD strength as a safe haven during times of uncertainty. We think the AUD could rise in the months ahead, boosted by the Chinese stimulus package and higher commodity prices, and it remains under-valued longer term. Resources were mixed over October with iron ore down, gold up, and oil (Brent Crude) flat.

As we have previously reported, the US Federal Reserve (Fed) in late September slashed its short-term rate target by 50 basis points and signalled more cuts to come. Since then, investors have pushed the yield on Treasury notes steadily higher. Why would long rates rise while the Fed's cash rates fall?

The Fed sets interest rates for the immediate future. Investors in bond markets are betting on the path of those rates for the next decade or longer. For many reasons, interest rates are likely to be higher in the coming decade than in the prior one.

One of those reasons is relatively benign: inflation and growth are unlikely to be as low as they were in the post-GFC period and before the pandemic. A second reason is more worrying with the US federal debt is on an unsustainable path, which might become even more unsustainable after the election, regardless of who wins.

Meanwhile, it is possible US economic growth will surprise with a robust 2.8% to 3.0% pace over the calendar year. That would suggest that the US economy has become less vulnerable to higher interest rates. Using the jargon employed by economists, the "neutral rate," which keeps inflation and unemployment roughly in balance, has apparently risen. As recently as last December, Fed officials thought neutral was 2.5%. By September this year, they had raised that to 3.0%, and some officials now see neutral at 3.5% or higher. By itself, a higher neutral rate is not especially worrying because it signals a return to normalcy.

But there are increasing risks for bond markets that cannot be ignored – one of which is the soaring US federal debt. Since 2007, the federal debt has climbed from 35% of gross domestic product to almost 100%. Much of this was a result of the 2008-09 global financial crisis and Covid-19. The borrowing did not initially put much upward pressure on bond yields because inflation and the neutral rate were so low. Low rates, in turn, made the debt relatively easy to service.

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Yet in the past fiscal year, concerns have started to rise. The US budget deficit is now projected at 6.4% of GDP, a record outside of war, recession or crises such as the pandemic. Interest expense is climbing steadily. The Congressional Budget Office projects that under current law, publicly held debt will hit 122% of GDP in 2034. Whereas the effect on long-term rates had been largely invisible thus far, the rising US Treasury yield is now garnering investor focus.

At this stage at least, the US economic soft landing has been achieved. Yet prudence would suggest noting that positive sentiment is stretched, valuations are high, geopolitical/economy risks are elevated, and uncertainty around policy and politics as the US votes in a new administration is growing. We think that a defensive stance remains sensible, even as positive market momentum appears to be the path of least resistance.

Some key observations from this year to date and which will likely persist into the year ahead:

- Inflation has peaked and is now falling in a steady trajectory.
- Cash interest rates are being adjusted down by central banks. The RBA will follow next year.
- Global economic growth is moderate, no world recession has occurred and nor is one likely.
- The USD and gold have been strong, and the AUD and crude oil weak.
- Sharemarket valuations are generally expensive.
- The US economy is growing in robust fashion while Australia's economy remains subdued.
- Bond markets are at risk from highly elevated debt levels in many developed economies.

Portfolio Snapshot

Inception Date	SMA Model Code	Portfolio Objective	Benchmark
20th October 2017	SRO011	Deliver strong risk-adjusted total returns	Blended Balanced Index

1 Sterling Clime Blended Balanced Index is comprised of a 45% weighting to S&P/ASX 200 Accumulation Index, 5% to S&P/ASX 200 A-REIT Accumulation Index, 10% weighting to MSCI World ex Australia Index (AUD), 35% weighting to the Bloomberg AusBond Composite Index and 5% weighting to the RBA Cash Rate.

Portfolio Performance* (31/10/2024)

	1 m	3 m	6 m	1 y p.a	3 y p.a	Inception p.a
Portfolio Return	-0.8%	0.5%	4.8%	14.9%	3.6%	6.2%
Capital Return	-0.8%	-0.2%	2.5%	11.0%	0.5%	2.9%
Income Return	0.0%	0.7%	2.3%	4.0%	3.1%	3.3%
Sharpe Ratio	-	-	-	2.00	0.09	0.44
Sterling Balanced Index	-1.4%	1.3%	6.5%	19.4%	4.9%	6.5%
Difference	0.7%	-0.9%	-1.7%	-4.5%	-1.3%	-0.3%
Number of Individual Holdings (excluding cash):	34					

**Due to rounding, the sum of the capital and income return figures may not add up to the portfolio return figure.*

Portfolio Commentary

The Sterling Clime Balanced portfolio returned -0.8% for the month of October, outperforming its benchmark which returned -1.4%. The key drivers of portfolio performance and major portfolio changes are outlined in the tables below.

Positive Attributors	Comment
Resmed Inc CHESSE Depository Interests on a ratio of 10 CDIs per ord.sh (RMD.ASX)	RMD was a positive contributor to performance over the month. The stock's rise was driven by another strong quarterly result which featured double digit sales growth across all divisions and geographies and on-going expansion in margin from product innovation and cost control. Also of help to RMD's performance over the month was the weaker AUD versus the USD. While RMD's share price has risen materially the last 12 months after negative sentiment flowing from the rise of weight-loss drugs, we still think the stock represents good value given the continuation of strong earnings growth.
Negative Attributors	Comment
Newmont Corporation Registered Shs Chess Depository Interests Repr 1 Sh (NEM.ASX)	NEM detracted from performance this month following a weak quarterly report, which included production downgrades for Lihir and Brucejack as well as cost increases across the company's gold mining portfolio. Investor expectations had risen on anticipated benefits from the integration of Newcrest assets and improving performance of the Nevada JV. We view this result as a reset of expectations and will continue to monitor NEM's operational performance closely.
Rio Tinto Limited (RIO.ASX)	The price of iron ore drifted lower during the month, reflecting weaker economic growth in China and a lack of anticipated fiscal stimulus, which impacted RIO's share price. Given the large number of new low-cost iron ore projects and a flat outlook for steel demand, our outlook for future iron ore prices has become less optimistic. Throughout October, we reduced our exposure to RIO.

Portfolio Activity

BUY	Comment
Ramsay Health Care Limited (RHC.ASX)	RHC is an owner and operator of private hospitals across Australia, the UK and Europe. Following a prolonged period of poor capital allocation and earnings pressure during the COVID era, we think RHC is entering a recovery phase as competitors exit the industry and as RHC management seek to address past poor decisions regarding investments undertaken in offshore markets. At \$41 per share (which is less than half the price that KKR bid in 2022), we think the market is overlooking the intrinsic value of RHC's freehold Australian hospital network.
SELL	Comment
Capstone Copper Corp. Shs Chess Depository Interests Repr 1 Sh (CSC.ASX)	The CSC position has been exited due to increased risks associated with its key growth project, Santo Domingo, particularly regarding operating cost projections. We expect cost pressures to impact the company's operations and believe that assumptions of near-perfect operational performance are unrealistic. We have chosen to take profits and reallocate capital to higher conviction opportunities.
Rio Tinto Limited (RIO.ASX)	RIO has been sold from the portfolio to reduce exposure to iron ore after a period of stronger share price performance relative to BHP. Given the large number of new low-cost iron ore projects and a flat outlook for steel demand, we are less optimistic about the future price of iron ore. We view BHP's growth in copper projects as having stronger long-term drivers of returns on capital. As a result, the proceeds from the RIO exit will be allocated to increasing the BHP weighting in the portfolio.

Top 5 Holdings

Security	Weight (%)
AB Global Equity Fund	12.4%
Vanguard MSCI Index International Shares (Hedged) ETF	8.2%
Realm High Income Fund	7.9%
TORICA ABSOLUTE RETURN INCOME FUND	7.9%
Vanguard Australian Government Bond Index ETF	5.8%

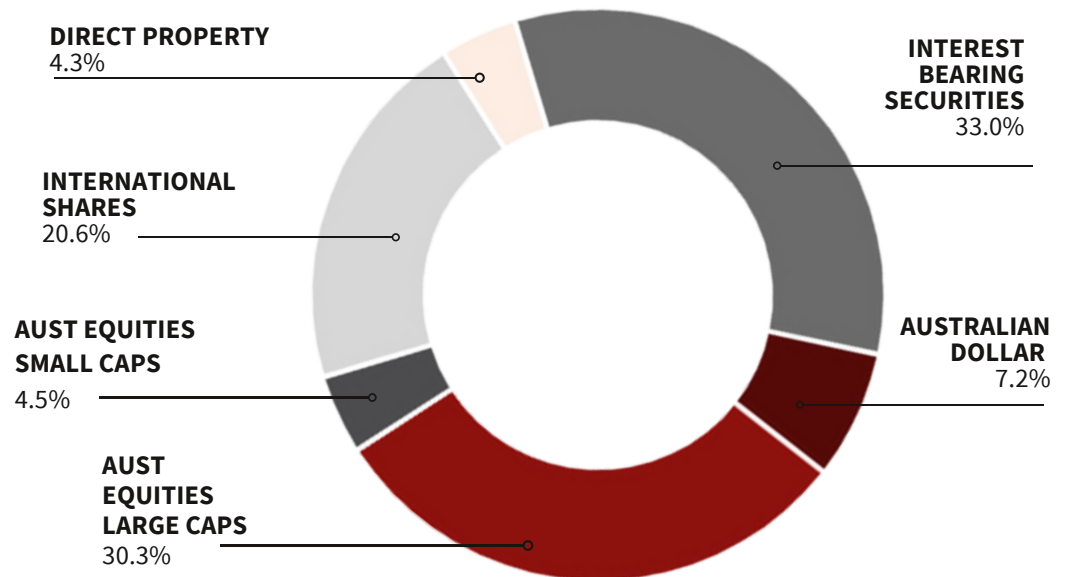
About the Model Manager

Clime applies a consistent approach to identify the most attractive investment opportunities within the universe of stocks.

Clime invests with a focus on quality and a strong valuation discipline. Our investment solutions are centred on helping clients grow their wealth.

Asset Allocation

Note: the sum here may not add up to 100% due to rounding



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