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Sterling Clime *Conservative* Portfolio (SR0010)

Investment Summary
June 2024

Praemium (SMA)

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Market & Economic Commentary

The mid-point of calendar 2024 is a useful time to take stock of financial markets and the forces driving them. Key themes that dominated the first six months included the scaling down of interest rate cut expectations in the face of persistent inflation, the resilience of the US economy, and a mixed picture in Europe and Asia. The key factor driving global markets remained the expectations for interest rates, and disappointing inflation data meant that markets anticipate that the US Federal Reserve will keep rates unchanged at a two-decade high until there is unequivocal evidence that inflation is declining towards their target of 2%. Rising political uncertainty with a number of elections being held across the globe was also a factor over the past few months, and will continue to be so until the US votes in November.

Over June, the ASX 200 Accumulation Index was barely changed (+0.9%), but that disguises large variations between sectors. Financials, Healthcare and Consumer stocks all performed well, while Materials and Energy stocks were weaker. In the US, indexes were higher, with the benchmark S&P 500 up 3.6%, but performance remains concentrated driven by the large mega-cap technology names. Other global markets were mixed: Germany's DAX was down 1.4%, the French CAC down 6.2% (shocked by President Macron's calling of a snap election and the strong showing of the far-right National Rally), and Britain's FTSE was down 1.3%. Japan's Nikkei was up 2.8%.

US and global bonds ended the month with yields generally higher and prices lower, affected by political uncertainty in France, and a growing sense that Donald Trump is gaining the lead over Joe Biden in the race for a second term. Long-term US government bond prices fell sharply following Biden's disastrous performance in the presidential debate, despite the lowest year on year print for the personal consumption expenditures figure since March 2021. We think the bond market is reacting to the increased probability of a second term in the White House for Trump, and fears that tax cuts will worsen deficits.

Central banks have indicated that official rates are likely to stay higher for longer and that they will not be rushed into rate cuts in the next few months. US ten-year Treasuries stabilised around 4.4%, with Australian government ten-year bonds at 4.3%. The AUD was slightly stronger over the month, settling around US$0.67 but remains weaker than we think it ought to be. Resources were mixed, with oil up, gold unchanged, and iron ore and coal both sharply weaker. The VIX volatility index remained at very low levels over June.

The US economy has shown more resilience than most people expected when the Federal Reserve started raising interest rates in March 2022. But now, more than two years into the Fed's tightening campaign, we find ourselves in a state of unstable equilibrium, with forces pulling the economy in oppositive directions.

On the one hand, the lagged effects of Fed rate hikes continue to rein in growth, with higher borrowing costs biting into over-leveraged consumers, corporates, and banks. This is causing rising consumer delinquencies, higher corporate bankruptcies, and increased pressure on some banks' balance sheets, especially smaller regional banks.

On the other hand, the Fed "pivot" in December 2023 triggered an easing of financial conditions: bond issuance surged, M&A activity awakened, risky assets rallied, and bond spreads tightened. These easier conditions have at least partly neutralized the effects of the Fed hikes, paving the way for a re-acceleration in both economic growth and inflation.

Given the current underlying strength of the US economy, we believe that easier financial conditions will continue to offset the effects of the Fed rate hikes, at least for the next couple of quarters, driven by strong consumer spending (particularly on services), high government spending, strong corporate earnings, and the wealth effect triggered by rising asset prices.

As a result, we expect US economic growth to maintain at around 2.5%, on the back of a still strong employment market. We also expect inflation to remain above the Fed's 2% target for the near future, and thus, in all probability, interest rates will remain higher for longer.

The current phase of elevated US rates means the USD is likely to remain strong in the short term, though longer term, we anticipate a period of greenback depreciation as US growth slows more noticeably, the Fed lowers interest rates and global financial conditions ease in 2025.

The economic growth divergence between the US and major developed economies that was apparent early this year may be turning to closer convergence. There are tentative signs of an approaching US economic slowdown, while European economies remain on an overall gradual upswing. We also observe a convergence on the inflation and interest rate front. Internationally, low productivity combined with labour cost pressures is contributing to lingering inflation risks, which could lead to later or more gradual easing from many foreign central banks.

Converging growth trends are matched with a global economic outlook that has softened and become modestly more uncertain. Election outcomes across many emerging economies (e.g. India, South Africa), and elections in France and the UK (in July) and the US (in November), have created temporary uncertainty; however, while we expect a fair degree of policy continuity and only moderate deviations from previous policy paths, political uncertainties have unquestionably increased.

Australia

Australia’s financial markets have marked time over the last few months as investors continued to assess the outlook for the Reserve Bank of Australia's monetary policy. The RBA June meeting minutes showed that the board left the door open for a rate hike if required. The minutes noted wages growth had likely passed its peak and highlighted that risks to the labour market “were seen to be to the downside.” On GDP growth, the minutes noted that growth in GDP had been weak and reflected subdued activity in the more interest rate-sensitive parts of the economy. The minutes also noted that consumer spending over the preceding 18 months had been revised upwards, bringing it closer into line with historical averages. That said, on the hawkish side, the minutes flagged the recent upward revisions to consumption and the need to remain vigilant to upside risks to inflation.

During June, data revealed that Australia’s monthly CPI rose by 4% in May, accelerating from a 3.6% advance in April and surpassing market expectations of a 3.8% increase. This has fuelled speculation that the RBA might raise interest rates in August. However, we think it unlikely that policy decisions would be made based on a single month’s inflation report, and further information will be required before the RBA changes course.

The current economic challenge is that any good news on the activity front is likely bad news for the interest rate outlook – which in turn is likely bad news for the equity market outlook. The RBA remains concerned about lingering inflationary pressures given limited spare capacity, and simply does not want to see much of a lift in overall demand anytime soon.

China

The Chinese economy has been facing a post-Covid period of slowdown, with slowing exports, deflation in its highly leveraged housing sector, and demographic deterioration (which can erode consumer spending over time). Additionally, trade conflicts with its global trading partners (especially the US, now that most disputes with Australia have been resolved) have revived fears of tit-for-tat restrictions on imports, which could lead to an aggregate slowdown in both global commerce as well as the flow of capital, both in foreign-direct investments and capital markets. No doubt, Chinese leaders will be watching the US Presidential election closely, with Trump’s proposals to extend tariffs on Chinese imports up to 60% in their focus.

Despite expected “bumps in the road”, we remain optimistic that inflation will continue to decline, that a soft landing for the global economy is the most probable scenario, and that 2024 is likely to see positive share market returns helped by falling rates later in the year or early in 2025. With share markets hitting new highs in recent months, it is time to be selective in constructing resilient and diversified portfolios. As we enter the second half of the year, the risks for equity holders are rising. Growth momentum is slowing. Valuations are elevated, and markets are concentrated. Geopolitical uncertainty is high. The focus on earnings is likely to be more critical during the next two quarters.

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Portfolio Snapshot

Inception Date	SMA Model Code	Portfolio Objective	Benchmark
20th October 2017	SROO10	Deliver strong risk-adjusted total returns	Blended Conservative Index

1 Sterling Clime Blended Conservative 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* (30/06/2024)

	1 m	3 m	6 m	1 y p.a	3 y p.a	Inception p.a
Portfolio Return	0.2%	-0.1%	2.7%	7.1%	3.2%	4.8%
Capital Return	-0.8%	-1.5%	0.1%	2.6%	-0.5%	1.2%
Income Return	1.0%	1.4%	2.6%	4.5%	3.7%	3.6%
Sharpe Ratio	-	-	-	0.60	0.14	0.41
Sterling Conservative Index	0.8%	-0.7%	2.4%	7.4%	1.2%	3.9%
Difference	-0.7%	0.6%	0.4%	-0.3%	2.0%	0.9%
Number of Individual Holdings (excluding cash):	35					

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

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Portfolio Commentary

The Sterling Clime Conservative portfolio returned 0.0% for the month of June, underperforming its benchmark which returned 0.81%. The key drivers of portfolio performance and major portfolio changes are outlined in the tables below.

Positive Attributors	Comment
Vanguard MSCI Index International Shares (Hedged) ETF (VGAD.ASX)	Global equities performed strongly in June, repeating the same trend seen in May. The performance of VGAD was aided by strong performance of the US technology sector and specifically the Magnificent 7.
CSL Limited (CSL.ASX)	CSL's strong share price performance in June, up over 5%, was driven by market expectations of solid Behring performance. Growth in plasma collections should underpin a double-digit recovery in earnings. Additionally, the stabilisation in bond yields positively impacted the share price. We continue to see value at current levels.

Negative Attributors	Comment
Cettire Ltd. (CTT.ASX)	Cettire's share price dropped sharply in June following a late-month trading update. Despite strong revenue growth, the market was surprised by a significant drop in EBITDA margin. Management attributed this to aggressive inventory clearance by two competitors, one bankrupt and the other under new ownership. Cettire chose to maintain market share at the expense of short-term profitability, meeting revenue but missing profitability expectations. While this issue is temporary, the market seeks more confidence in management and the company's earnings. We have maintained our position, recognizing the large growth opportunity ahead.
BHP Group Ltd (BHP.ASX)	BHP underperformed in June as a lack of new project starts in China flowed through to a weaker outlook for steel producers, which put downward pressure on the price of iron ore. We retain a positive outlook for BHP's diversified strategy and its growing exposure into copper.

Portfolio Activity

BUY	Comment
Capstone Copper Corp (CSC.ASX)	We have initiated a position in CSC which has four operating mines and a catalyst rich pipeline of growth projects. The miner is at an attractive cash flow inflection point as its copper production rises and cash cost profile decreases. We are positive on the outlook for the price of copper which is critical to the electrification process and expect continued tight supply-demand conditions for the metal.
Westpac Banking Corporation (WBC.ASX)	2023 was not the best year for WBC, as they dealt with a worsening NIM position due to mortgage pricing competition, as well as persistently being the laggard in technology investment, which made WBC finally pull the trigger with a $2billion capital expenditure in its IT system. However, WBC since then has improved with its NIM bottoming out as most banks become more rationale in mortgage pricing. Additionally, WBC will benefit from a smaller term funding facility expiring in June 2024. WBC is placed to receive cost out advantages as distortions from one-off redundancies wash through, which are offset by costs on tech and amortisation which are set to increase through to the second half. Westpac is growing well above system growth in its core mortgage book, with pricing above their cost of capital. It has roughly $30billion in fixed rates loans at an average rate of 4% which are converting to variable rates. This will serve to materially boost cash earnings. Although there's some execution risks from their IT upgrade, WBC's valuation looks attractive with a dividend yield well above the market, as well as a healthy franking balance to sustain a higher payout ratio for FY24 and FY25. We decided to introduce WBC to our portfolio as it presents superior upside versus peers.
Woolworths Group Limited (WOW.ASX)	WOW is Australia's premium supermarket operator with a market leading online grocery business, strong ancillary business units which support margins, and tailwinds from population growth supporting trends towards eating at home. Clime is leveraging the recent share price strength in COL to exit our position and increase portfolio weight in WOW which has larger share price upside.

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Portfolio Activity

SELL	Comment
Jumbo Interactive Limited (JIN.ASX)	Jumbo Interactive has enjoyed boisterous market conditions for the first six months of 2024, with the jackpot cycle producing a number of $100m+ draws including Australia's largest ever at $200m. This has driven solid customer acquisition and growth of its new initiatives, such as Splash for Good. Whilst we continue to be attracted to Jumbo's capital light and highly profitable business model, we believe its recent share price run is valuing it to perfection.
Cettire Ltd. (CTT.ASX)	Cettire Limited released a trading update revealing a significant margin reduction during the quarter due to competitor insolvencies and aggressive stock clearances. Concurrently, major fashion houses reported weak sales. Cettire opted to maintain market share, growing revenue at lower margins. Although revenue met consensus, EBITDA margin fell short of expectations. We still favour Cettire's long-term prospects but believe the company needs a series of strong results to restore market confidence. For now, we see better opportunities for your capital.
Coles Group Ltd. (COL.ASX)	COL has been a strong performer relative to its key listed competitor, WOW, year-to-date, successfully growing its market share and implementing a competitive own-brand strategy. Clime is leveraging the recent share price strength to exit the position on valuation grounds and to take advantage of the stronger share price upside in WOW.
National Australia Bank Limited (NAB.ASX)	NAB's share price has rallied hard since its latest result which announced a $1.5billion buy-back. NAB is likely to feel some NIM pressure as their term funding facility matures on the 30th June 2024, and an on-going deposit competition continues within the institution/business segment, where NAB has traditionally held a strong position. On top of that, recent APRA data is indicating weaker growth from NAB compared to competitors, which makes it hard to justify its current valuation premium versus peers. Our view is that the current on-going buy-back, although it may benefit the share price in the short term, is not the best use of their capital from an ROE perspective and thus we are moving underweight NAB relative to the market.

Top 5 Holdings

Security	Weight (%)
Realm High Income Fund	12.3%
TORICA ABSOLUTE RETURN INCOME FUND	12.3%
Vanguard Australian Government Bond Index ETF	9.8%
iShares Government Inflation ETF	9.8%
ETFS US Treasury Bond (Currency hedged) ETF Units	9.8%

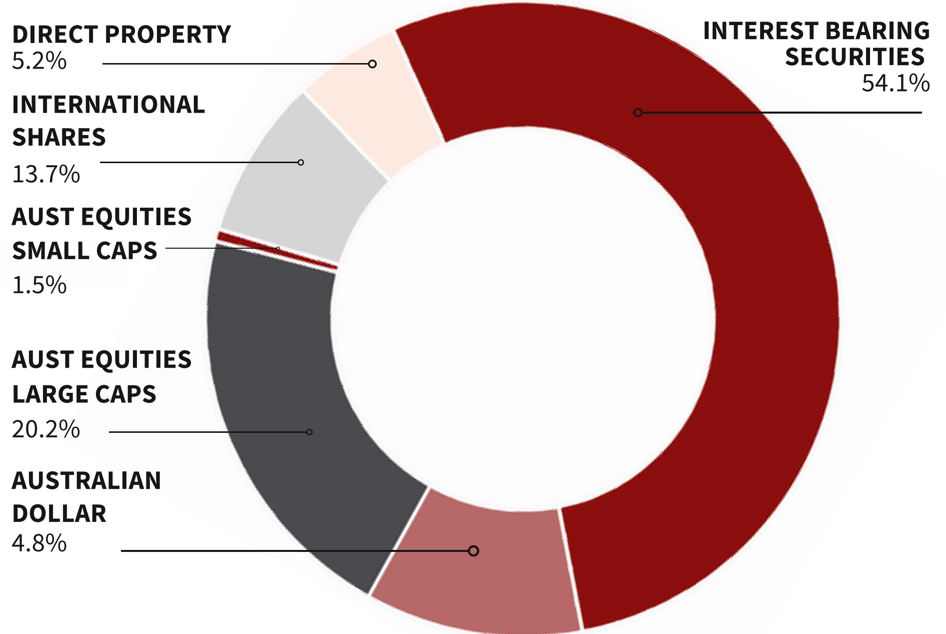
About the Model Manager

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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