Sterling Clime Balanced Portfolio (SR0011)

Investment Summary
July 2024

Praemium (SMA)

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Market & Economic Commentary

July was a broadly positive month for markets, but there are clear indications of overstretched valuations and concerns are growing about the outlook. The US economy seems to be stalling, probably because low-end consumers are feeling the squeeze of higher living costs, higher interest rates, higher local taxes and insurance payments, while wages are no longer rising so fast. There is also disappointment at the lack of traction in the Chinese economy and the absence of new stimulus following the Communist Party's third plenum in July. In addition, there is the disruption of the yen carry trade as the Japanese currency has rallied strongly, and heightened fears of a broader regional war in the Middle East. Growing political uncertainty in the US following the failed assassination attempt on Donald Trump, the withdrawal from the campaign of Joe Biden, and the rise in the polls of Kamala Harris are further factors unsettling markets.

In the US, indexes were higher in July, with the benchmark S&P 500 up 1.1%, and up 15.8% year to date. The Dow Jones was up 4.4% for the month, and up 8.4% year to date. Nasdaq lost 1.6% in July, with performance driven by the large mega-cap technology names, and evidence that investors are rotating out of the sector and banking large profits. Other global markets were lower: Germany's DAX was down 2.3%, the French CAC down 2.1% and Britain's FTSE was down 1.0%. Japan's Nikkei was down 2.5%.

US and global bonds ended the month with yields lower and prices higher. US 10-year Treasury notes fell 32bps in yield to below 4.0%, and Australian 10-year yields fell 19bps to end the month just above 4.0%. Treasury yields have been in a downward trend since April on the back of softening economic data, with market expectations that the Fed will start cutting rates this September. Specifically, the July 5th Jobs Report saw the monthly unemployment rate tick up and the July 11th CPI report showed both headline and core CPI below consensus. The 2-year yield ended July near its lowest level since February, while the 2/10 spread hit its least inverted point in two years.

The AUD was weaker over the month, settling slightly below US$0.65. Resources were mixed, with oil lower, gold up, and iron ore sharply weaker. The VIX volatility index rose sharply from its low of around 12 to a touch over 18 in July.

Investor focus has moved decisively from considerations around US inflation to those around US economic growth. The US unemployment rate in July rose above the psychological 4.0% barrier to 4.3%, and the new employment number of only 114,000 resulted in concerns about a potentially weakening US economy. Both the US Manufacturing and Services PMI Indices are currently in contraction territory, with the former now dropping after a recovery period. It is clear that the sustainability of current economic growth is coming under question.

With US inflation seemingly under control (even though it still has some way to go to the Federal Reserve's target rate of 2%), the sustained health of the US economy is becoming a focus point. It is clearly a critical task for the Fed to consider their potential stimulus at the right time to prevent a potentially too quickly cooling economy turning into a recession. There are only three Fed meetings remaining this year. We can expect pressure from the public on the Fed to be quick with their easing process, and to keep the US economy on course.

The change in the US economic outlook has caused a volatile reaction in the stock market as investors switched from their higher-valued large capitalisation growth stocks to lower- valued and small capitalisation stocks. This "rotation" is based on the premise that these lower quality businesses will find it easier with lower interest rates, and is particularly affecting technology stocks. The extent of the rotation in favour of small-cap stocks was indicated by the Russell 2000 Index outperforming the S&P 500 by 14% in July, a huge margin.

The second quarter earnings season is well under way, with three quarters of the S&P 500 constituents already having reported. On a consolidated basis they have delivered revenue growth of +5% and bottom-line earnings growth of +11%. This is somewhat better than consensus expectations, but those companies that disappointed on their results or outlook comments were severely punished by the market.

The S&P 500 Index follows the consensus target valuations over time. Should earnings be exceeded, the chances are that valuations may increase in time based on lower interest rates. With the US election campaigns having started in earnest, investors look forward to more information of their respective promises and more clarity on the potential effects on capital markets.

Australia

In Australia, according to the NAB monthly business survey, business conditions edged down in June, continuing the long running trend since peaking in late 2022. Conditions declined in wholesale, construction, manufacturing and finance, business & property, with the non-mining goods sectors now clearly softer than the services sectors. Retail, despite increasing in the month, remains weakest (and the only industry in negative territory) in trend terms. While the activity side of the survey has shown a consistent easing, capacity utilisation remains high. This lines up with the slowing in activity we have seen more broadly but also with a still high level of demand relative to supply in the economy. Consistent with this, prices and cost growth generally remain elevated. Encouragingly, both labour and purchase cost growth largely reversed last month's increase, and output price growth also slowed.

However consumer sentiment remains weak. The Westpac Consumer Sentiment Index measures the change in the level of consumer confidence in economic activity. On the index, a level above 100 indicates optimism; below indicates pessimism. The Consumer Sentiment index in Australia decreased to 82.7 in July 2024, the lowest in six months, from 83.6 in June of 2024. Consumer Confidence in Australia averaged 100.45 points from 1974 until 2024, reaching an all-time high of 124 points in May of 2007 and a record low of 64.6 points in November of 1990.

The fall in Australian consumer sentiment was driven by weaker perceptions of personal finances, and occurred alongside a sharp rise in expectations around the level of mortgage rates. Westpac noted that "fears of persistent inflation and further interest rate rises are again weighing more heavily on the consumer mood" and have offset any boost from the arrival of the stage 3 tax cuts and other fiscal support measures.

On interest rates and housing, expectations for the level of mortgage rates rose sharply (+12.8%mom), marking the steepest rise since the start of 2022. Nearly 60% of consumers surveyed now expect mortgage rates to increase over the next year.

Valuations on the ASX ended July in stretched territory, with the index flirting with new record levels. Heading into reporting season, the market PE at month end was around 17.1x, well ahead of the long-term average of around 14.5-15x. As the ASX is dominated by miners and banks, it is noteworthy that both these sectors are somewhat vulnerable – miners to the prices of global commodities, which in turn are highly sensitive to a slowing global economy, and the banks which are already trading at very demanding multiples.

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Portfolio Snapshot

Inception Date	SMA Model Code	Portfolio Objective	Benchmark
20th October 2017	SROO11	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* (31/07/2024)

	1 m	3 m	6 m	1 y p.a	3 y p.a	Inception p.a
Portfolio Return	2.8%	4.1%	6.0%	9.7%	2.9%	6.4%
Capital Return	2.3%	2.6%	3.5%	5.7%	-0.3%	3.1%
Income Return	0.4%	1.6%	2.5%	4.0%	3.2%	3.3%
Sharpe Ratio	-	-	-	0.82	0.04	0.46
Sterling Balanced Index	2.9%	5.0%	6.0%	11.3%	4.2%	6.5%
Difference	-0.1%	-0.9%	-0.1%	-1.7%	-1.3%	-0.2%
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.

Portfolio Commentary

The Sterling Clime Balanced portfolio returned 2.8% for the month of July, underperforming its benchmark which returned 2.9%. The key drivers of portfolio performance and major portfolio changes are outlined in the tables below.

Positive Attributors	Comment
Newmont Corporation Registered Shs Chess Depositary Interests Repr 1 Sh (NEM.ASX)	NEM was a top performer during the month, aided by continued strength in the price of gold which rose to an all time high of US$2,468/oz. NEM reported good operational performance in its June quarterly and surprised the market with a US$1billion buyback, while guiding its asset divestment plans to deliver a combined value in excess of US$2billion. We retain confidence in NEM's asset optimisation strategy and consider the high quality gold miner as an attractive investment benefitting from earnings upgrades.
Resmed Inc CHESS Depositary Interests on a ratio of 10 CDIs per ord.sh (RMD.ASX)	ResMed (RMD) significantly contributed to portfolio performance in July, returning 11.65%. This was due to several factors, including investor anticipation of positive impacts on margins from the launch of the new AirSense 11, the absence of immediate competition from Philips in the US, and increased awareness of sleep apnea. Early August results confirmed these trends, further reinforcing the stock's upward momentum.

Negative Attributors	Comment
Capstone Copper Corp. Shs Chess Depository Interests Repr 1 Sh (CSC.ASX)	CSC continued to move lower in July following weakness in the copper price, reflecting concerns over global growth and weak economic data from China. CSC's recently released updated Santo Domingo feasibility study was well received by the market, highlighting stronger copper production, lower operating costs and sustaining capex relative to expectations. We remain positive on the outlook for the price of copper over the medium to long term given its critical importance in the electrification process.

Portfolio Activity

BUY	Comment
Westpac Banking Corporation (WBC.ASX)	Although execution risks remain, Westpac's valuation looks attractive with NIM's appearing to have bottomed, a dividend yield well above the market and a healthy franking balance to sustain higher level of payout ratio for FY24 and FY25. We introduce Westpac into the portfolio, supported by greater upside versus its peers.

SELL	Comment
National Australia Bank Limited (NAB.ASX)	NAB's share price has rallied strongly since its last result and announcement of $1.5bn buy-back. Looking ahead, we see headwinds to its valuation driven by increased pressure on NIMs as their TFF matures, deposit competition remains high and weaker APRA data suggests NAB's growth is lagging its peers. Trading well above all key historical valuation metrics, we reduced the position and utilised the capital to take advantage of opportunities offering greater upside.

Top 5 Holdings

Security	Weight (%)
AB Global Equity Fund	12.1%
Realm High Income Fund	7.9%
TORICA ABSOLUTE RETURN INCOME FUND	7.8%
Vanguard MSCI Index International Shares (Hedged) ETF	7.7%
iShares Government Inflation ETF	6.0%

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