# Sterling Clime Balanced Portfolio (SR0011)

Investment Summary
August 2024

Praemium (SMA)

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# Market & Economic Commentary

August was eventful for markets, characterised by an early and vicious sell-off but ending at or close to all-time highs. After the S&P 500 reached its 38th all-time high in July (marking a 19% calendar year-to-date return), it saw a strong pullback in early August. The whiplash was short-lived, however, as stocks quickly recovered and at month end were once again touching new record highs. Outside of stocks, the most important news of the month for investors was that the US Federal Reserve (Fed) was preparing to cut rates and is almost certain to do so in September. Fortunately, the correction in Australia was less severe than in the US, and nothing like the surprising crash in Japan.

The sell-off was triggered by the US July labour market report, which missed expectations, pushing the unemployment rate to 4.3% and triggering the "Sahm Rule," often linked to recessions. Global risk assets suffered in the days following the release, and the unwind of the yen carry trade and news that Warren Buffett had sold half his Apple holdings, further exacerbated the moves.

The CBOE Volatility Index (VIX) spiked over 60, levels seen during the COVID-19 pandemic and the Global Financial Crisis. Stocks fell worldwide while bonds and gold rallied. However, within a week, investors bought back in, capitalising on the pullback. The S&P 500 is on track for its best earnings season since Q1 2022, with profits up 12% year-over-year.

Most importantly, the Fed signalled imminent rate cuts. Fed Chair Jerome Powell indicated at Jackson Hole that “The time has come for policy to adjust” which should boost the economy and labour market.

US indexes ended August higher, with the S&P 500 up 2.28%, the Dow Jones up 1.76%, and Nasdaq up 3.30%. The ASX 200 was flat in the month but remains 10.7% higher year-over-year. Japan's Nikkei fell as did China's Shanghai index.

US and global bond yields rose slightly. The AUD increased from USD 0.6492 to just below USD 0.6800. Resources were mixed, with gold hitting new highs while oil and iron ore weakened.

**Gold**

When interest rates decrease, gold typically increases in value. This trend is influenced by several key factors:

- Opportunity cost: high interest rates make interest-bearing assets like bonds, term deposits, and savings accounts more attractive. When rates drop, the appeal of these assets diminishes, making gold more attractive.
- Inflation expectations: gold serves as a hedge against inflation. When inflation is expected to rise, investors often turn to gold to preserve their purchasing power.
- Currency strength: gold is priced in US dollars. A weakening USD generally benefits gold prices, as it becomes cheaper for holders of other currencies.
- Geopolitical risks: gold has been a store of value for thousands of years. During times of heightened geopolitical tensions, investors tend to flock to gold as a safe haven.

**Australia**

Reserve Bank of Australia (RBA) Governor Michelle Bullock reiterated that it is "premature to be thinking about rate cuts" with inflation still high, though she acknowledged that "circumstances may change." The RBA is expected to begin a gradual easing cycle in February unless the labour market deteriorates. On the outlook for rates, Governor Bullock noted "financial markets are still pricing in a rate cut by the end of the year.” Though, it is premature to be thinking about rate cuts. Inflation is still too high and, in underlying terms, is not expected to be back in the top of the band until the end of next year. “But based on what the Board knows at present, it does not expect that it will be in a position to cut rates in the near term."

The Australian reporting season ended with "lackluster" results. According to FNArena, 36% of companies missed analyst expectations, 30% exceeded, and 34% were in line. Unsurprisingly, downgrades outpaced upgrades, with growth expectations for FY25 falling from 5% to 3%. Costs, particularly labour and inputs, remain a key concern. Banks performed well, though valuations may be stretched.

Summing up, there is a tendency for election years in the US to see seasonal weakness from September through to November (especially when the election is on a knife-edge). Positive sentiment is stretched, valuations are high, geopolitical/economy risks elevated, and uncertainty around policy and politics as election time approaches – all suggest a cautious and defensive stance is sensible. That said, with the Fed confirming rate cuts are coming and everyone expecting a string of rate cuts ahead, the soft landing we have written about previously, appears to have been achieved.

## 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* (31/08/2024)

| | 1 m | 3 m | 6 m | 1 y p.a | 3 y p.a | Inception p.a |
|---|---|---|---|---|---|---|
| **Portfolio Return** | 0.1% | 3.6% | 5.1% | 10.3% | 2.7% | 6.3% |
| **Capital Return** | 0.0% | 2.1% | 2.7% | 6.3% | -0.5% | 3.0% |
| **Income Return** | 0.1% | 1.4% | 2.4% | 4.0% | 3.2% | 3.3% |
| **Sharpe Ratio** | - | - | - | 0.92 | 0.00 | 0.45 |
| **Sterling Balanced Index** | 0.9% | 4.8% | 5.9% | 12.4% | 3.9% | 6.6% |
| **Difference** | -0.7% | -1.3% | -0.8% | -2.1% | -1.2% | -0.2% |
| **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 0.1% for the month of August, underperforming its benchmark which returned 0.9%. The key drivers of portfolio performance and major portfolio changes are outlined in the tables below.

| Positive Attributors | Comment |
|---|---|
| **Resmed Inc CHESS Depositary Interests on a ratio of 10 CDIs per ord.sh (RMD.ASX)** | August started with a sharp sell-off in global equity markets, driven by disappointing US economic data and an interest rate hike by the Bank of Japan. However, markets rebounded by month end, finishing positive as investors anticipated more aggressive policy easing by the US Federal Reserve. |
| **Westpac Banking Corporation (WBC.ASX)** | WBC contributed positively to performance in August, driven by a solid 3Q24 result. While revenue was slightly softer due to weaker Markets & Treasury income, this was more than offset by lower-than-expected credit impairments and stable net interest margins (NIM), which exceeded market expectations. Core NIM improved slightly, highlighting WBC's operational resilience. Although there are emerging concerns around asset quality, the bank's strong capital position and cost management provide confidence in its ability to navigate near-term challenges. Consensus forecasts have seen solid upgrades since the result, reflecting the market's renewed confidence in WBC's competitive position. |

| Negative Attributors | Comment |
|---|---|
| **NIB Holdings Ltd (NHF.ASX)** | NIB Holdings detracted from the porfolio in August, following a softer-than-expected FY24 result. The main areas of weakness were higher resident health insurance claims, which have rebounded more quickly than anticipated, and concerns around the growth outlook for FY25. Margins for the 2H24 were notably pressured, falling back to 6-7%, and claims inflation remains elevated at 6.6%, outpacing premium increases. Additionally, the upcoming CEO change added to uncertainty. Despite these challenges, we remain confident in NIB's long-term growth, particularly in its international insurance and NDIS divisions - noting the risk/reward proposition remains strong. |

## Portfolio Activity

| BUY | Comment |
|---|---|
| - | - |

| 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 | 11.8% |
| TORICA ABSOLUTE RETURN INCOME FUND | 7.9% |
| Vanguard MSCI Index International Shares (Hedged) ETF | 7.9% |
| Realm High Income Fund | 7.9% |
| ETFS US TREASURY BOND (CURRENCY HEDGED) ETF (Currency Hedged) Exchange traded Fund Units | 6.1% |

## 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