



# Quarterly Investment Report January 2024

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The Everything Rally



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# Summary

Global equities and bonds ended the year with gains of +22% and +5%, respectively.

Contrary to expectations of an impending recession, 2023 was a favourable year for the global economy and even more so for investors. This was reflected in the significant gains of global equities and bonds, which rose by +22% and +5%, respectively.

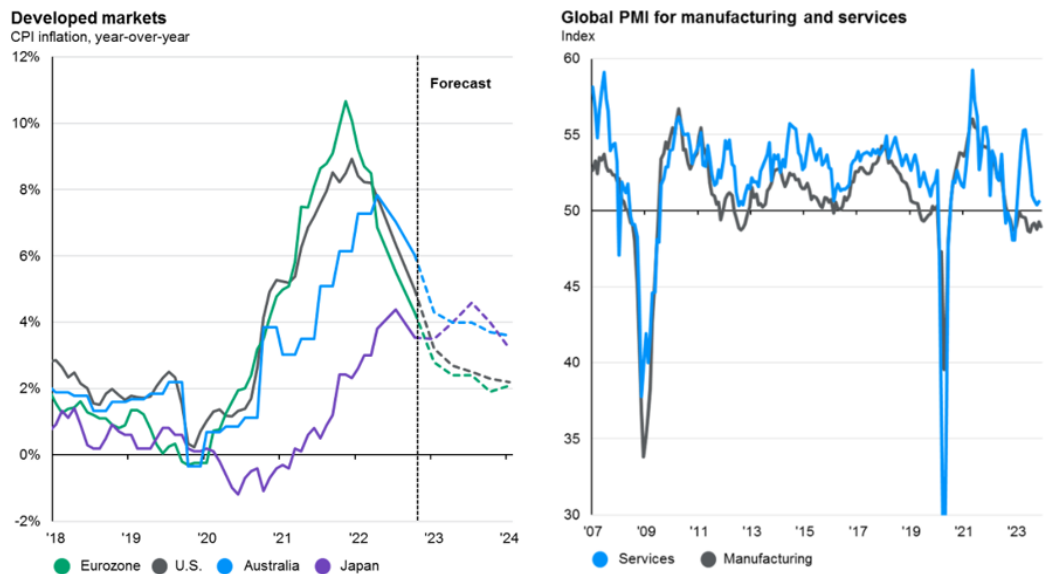
Investing is rarely straightforward, and last year highlighted the challenge of predicting economic trends and aligning investments accordingly.

Concerns about a recession have lessened in recent months, with the market shifting its attention towards possible rate cuts amid signs of lower inflation and a slowing but not stalling global economy (soft landing).

The market's anticipation of future rate cuts has driven up the prices of equities and bonds.

## Slowing but not stalling

Global inflation & economic activity data (PMI)



Source: JP Morgan Guide to Markets – January 2024

Central banks in developed markets often follow the actions of the U.S. Federal Reserve.

The market's anticipation of future rate cuts has driven up the prices of equities and bonds – a phenomenon referred to as the 'everything rally'. There is a risk that markets are priced for perfection, as lower bond yields can only sustain equity valuations if earnings growth remains steady.

Historically, central banks in developed markets often follow the actions of the U.S. Federal Reserve. Thus, the Fed's decisions in 2024 will be closely watched, especially considering significant political pressures like the U.S. election and government spending. Similar political pressures are evident in Australia.



Historical trends suggest that investors should focus more on the reasons behind central banks' rate cuts.

Equities usually increase following the first rate cut in non-recessionary periods.

Investors need to consider both growth and defensive assets, adaptable to various economic conditions.

Fixed Interest offers appealing income prospects and a potential buffer in case of a recession.

If economic growth outperforms expectations, there's a risk of inflation returning, reminiscent of the errors made in the 1970s and 1980s. Given that policy decisions currently blend art and science, concerns about inflation could lead to delayed rate cuts, potentially destabilising markets.

Despite these uncertainties, historical patterns indicate that investors should focus more on the reasons behind central banks' rate cuts rather than their timing. Future returns depend on whether rates are cut due to a recession (hard landing) or to prevent one (soft landing).

Goldman Sachs' recent analysis of U.S. equities and bonds over the past 40 years reveals that equities usually increase following the first rate cut in non-recessionary periods. In contrast, recessionary periods often see a significant drop in equities and a more noticeable decrease in bond yields (prices higher) as earnings fall more than expected.

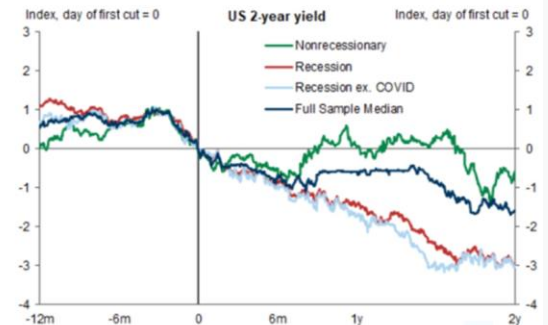
### Focus on Why, Not When

Equity and bond performance before and after rate-cutting cycles

**Exhibit 2: Equities tend to rally after the Fed starts to cut...**  
Median across each sample



**Exhibit 3: ...while yields tend to fall**  
Median across each sample



Source: Goldman Sachs Global Investment Research – Jan 2024

While we do not anticipate a global recession, investors need to consider both growth and defensive assets within a portfolio context, adaptable to various economic conditions - the focus should be on preparation rather than prediction. A well-diversified portfolio can help withstand shocks, particularly in a post-pandemic era with complex market trends and increased geopolitical risk.

Our portfolios remain balanced across all asset classes, slightly underweighting Global Equities and favouring Fixed Interest, considering the near fifteen-year high bond yields.

As 2024 progresses, we may see opportunities for a more optimistic stance on Global Equities, particularly in small to mid-cap strategies linked to the economic cycle. These decisions will depend on price fluctuations and the extent to which interest rate expectations influence global equities.



# Positioning

As of January 2024	Positioning (DAA)		
Asset Class	Underweight	Neutral	Overweight
Cash			
Fixed Interest			
Australian Fixed Interest			
Global Fixed Interest			
Australian Equities			
Global Equities			
Developed Market Equities			
Emerging Market Equities			
Property			
Australian Property			
Global Property			
Alternatives (Inc. Infrastructure)			
Infrastructure			
Other Strategies (Private Markets, Hedge Funds)			

## Positioning Definitions

**Overweight**  $\geq 2.0\%$  above benchmark strategic asset allocation weight

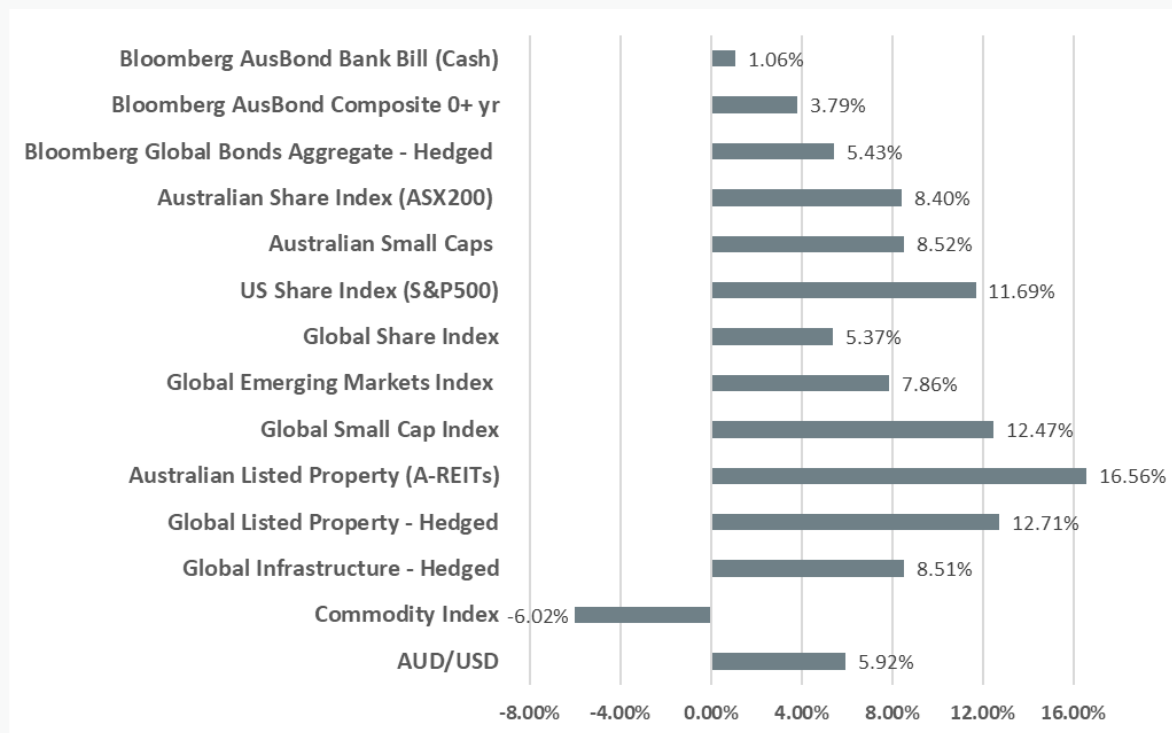
**Neutral**  $\leq 2.0\%$  versus benchmark strategic asset allocation weight

**Underweight**  $\geq 2.0\%$  below benchmark strategic asset allocation weight



# Asset Class Returns – Q4 2024

"Everything rally" driven by the prospect of rate cuts





# Cash

## Themes

- The cash rate is 4.35% after the RBA raised rates by 0.25% in November 2023.
- Interest rates have risen by +4.25% since May 2022, the fastest tightening cycle in a generation.
- Interest rates appear to have peaked this cycle, with expectations of rate cuts in 2H 2024 after encouraging signs inflation is tracking lower.

## Strategy

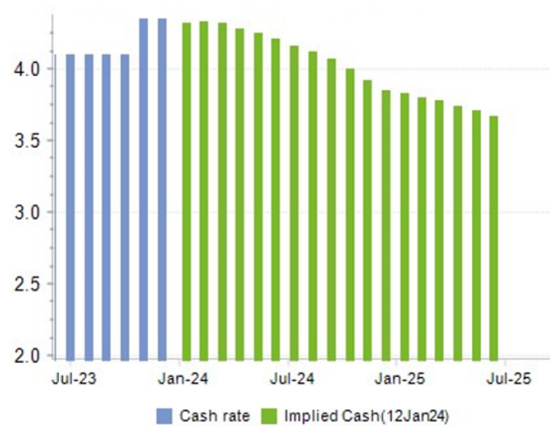
- Current savings and term deposit rates are attractive in an uncertain environment.
- Cash provides capital preservation and liquidity in a volatile market.

## Positioning

- **Neutral** – We maintain our neutral allocation and will look to increase growth assets as opportunities arise.

### Australian Cash Rate Forecast

Peak rates?



Source: ASX, RBA – Jan 2024.

Overweight

Neutral

Underweight



# Fixed Interest

## Themes

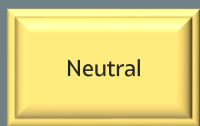
- After hitting 5% in mid-to-late October, Australian and U.S. bond yields dropped below 3.9% on the lower inflation and the prospect of imminent interest rate cuts.
- Perhaps surprisingly, bond yields ended 2023 at end-2022 levels.
- Most global central banks have reached the end of their tightening cycles and are now considering policy rate cuts as inflation nears central bank targets.
- Uncertainty around the exact timing of cuts will add volatility, but it will not change the downward trend in yields over the medium term.

## Strategy

- Fixed Interest provides potential resilience in various economic scenarios, which is crucial given the rise in geopolitical risk and market volatility in recent years.
- Over the past six months, we have increased exposure to long-term bonds, locking in higher yields.
- Private credit continues to provide attractive absolute returns with relatively lower risk to equities. We expect private credit to deliver consistent returns in 2024, supported by higher base interest rates, robust balance sheets, and increasing demand for non-bank lenders.

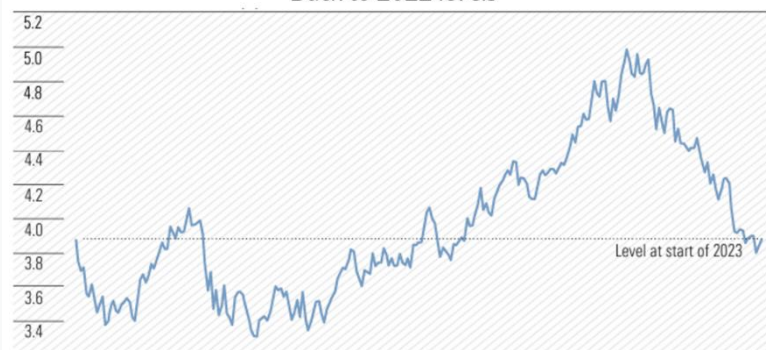
## Positioning

- **Overweight** – We maintain our overweight position to Fixed Interest due to the broad appeal of the assets in the foreseeable future due to their attractive yields and valuations.

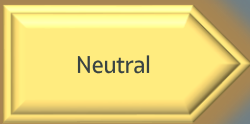
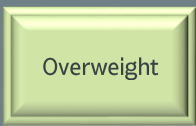


## U.S. 10yr Treasury Bond Yield

Back to 2022 levels







# Australian Equities

## Themes

- Australian shares experienced a significant recovery in December, surging by 7.3% and nearing record highs.
- The Australian market's annual increase of 12.4% lagged behind global markets by more than 10%.
- The earnings outlook for Australia remains subdued, with consensus EPS growth for the next 12 months around 2%.
- ASX reporting season in February 2024 should clarify company earnings estimates and outlooks over the medium term.

## Strategy

- Valuations remain above long-term averages despite consensus suggesting a soft period for company earnings. Investors continue to see through any slowdown, which we believe is optimistic over the short term.
- We remain patient and will look to increase exposure upon price volatility.
- Small caps strategies and healthcare and energy sectors look attractive from a valuation and earnings expectation view (overly pessimistic).

## Positioning

- **Neutral** – We maintain our neutral position on Australian shares, actively looking to buy upon weakness.



# Global Equities

## Themes

- Global equity markets had a strong quarter, with the MSCI World Equity Index up 9.22%, led by S&P500 up 11.69% over the same period.
- The global market was up 21.66% for the year, which is extraordinary considering the recession fears.
- At the heart of the strong performance was the resilience in economic data, corporate earnings, and the larger-than-expected decline in inflation.
- Emerging markets rose 3.9% in December (USD terms), lagging global developed and domestic equities considerably.
- Chinese equity market performance has undermined emerging market returns. China continues to see an ailing property sector and a lack of serious policy stimulus.

## Strategy

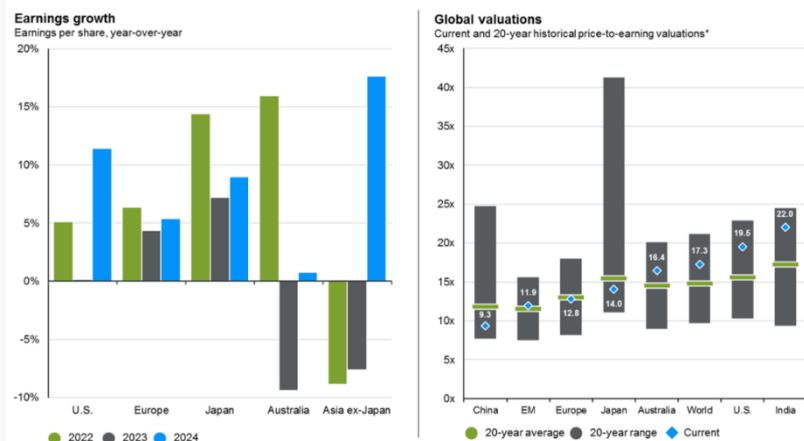
- Falling bond yields have driven a sharp market rally, but this can only be sustained if earnings deliver. Softer economic growth in 2024 and uncertain timing around rate cuts suggest some volatility ahead.
- Some areas of the market provide valuations at recessionary levels with modest upside – small caps and emerging markets.

## Positioning

- **Underweight** - In the face of optimistic valuations and ongoing uncertainty surrounding the growth outlook, we maintain a small underweight position.

### Priced to Perfection?

Valuations are not as stretched as they may seem





Overweight

Neutral

Underweight

# Property

## Themes

- Listed property assets increased over the quarter, with Australian REITs up +16.56% and Global REITs +9.46%.
- Rising interest rates have been a headwind for many asset classes, with property listed and unlisted as a particularly interest rate-sensitive sector.
- With bond yields likely having peaked, REITs are facing a much brighter outlook.
- REITs, particularly overseas, have been challenged over the past two years and still offer some valuation appeal.
- Office REITs remain the weak spot. Yet, investors should note that traditional office space accounts for only 7% of the Australian market and 6% globally.

## Strategy

- Despite negative headlines surrounding the property markets, we maintained a neutral allocation throughout 2023, with our portfolios benefiting over the quarter.
- Listed property (REITs) offer compelling return potential over the medium term after a peak in bond yields.
- We continue to invest in selective REIT strategies (Australia and Global) that are trading at a discount to NTA and have exposure to quality assets.
- Our portfolios have no exposure to unlisted property assets. History supports our valuation lag concerns about unlisted property assets, specifically low-quality assets.

## Positioning

- **Neutral** – We maintain a neutral allocation to property, seeing improved returns over the medium term as interest rates trend lower.



# Alternatives

## Themes

- Listed global infrastructure was up 8.51% for the December quarter, assisted by lower bond yields.
- Inflation protection is a strength of infrastructure assets, but it may take time for the effects of inflation to fully impact the financials of infrastructure revenue.
- Private market strategies delivered positive returns during the quarter of between 1.0%-2.5%.
- Hedge funds continued to deliver uncorrelated returns to equity markets, with our selected exposure down 11% over the quarter.
- Performance dispersion across private asset managers is wide, highlighting the importance of manager selection and diversification – e.g., managers who prepared for higher rates vs. those who did not.

## Strategy

- We will increase exposure to hedge funds due to the favourable conditions created by increased correlations and anticipated high volatility. These market dynamics provide opportunities for effective implementation of hedge fund strategies.
- Infrastructure investments offer more stability within a well-diversified portfolio and typically perform well after a peak in bond yields – similar to listed property.
- We have gradually added to private markets (Private Equity & Debt) over the past 12 months, providing diversification benefits to clients across both income and growth strategies.

## Positioning

- **Neutral** – We maintain our neutral position, favouring quality strategies with consistent performance through market cycles.

Overweight

Neutral

Underweight



## Independent Advisory Board

The Advisory Board believe a robust governance framework is critical in forming a House View and making effective Asset Allocation decisions. An Advisory Board charter governs the process and comprises experienced investment professionals with diverse areas of expertise, reflecting an industry best practice in decision-making.

The Advisory Board is responsible for setting and reviewing the House View and upholding the fundamental values and investment philosophy of Mackay Private.

The Advisory Board meets quarterly to meet intra-quarter as required. Voting members make all dynamic asset allocation decisions of the Advisory Board. Please visit our webpage, [www.mackayprivate.com](http://www.mackayprivate.com) or contact us directly at [info@mackayprivate.com](mailto:info@mackayprivate.com) or 1300 721 986.

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