Ausbil Balanced Fund

Quarterly Investment Report

September 2024

Ausbil Investment
Management Limited
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ausbil

Economic Review

Economic Review

The month of September saw the US and China join the growing list of central banks in the global rate cutting cycle which has been underway since the June quarter of 2024. The US Federal Reserve opened with an outsized 50bps cut in the Fed funds rate to 5%, as they recalibrate restrictive policy settings. The Chinese authorities surprised with the Peoples Bank of China and the Central Committee Politburo meeting, announcing co-ordinated multiple measures aimed at supporting the housing market, boosting household consumption and achieving the 5% growth target for 2024. The measures included a comprehensive suite of monetary easing, a commitment to fiscal spending, targeted property sector support and the establishment of an equity stabilisation fund. In the aggregate, these announcements are the equivalent to what former ECB President Draghi said in July 2012 in doing "whatever it takes" to rescue the Euro. The same now can be said for China.

On geopolitics, following the surprise 'pager' and 'walkie-talkie' device explosions targeting Hezbollah members, Israel commenced "targeted and localised" military ground operations across the border with southern Lebanon. President Putin updated Russia's nuclear doctrine stating the right to use nuclear weapons "in the event of aggression" against Russia and Belarus. And would consider any assault by a non-nuclear state that had the support of a country with nuclear powers to be a "joint attack". Japan has appointed Shigeru Ishiba as their new PM and leader of the ruling Liberal democratic Party, who in turn promptly called for a general election to be held on the 27th of October.

Global equity capital returns powered ahead in September with the MSCI Emerging Markets index surging 6.8% driven by a skyrocketing 23.1% rise in the China MSCI. Meanwhile, the MSCI World Index for developed markets was up 1.7%, the US S&P500 up 2.0% and Europe's STOXX flat. In Australia the S&P/ASX 200 was up 2.2% with a sharp rotation out of banks/financials into materials/resources as iron ore prices recovered. Brent crude oil declined 5.5%, spot gold was up 5.4% and the Japanese 10-year bond fell to 0.85% from 0.89%. US 10-year yield fell 12bps to 3.78%, the 2/10-year curve returned to normal to be positive 14bps, corporate credit spreads widened by 3-7 bps,10-year inflation-protected real yields fell 16bps to 1.60%, and the US dollar index depreciated 0.9%. In Australia, the 10-year bond yield rose 3bps to 4.0%, the 2/10-year yield curve steepened to 32bps, and the 10-year bond spread to the US widened to be 22bps above. The Australian dollar appreciated by 2.6% and the trade-weighted index appreciated by 0.3%.

US Federal Reserve Chair Powell pointed out that policy is not on any "preset course" and 50bps increments are not going to be the new norm, as "this is not a committee that feels like it is in a hurry to cut rates quickly. "The statement highlighted that the balance of risks has now shifted toward higher unemployment, given the greater confidence that inflation "is on a sustainable path to 2%." The September FOMC Summary of Economic Projections (SEP) showed median estimates of 50bps additional cuts in 2024 to 4.50%, 100bps of cuts in 2025 to 3.50%, and 50bps of cuts in 2026 to 3.0%, no rate cuts in 2027 and a lift in the median estimate of the real neutral rate by 10bps to 90bps. The updated economic projections for 2024-2027 have a higher path for the unemployment rate in the low to mid 4% range, GDP growth at 2.0% and PCE inflation on a lower path toward the 2% target.

The European Central Bank cut for a second time by 25bps to 3.50%, adhering to its data dependency and a meeting-by-meeting approach. Sweden, Switzerland and Canada have cuts rates by 25bps to 3.25%, 1.00% and 4.25%, respectively. The Bank of Japan's Governor Ueda reiterated that should the forecasts be realised then "it will be appropriate to accordingly raise the policy interest rate." The Reserve Bank of Australia left rates on hold at 4.35% and we learned from the Q&A that the board members did not explicitly discuss the scenario for a rate hike. Instead, they focused on what has changed since the August meeting and whether it would warrant a change in policy either way. They concluded that "policy is currently restrictive and working broadly as anticipated" and reiterated that the bank is not ruling anything in or out with respect to rates and will do what is necessary to return inflation to target in a sustainable manner.

Economic Review

On the data front, the OECD sees global growth moving beyond the inflation crisis levels and stabilising at a resilient 3.2% in 2025. Releases in the US have surprised to the upside for retail sales, industrial production and recovery in non-farm payrolls. The ZEW investor confidence and German IFO business sentiment surveys remain in a funk requiring additional policy easing to sustain the modest European recovery. In Australia, the data continues show weak activity and a gradual easing in inflationary pressures. The monthly indicator for headline inflation eased to a 2.7% annual rate in August, with the various measures of underlying inflation easing slightly. The final budget outcome for fiscal year 2023/24 exceeded forecasts coming in at an underlying cash surplus of $A15.8bn (representing 0.6% of GDP), higher than the budget time estimate of $A9.3bn.

Economic Outlook

Economic Outlook

Global macro settings are expected to remain within their 'back to normal' levels in 2025. We are forecasting growth, lower inflation, real rate cuts and a recalibration of restrictive policy settings towards a higher neutral level for this cycle. Ausbil believes fears of a US recession are unsubstantiated. The risk of a sharper slowdown is mitigated by the fact that central banks now have significant room to cut rates The structural themes of decarbonisation and slowing globalisation continue to underpin activity. In the aggregate, global GDP growth is on a positive upward trajectory towards its trend rate as illustrated in Table 1.

The US Federal Reserve has joined the growing list of central banks in the global rate cutting cycle, which has been underway since the June quarter of 2024. Underlying resilient private demand, business investment, employment growth, and multiple rate cuts will sustain the expansion of the global business cycle. We remain vigilant to unpredictable geopolitical events that may materially impact our view.

Table 1: Global growth – on an upward path toward long-run trend

Real GDP % year average	Long run average 2010 to 2019	**Ausbil 2024 (f) %**	**Ausbil 2025 (f) %**
United States	*2.3*	**2.1**	**2.2**
Japan	*1.2*	**1.1**	**1.2**
Eurozone	*1.4*	**0.9**	**1.6**
China	*7.7*	**4.8**	**4.6**
India	*7.0*	**6.7**	**7.0**
Australia	*2.6*	**1.2 to 1.5**	**2.5**
Global GDP	*3.7*	**3.3**	**3.5**

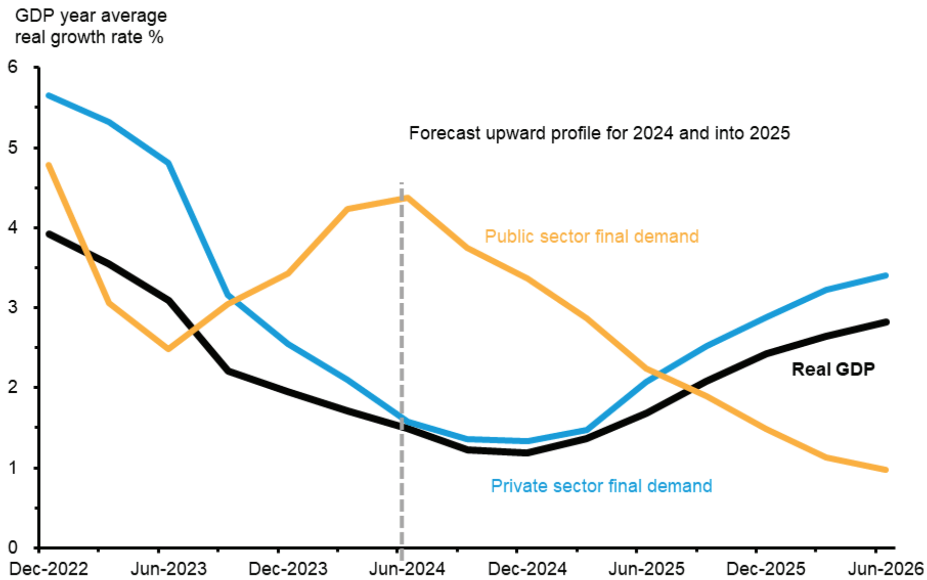
Source: Ausbil, FactSet as of September 2024.

On global economic growth. We are forecasting a resilient US and a modest recovery for Europe in 2025. The US growth outlook is driven by a resilient labour market remaining within close range of full employment levels, and underlying strength in the consumer from real wages growth and the drawdown in excess savings. Europe has exited very shallow recessionary conditions and is on a gradual recovery, assisted by ongoing European Central Bank rate cuts. The Asia-Pacific growth engine will continue outpacing the rest of the world. China's ongoing expansionary fiscal stance, monetary easing and latest measures to stabilise the property sector should sustain growth in the mid 4% plus range.

Economic Outlook

Australia's economic outlook. Australia's GDP is expected to recover through the second half of 2024 at an average pace of 1.4% and move higher through 2025 toward trend pace at 2.5%. We see a diminishing drag on activity coming from the household consumption channel. The activity drivers in final domestic demand sees the growth baton passing from the public sector to the private sector, as illustrated in Chart 1 below. The labour market remains resilient, and as supply increases and positive demand slows, we see a modest uptick in the unemployment rate in the low 4% range, with the economy holding on to the 50-year broad-based gains. This is a remarkable outcome that would see the unemployment rate remain below the NAIRU (natural rate of unemployment) estimates of Federal Treasury and the Reserve Bank of Australia (RBA) in the range of 4.25% to 4.50%. Structural demand for resources and a rising interest rate differential favouring Australia, should collectively underpin the Australian dollar. We are forecasting the AUD to appreciate into the range of US70 cents, with the trade weighted basket also trending higher.

Chart 1: Growth baton switches from the public sector to the private sector



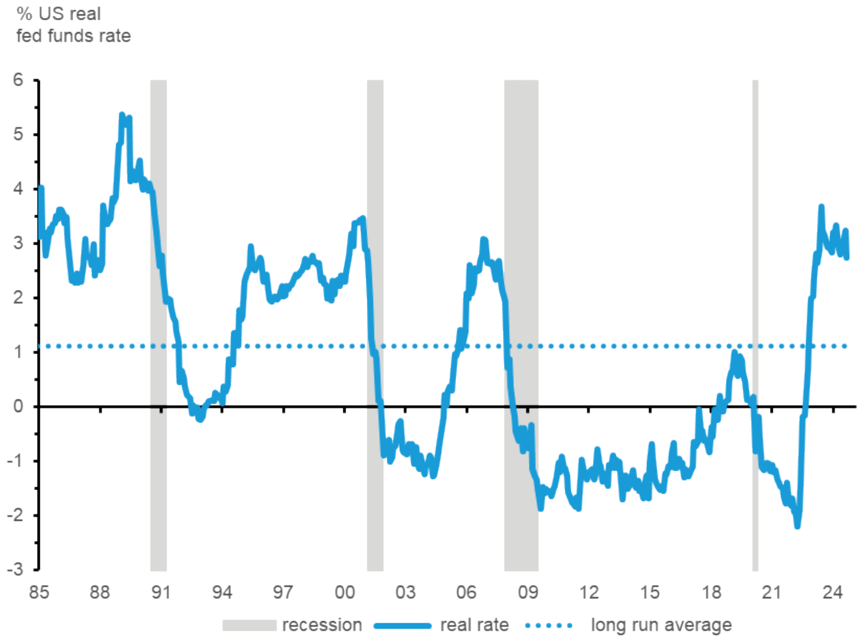
Source: Ausbil, FactSet, September 2024.

On inflation. Inflation is falling, and the forecast trajectory is for a return to above central bank target levels out to 2025, in the US and globally. Core inflation dynamics are switching, and we see persistent sticky services (ex-housing) inflation, lower housing inflation to a lesser degree, and upside risk from goods inflation. In Australia, although service inflation is proving to be persistent, pressures are gradually easing.

Economic Outlook

On the outlook for rates. The US Federal Reserve will continue to deliver rate cuts in 2024 and into 2025. Of greater significance is the ongoing incremental upgrade to the FoMC's long-run estimate for the neutral real rate. We see the neutral rate trending higher at the quarterly macro forecast updates over the near to medium term. See Chart 2 below.

Chart 2: Restrictive policy settings – modest real rate cuts are coming



Source: Ausbil, FactSet, September 2024.

For Australia, an ongoing improvement in the inflation dynamics should provide an opening for the Reserve Bank of Australia to adjust rates to a lower terminal level of 3.85% in 2025.

Growing risks from unpredictable geopolitical events

Developments in the Middle East between Israel, Hamas and now directly with Iran, are a concerning threat to global stability. In the context of Russia's invasion of Ukraine, and ongoing political tensions with China, the world is now in a state of heightened tension and uncertainty. The confluence of risks from both wars could easily reignite inflationary price shocks in energy, metals and food. In this environment, there is a significant risk of further oil price inflation, placing upward pressure on interest rates, and adding further drag on economic growth, which is a concern for all markets.

Risk of a US recession

Ausbil believes fears of a US recession are unsubstantiated. Should this risk become tangible, it will be mitigated by the reassuring fact that central banks now have significant policy room to cut rates.

In the US labour market, we highlight the following features. The non-farm payrolls measure on a 3-month moving average rate is back at pre-pandemic levels. The ratio of job openings to unemployed persons is back at levels when prior tightening cycles commenced. Finally, the weekly jobless claims measure as a lead employment indicator has a run rate that is well below, and inconsistent with, market fears of a recession triggered by a surging unemployment rate.

Economic Outlook

In addition to these fundamental measures, financial markets are showing the US 2/10yr bond yield curve back with a normal upward slope from being inverted for the last two years, reflecting a series of cuts in the Fed funds rate. Moreover, non-investment credit spreads have narrowed year to date, the net worth of households has risen by 7.1% on a year ago, on rising equity and housing valuations, and the ratio of total private debt to gross domestic product declined further, approaching its historical average, with both business and household ratios lower.

Consumer debt servicing levels in the US appear manageable and have fallen for those with fixed rate mortgages, with credit growth flowing through to all sectors. Finally, financial system stability is sound and resilient according to Federal Reserve's half yearly report. There is little sign of financial vulnerabilities triggered by valuation pressures, borrowing by businesses and households, financial-sector leverage, or funding risks.

Jim Chronis

Chief Economist, Associate Director

As Ausbil's Chief Economist, Jim is responsible for macroeconomic research and strategy. As Associate Director – Debt and Diversifieds, Jim manages the Ausbil Balanced Fund cash and fixed interest mandates. Jim holds Bachelor of Laws and Bachelor of Economics (Honours) degrees from the University of Sydney.

Investment Market Review

Investment Market Review

Table 2: Key benchmark returns by asset class - total return

Asset Classes	3 months %	12 months %
Australian Equities	7.85	21.58
Australian Bonds (UBSA Composite Bond Index)	3.02	6.95
Australian Property - Direct Property	2.41	10.45
Australian Property - REITS	14.47	47.00
Global Equities (benchmark)	3.05	21.59
Cash	1.11	4.41

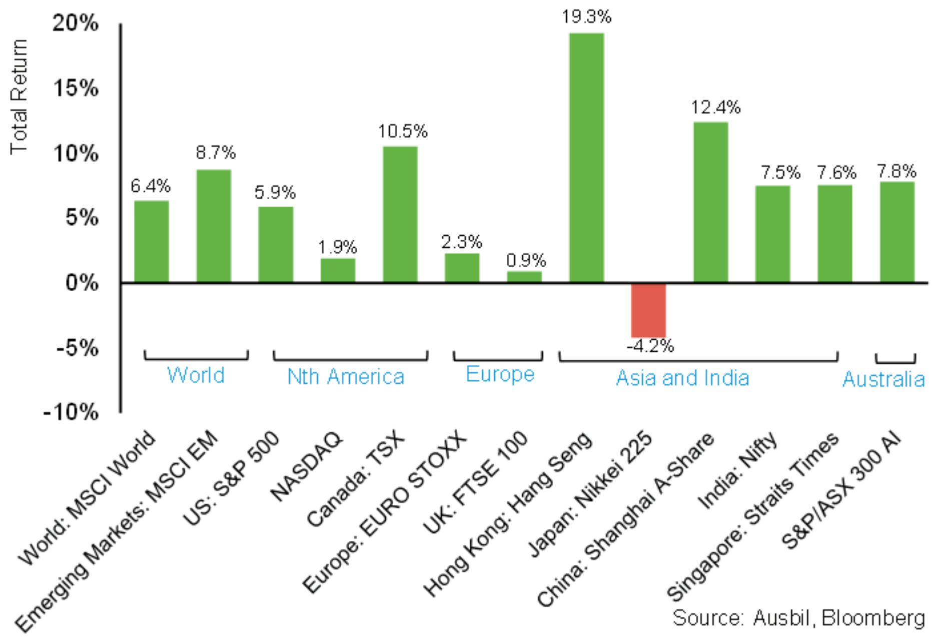
Equity Market Review

Equity Market Review

The September quarter was positive for equities with the US Federal Reserve cutting interest rates slightly more than expectations (50bps) combined with a rate cut in China with the additional promise of more stimulus (monetary and fiscal) as needed to achieve GDP targets. The S&P/ASX 300 Accumulation Index delivered a positive return of +7.8%, bringing the trailing market 1-year return to +21.7%.

Globally, emerging markets (MSCI EM) outperformed developing markets (MSCI World). With the exception of Japan, all major developed markets were up in September, as shown in Chart 3.

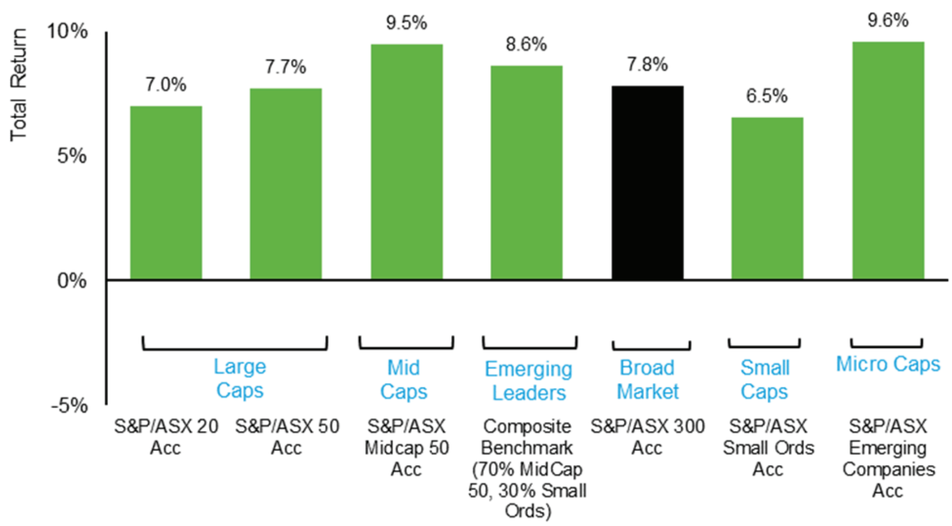
Chart 3: World equity market returns – September Quarter 2024



Source: Ausbil, Bloomberg

On the domestic front, Australia's broad market index rose this quarter, buoyed by positive sentiment from the first US rate cut and China stimulus, as shown in Chart 4. Returns were positive across the market, with mid-cap and micro-cap securities faring best.

Chart 4: Domestic returns by segment – September Quarter 2024

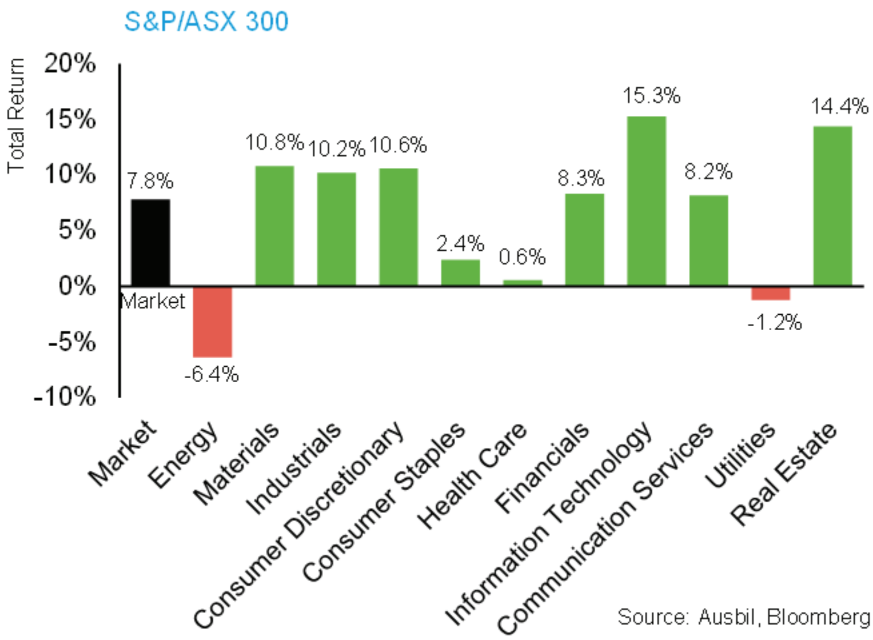


Source: Ausbil, FactSet

Equity Market Review

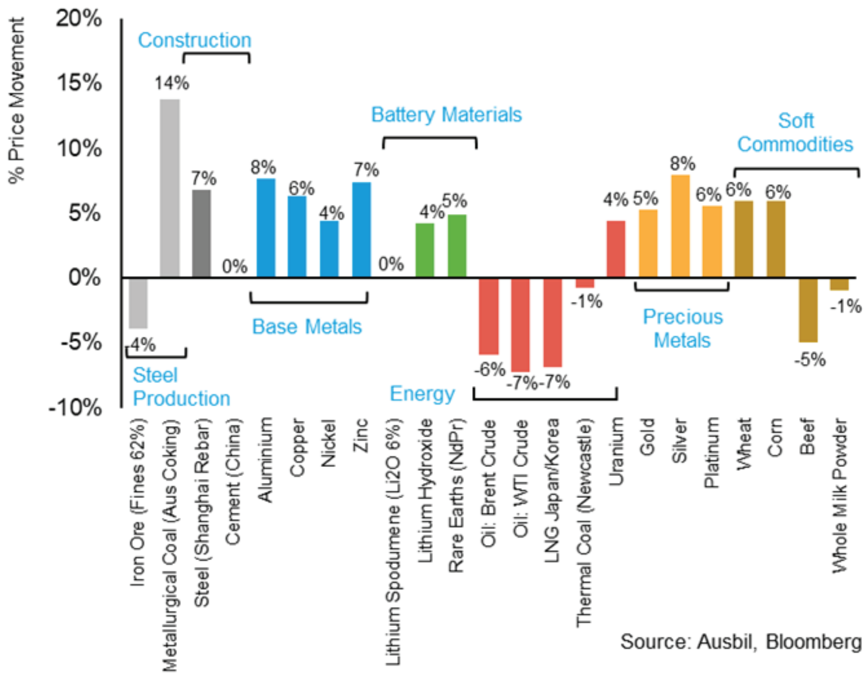
At a sector level, performance was largely positive across the September quarter, as shown in Chart 5, with the exception of Energy which is under pressure from the combination of weaker than expected demand, and concerns regarding the potential that Saudi Arabia may be considering changing its oil price strategy and increasing output into an already well supplied market.

Chart 5: Sector returns – September Quarter 2024



The surprise September rate cut in China and the promise of additional support for the property sector and their economic growth targets provided a major catalyst for commodity prices (Chart 6) late in the quarter, sparking a major retracing in outlook.

Chart 6: Commodity markets – September Quarter 2024

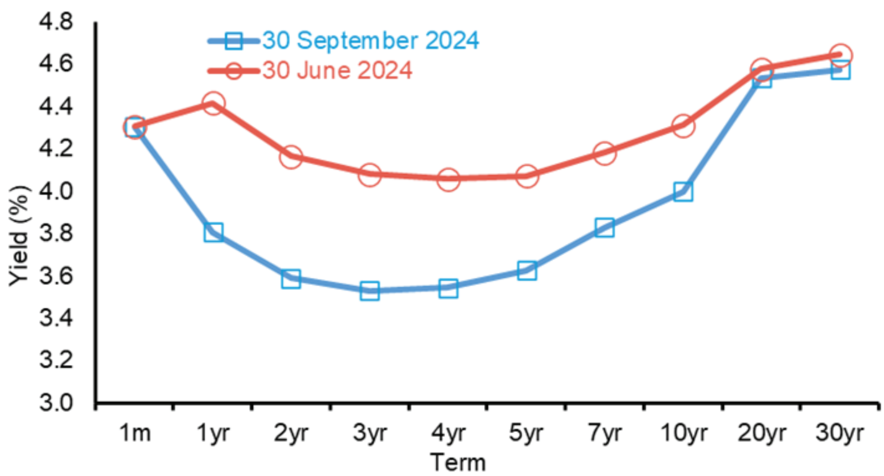


Equity Market Review

Long-term demand for commodities is underpinned by the ongoing push towards net zero climate change targets and the boom in artificial intelligence, which is seeing significant investment in electricity grids, data centres, renewable energy generation, communications lines, EVs and battery materials. Moreover, key commodities like base metals, iron ore and metallurgical coal are benefitting some long thematic demand growth in China and India. Most commodities are looking toward a more positive environment heading into 2025 as economic growth improves, providing more support for cyclical sectors.

In fixed income, the yield curve remained unusual and inverted across a number of terms, as shown in Chart 7, as the market awaits movement on rates from the RBA, which is not expected until calendar 2025. The US commenced their rate cycle in September, joining other major central banks in cutting rates. As Australia is expected to loosen monetary policy in Calendar 2025, we expect the yield curve will increasingly normalise.

Chart 7: Australian government bond yields – September Quarter 2024



Source: Yield curve showing interest rate (real rates plus inflation) expectations looking forward, Bloomberg.

This quarter, the AUD/USD appreciated by +3.6%, closing the month at US$0.6913. In fixed income markets, US 10-year Treasury yields closed at 3.78% and Australian 10-year Government Bond yields closed the month at 4.00%. In credit markets, investment grade credit spreads closed at 53 bps and high yield spreads at 329 bps.

Fixed Interest and Cash Rates

Fixed Interest and Cash Rates

The September quarter saw the US and China join the growing list of central banks in the global rate cutting cycle which has been underway since the June quarter of 2024. the US Federal Reserve open with an outsized 50bps cut to 5%, as they recalibrate restrictive policy settings. China announced measures that included a comprehensive suite of monetary easings, a commitment to fiscal spending, targeted property sector support and the establishment of an equity stabilisation fund.

Japan hiked 15bps to 0.25% and announced the tapering of bond holdings on their balance sheet. The European Central Bank cut for a second time by 25bps to 3.50%, adhering to its data dependency and a meeting-by-meeting approach. Sweden, Switzerland, Canada, England and New Zealand continue to cut rates to 3.25%, 1.0%, 4.25%, 5% and 5.25% respectively. The Bank of Japan reiterated that should their forecasts be realised then “it will be appropriate to accordingly raise the policy interest rate.” The Reserve Bank of Australia left rates on hold at 4.35% and we learned from the Q&A that the board members did not explicitly discuss the scenario for a rate hike. They concluded that “policy is currently restrictive and working broadly as anticipated” and reiterated that the bank is not ruling anything in or out with respect to rates and will do what is necessary to return inflation to target in a sustainable manner.

For the September quarter, bond yields closed lower and were volatile, as cash rate expectations priced in aggressive rate cuts for this new easing cycle. The Japanese 10-year bond fell 20bps from 1.05% to 0.85%. The US 10-year yield fell 62bps from 4.40% to 3.78%, the 2/10-year curve returned to normal from being inverted for almost 2 years, corporate credit spreads narrowed, 10-year inflation-protected real yields fell 51bps from 2.11% to 1.60% and the US dollar index depreciated 4.8%. In Australia, the 10-year bond yield fell 34bps from 4.31% to 3.97%, the 2/10-year yield curve steepened, and the 10-year bond spread to the US widened to close 22bps over. The Australian dollar appreciated by 4.0% and the trade-weighted index depreciated by 0.8%.

The September FOMC Summary of Economic Projections showed median estimates of 50bps additional cuts in 2024 to 4.50%, 100bps of cuts in 2025 to 3.50%, and 50bps of cuts in 2026 to 3.0%, no rate cuts in 2027 and a lift in the median estimate of the real neutral rate by 10bps to 90bps. The updated economic projections for 2024-2027 have a higher path for the unemployment rate in the low to mid 4% range, GDP growth at 2.0% and PCE inflation on a lower path toward the 2% target.

Fund Review

Fund Review

The Balanced Fund outperformed its benchmark index for the September quarter 2024, returning 6.73% (gross of fees) versus the benchmark of 5.35%. Over the past 12-months, the Balanced Fund outperformed returning 21.81% (gross of fees) versus the benchmark of 18.47%.

July saw asset markets continue to trend higher on a broadening in the global earnings cycle and on falling bond yields. Federal Reserve Chair Powell stated that the latest inflation data is showing "further progress", with voting members Williams and Waller supporting an easing cycle later this year. There was a failed assassination attempt on former President and current Republican nominee, Trump. President Biden announced he would no longer seek the Democratic party's nomination and endorsed VP Harris as the nominee. Highlighting the vulnerabilities of digital economies, there was a global outage that crashed computers running cybersecurity software CrowdStrike Falcon, resulting from a defect in a single content update for Windows hosts.

August saw financial assets recover from the first days of intense turbulence triggered by the unwind of the "yen carry trade", estimated at US$250bn that was leveraged multiple times into equity and currency markets to take advantage of negligible borrowing costs in yen. The Japanese Nikkei 225 equity index collapsed 12% in a single day and the VIX spiked to levels last seen during COVID-19. By month end, the Nikkei closed down just 1.2% and the VIX settled back to normal trading levels. Adding to the marked turnaround in investor sentiment were firm and unambiguous comments from the Federal Reserve at the global central bank symposium in Jackson Hole, Wyoming. Chair Powell declared that "the time has come for policy to adjust," increasing confidence that inflation is well under control. With these comments, Powell signalled the commencement of a rate cutting cycle at the September meeting as the dual mandate focus shifts to preserving 50-year employment gains as the Fed "does not seek or welcome further cooling in labour market conditions."

The month of September saw the US Federal Reserve open with an outsized 50bps cut in the Fed funds rate to 5%, as they recalibrate restrictive policy settings. The Chinese authorities surprised with the Peoples Bank of China and the Central Committee Politburo meeting, announcing co-ordinated multiple measures aimed at supporting the housing market, boosting household consumption and achieving the 5% growth target for 2024. In the aggregate, these announcements are the equivalent to what former ECB President Draghi said in July 2012 in doing "whatever it takes" to rescue the Euro. The same now can be said for China.

On geopolitics, we saw the following developments unfold. In July, fears mounted of an impending conflict between Iran and Israel, with the Ayatollah declaring a duty to avenge the death of the Hamas leader in Tehran. In response, the United States sent an aircraft carrier and urged citizens to leave Lebanon.

In August, the International Atomic Energy Agency said that Iran has increased its stockpiles of highly enriched uranium to near weapons grade levels. Countering the growing unfairness in Chinese industry subsidies, the European Union and Canada imposed additional tariffs on Chinese imports. The EU announced that Tesla's China imports will be subject to an additional 9% tariff (was initially 20.8% in July), while the bloc lowered previously proposed levies for Chinese manufacturers. The new levies are on top of the 10% duties that exporters from China already incur. Canada will impose 100% tariffs on imports of electric vehicles, and a 25% levy on steel and aluminium. Semiconductors, batteries, solar products and critical minerals are also under review. Prime Minister Trudeau accused China of having "an unfair advantage" in the critical minerals market.

In September, following the surprise 'pager' and 'walkie-talkie' device explosions targeting Hezbollah members, Israel commenced "targeted and localised" military ground operations across the border with southern Lebanon. President Putin updated Russia's nuclear doctrine stating the right to use nuclear weapons "in the event of aggression" against Russia and Belarus. And would consider any assault by a non-nuclear state that had the support of a country with nuclear powers to be a "joint attack". Japan has appointed Shigeru Ishiba as their new PM and leader of the ruling Liberal democratic Party, who in turn promptly called for a general election to be held on the 27th of October.

Strategy and Outlook

Strategy and Outlook

The Balanced Fund strategy will maintain its current asset class positioning favouring growth and a broadening in equity earnings.

Global macro settings are expected to remain within their ‘back to normal’ levels in 2025. We are forecasting growth, lower inflation, real rate cuts and a recalibration of restrictive policy settings towards a higher neutral level for this cycle. The US Federal Reserve will continue to deliver rate cuts in 2024 and into 2025. The structural themes of decarbonisation and slowing globalisation continue to underpin activity. In the aggregate, global GDP growth is on a positive upward trajectory towards its trend rate.

Australia’s GDP is expected to recover through the second half of 2024 at an average pace of 1.4% and move higher through 2025 toward trend pace at 2.5%. The activity drivers in final domestic demand sees the growth baton passing from the public sector to the private sector. An ongoing improvement in the inflation dynamics should provide an opening for the Reserve Bank of Australia to adjust rates to a lower terminal level of 3.85% in 2025. Structural demand for resources and a rising interest rate differential favouring Australia will collectively underpin the Australian dollar into the range of US70 cents.

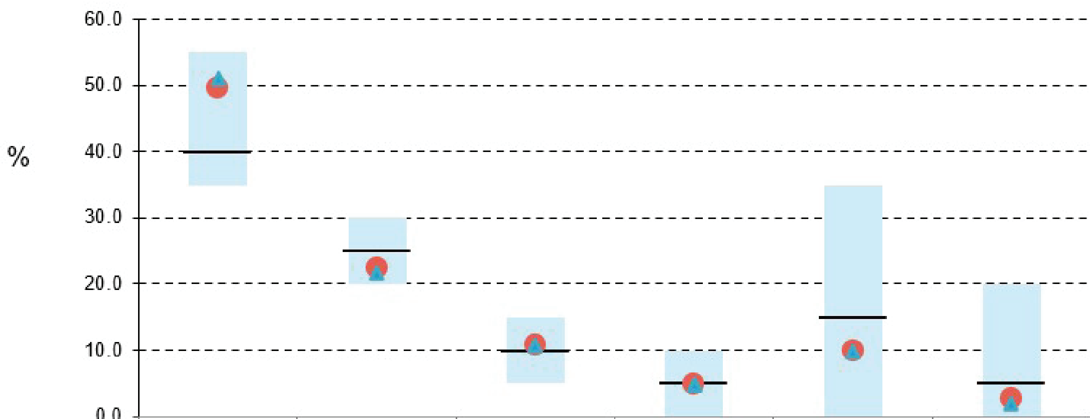
Fund Overview

Fund Return

Period	Fund Return % Gross	Fund Return % Net	Bench-mark* %	Out/Under performance % Gross	Out/Under performance % Net
1 month	3.17	3.10	1.85	1.32	1.24
3 months	6.73	6.49	5.35	1.38	1.15
6 months	5.77	5.29	4.57	1.20	0.72
1 year	21.81	20.77	18.47	3.34	2.30
2 years pa	16.33	15.32	15.11	1.23	0.21
3 years pa	7.10	6.16	6.75	0.36	-0.59
5 years pa	9.47	8.50	7.77	1.69	0.73
7 years pa	10.44	9.46	8.72	1.72	0.74
10 years pa	10.00	9.03	8.42	1.58	0.60
15 years pa	9.89	8.92	8.11	1.78	0.81
20 years pa	9.46	8.59	7.69	1.78	0.90
25 years pa	9.04	8.14	7.26	1.78	0.87
Since inception pa Date: July 1997	9.22	8.31	7.38	1.83	0.92

* The benchmark returns represent the neutral strategic asset allocation return.

Asset Allocation



	Australian equities	International equities	Direct and listed property	Alternatives	Australian fixed interest	Cash
Maximum range (%)	55.0	30.0	15.0	10.0	35.0	20.0
– Benchmark (%)	40.0	25.0	10.0	5.0	15.0	5.0
Minimum range (%)	35.0	20.0	5.0	0.0	0.0	0.0
● Current (%)	49.49	22.35	10.69	4.88	9.80	2.78
▲ Year ago (%)	50.99	21.74	10.71	4.85	9.85	1.86

Notes:
•1) As at 30 September 2024, hedged currency exposure amounts to 18.4%. This is made up of International shares 13.5% and Global Infrastructure 4.9%.
•2) As at 30 September 2024, the Australian Fixed Interest portfolio modified duration is 4.63 years compared to the benchmark index of 4.97 years.

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