INNOVA ASSET MANAGEMENT

HIGHLIGHTS

- Two main themes dominated equity markets in 2023 - the 'new paradigm' of generative A.I and interest rate expectations.
- The "Magnificent 7" – the largest 7 companies in the US market, all tech related in some fashion, drove the majority of the returns.
- NVIDIA was the posterchild of the A.I. rally, however other companies such as Microsoft also dominated attention with the launch of their own A.I. offerings.
- The resilience of US GDP driven by a strong US consumer was a surprise. As inflation began to recede, sentiment improved, housing even started to pick up and retail numbers have also improved. This is offsetting a lot of the negative industrial activity and inverted yield curve effects.
- Overall, this has reduced the chance of recession in the US to below 50%.
- Given the numerous rate cut expectations, the counter argument to that is strong economic fundamentals and corporate earnings would reduce the impetus for central banks to reduce rates. We tend to think the market has gotten ahead of itself on rate expectations.

	31/12/2023	30/11/2023	2/10/2023	2/01/2023	31/12/2020
Equities		**1 Month Return**	**3 Month Return**	**1 Year Return**	**3 Year Return**
S&P/ASX 200	95,767.32	7.26%	8.63%	12.42%	9.24%
S&P/ASX Small Ordinaries Index	9,684.30	7.23%	8.73%	7.82%	0.95%
MSCI ACWI Index	1,293.80	4.83%	11.66%	22.62%	6.26%
S&P 500	7,495.01	4.53%	11.67%	26.26%	9.98%
Nikkei 225 Japan Index	48,937.20	0.04%	5.48%	30.90%	8.96%
MSCI Europe Index	346.20	3.72%	7.57%	15.39%	10.10%
FTSE100	17,389.17	3.85%	3.63%	7.68%	10.06%
MSCI Emerging Markets index	1,936.74	3.88%	7.99%	10.14%	-4.81%
Real Assets (local Currency)		**1 Month Return**	**3 Month Return**	**1 Year Return**	**3 Year Return**
FTSE EPRA/NAREIT Develop Index	4,196.16	8.30%	11.69%	6.85%	5.68%
S&P/ASX 200 A-Reit index	5,395.30	11.54%	16.11%	17.79%	5.79%
S&P Global Infrastructure Index	5,302.49	4.25%	14.21%	6.46%	6.02%
Bonds		**1 Month Return**	**3 Month Return**	**1 Year Return**	**3 Year Return**
Australian Corporate Bond Composite	10,880.94	2.10%	3.18%	6.82%	-0.67%
Bloomberg Ausbond Credit FRN 0+ Year Index	2,977.04	0.51%	1.34%	5.07%	2.20%
Barclays Global Aggregate Composite AUD Hedged	1,011.74	3.02%	5.90%	5.31%	-3.11%
Global Investment Grade Credit	272.48	4.25%	9.74%	9.61%	-3.94%
Commodities		**1 Month Return**	**3 Month Return**	**1 Year Return**	**3 Year Return**
Gold spot in AUD	3,028.69	-1.76%	5.43%	13.18%	7.09%
CRB Commodity index (AUD)	385.99	-6.83%	-13.03%	-5.23%	20.96%
Iron Ore (AUD)	192.83	1.62%	6.00%	17.74%	-1.01%
FX		**1 Month Return**	**3 Month Return**	**1 Year Return**	**3 Year Return**
USD index (USDX, DXY)	101.33	-2.09%	-5.21%	-2.11%	4.06%
AUDUSD Spot Exchange Rate	0.68	3.18%	6.49%	0.24%	-4.15%

WHAT'S HAPPENED IN MARKETS

Global equity markets had a strong 2023, as markets like the MSCI Growth Index recorded over 37% for the year. As can be seen below, any style, factor or index with a high weighting to these stocks performed well, and the higher the allocation to tech, the greater the performance. We have charted the S&P500 equal weight TR index against the S&P500 TR and Nasdaq, all with ascending concentrations in tech:

Source: Bloomberg and Innova Asset Management

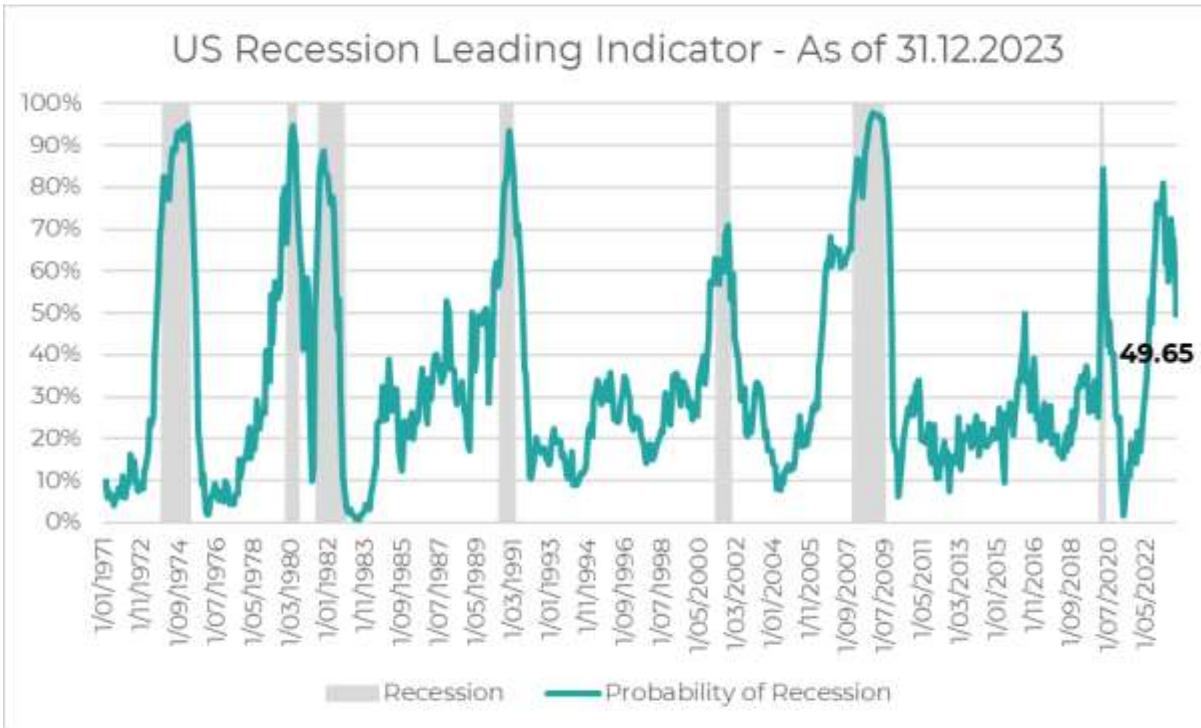
From 2/1/2023 to 23/1/2024 their total performance was:

S&P500 equal weight TR:	12.60%
S&P500 TR:	28.71%
Nasdaq Comp:	60.79%

This rally continued into December, especially after the Fed's comments in the month which acted as a "pivot" in terms of the direction of monetary policy – moving from staying higher for longer to a potential cutting cycle in 2024.

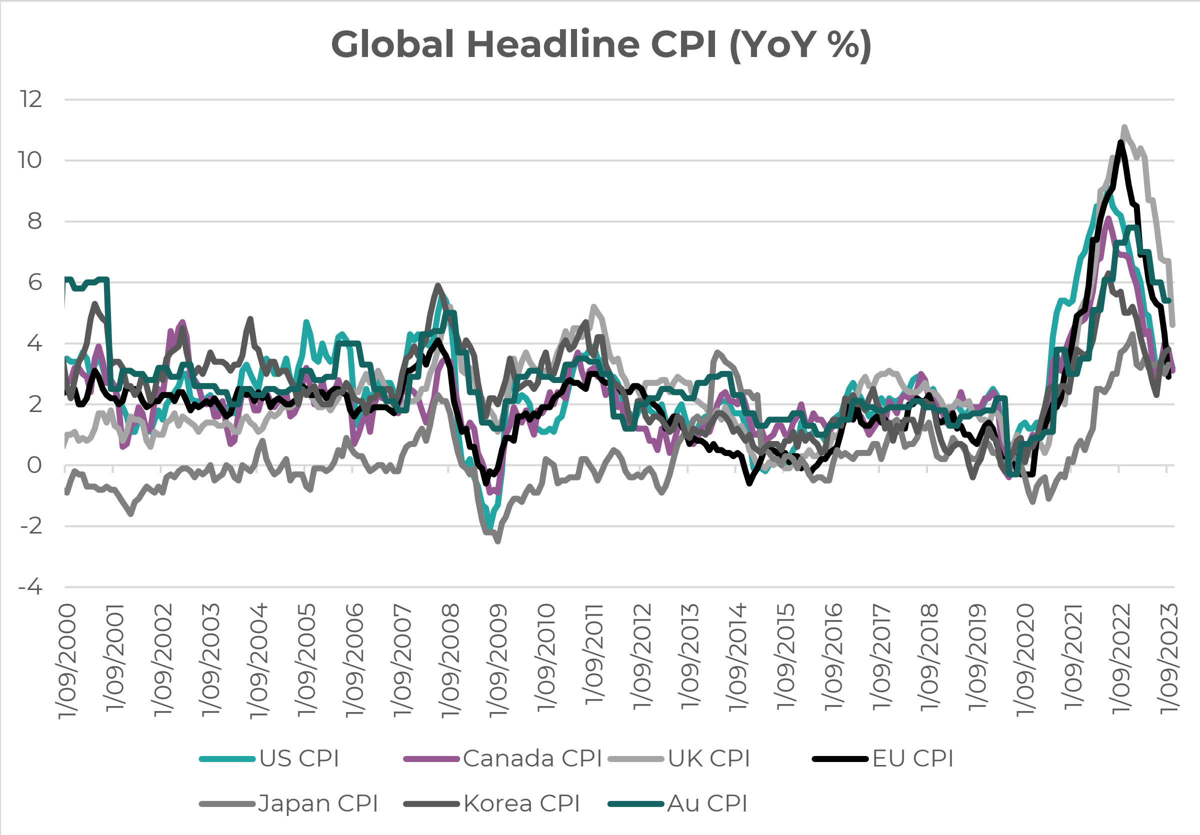
MARKET OUTLOOK

As inflation has receded, sentiment has improved, housing has started to pick up and retail YoY has also improved, this is offsetting the various industrial activity numbers as well as the inverted yield curve. In our economic calculations, this has reduced the chance of recession in the US to below 50%:



Source: Innova Asset Management

After reaching multi-decade highs in 2022, inflation amongst most developed market economies appears to have peaked. The chart below illustrates that most economies are experiencing a peak in headline inflation figures, peaking between June and December 2022. Given this normalisation of headline CPI, the market has priced in interest rate cuts by the Federal reserve, coupled with an assumption of strong economic fundamentals. The counter argument to that is strong economic fundamentals and corporate earnings would reduce the impetus for central banks to reduce rates. We tend to think the market has gotten ahead of itself on rate expectations.

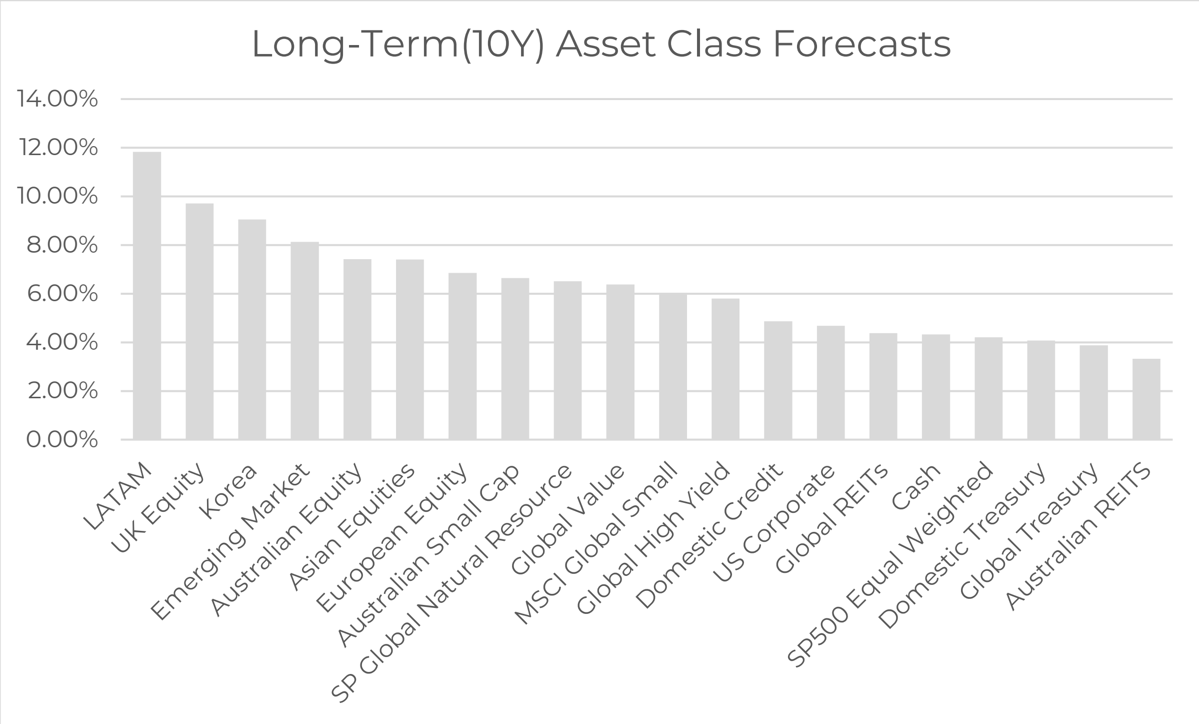


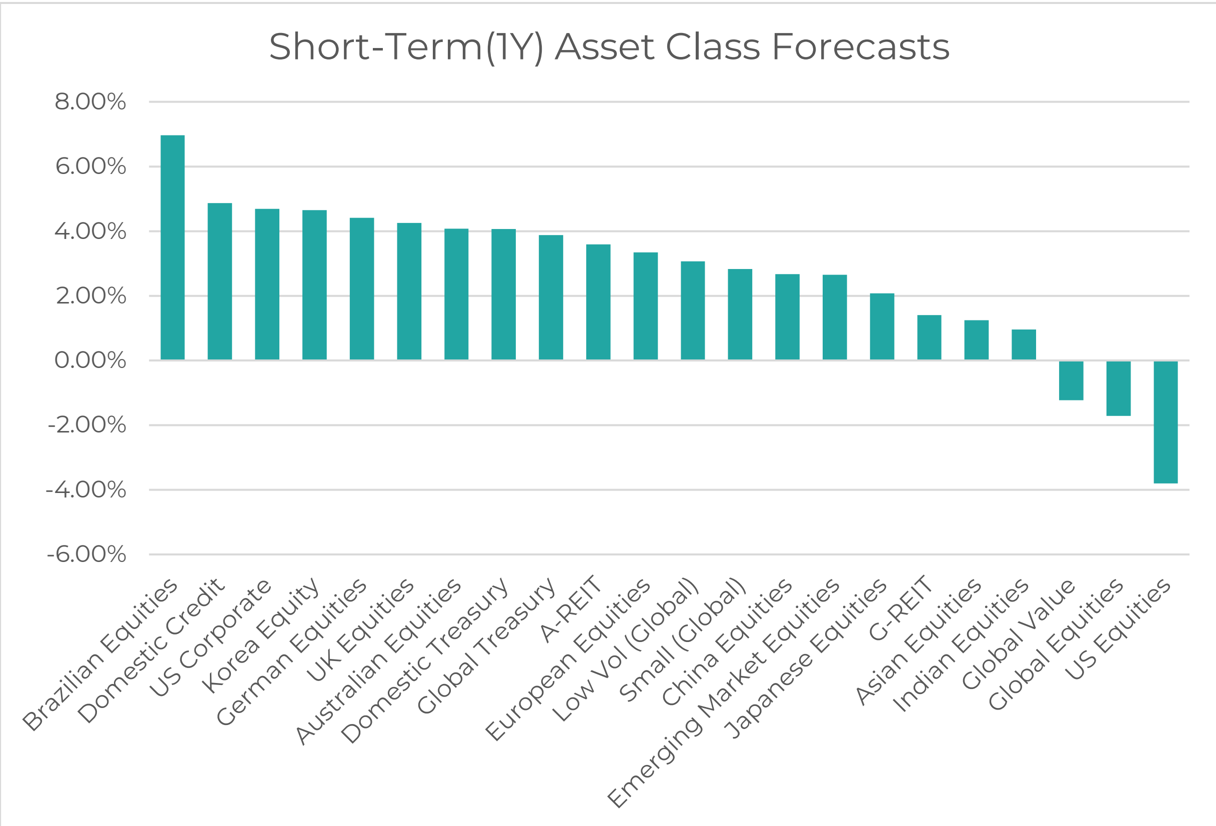
Source: Innova Asset Management

In terms of valuations, there has been a clear separation between US large cap and the rest of the equity universe. The S&P500 is currently trading on valuations only seen twice before since 1995: 2021 and 2000. It is currently higher than the peak of the GFC – in both scenarios the valuation continued to grow, but eventually led to a poor result, the tech-wreck being the worst of the two obviously, but 2022 wasn't a great period for US equities either. The Nasdaq is not yet trading at the extremes of the tech-bubble, but is certainly trading on rich valuations compared to history. If the tech-bubble/wreck is removed as an outlier, this calculation looks even more extreme.

At these valuations, even with strong and robust economic growth, the price being paid for US tech has always ended badly from this point for the S&P500 and Nasdaq.

ASSET CLASS FORECASTS





Market-cap weighted US stocks continue to have a negative expected return, duration looks attractive, and our overweights continue to be stacked at the top for both short and long-term returns.