DRUMMOND

CAPITAL PARTNERS

INVESTMENT PERSPECTIVES

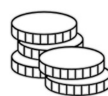
December 2023

Month In Review

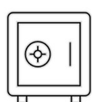
Global Equities
4.1%

Aus Equities
7.3%

Aus REITs
11.9%



AUD/USD
2.9%



US Bonds
3.4%

Commodities
-3.3%

Major equity market indices continued their year-end rally in December due to falling inflation, economic resilience, and a supportive tone from the US Federal Reserve (Fed). Global equities (MSCI ACWI Index) rose 4.1% which resulted in a fresh year-to-date high whilst market participation broadened into year-end. Geopolitical risks persisted, but markets remained steadfast. Australian equities (ASX200) also rose strongly, gaining 7.3%, outperforming offshore benchmarks, as all 11 sectors were in the black with real estate surging 11.2%. Emerging markets were the standout laggard (+3.9%) for most of the month as China uncertainty and deflation continued.

In the last Fed meeting for the year, the Committee left its target rate range at 5.25-5.50% for the third consecutive meeting, but Chairman Jerome Powell signaled the prospect of rate cuts next year. This pivot from his previous stance of higher for longer interest rates led the bond market to rally with 10-year government bond yields concluding 2023 at or below where they started the year. US and Australian bonds both gained around 3% for the month as markets repriced for a lower inflation and lower rate environment. Credit markets also strengthened as the probability of a recession fell and spreads tightened.

The broad commodity market was weaker again over December, down -3.7%, despite the gold price strengthening by 1.4%. Oil price weakness (-4.9%) continued as a weaker demand outlook and the failure of OPEC+ nations to convince the world of further supply cuts both proved to be headwinds. The AUD posted its second consecutive monthly increase against the USD, climbing 2.9% during November as interest rate expectations shifted.

Things That Matter

1.	Most global central banks have aggressively tightened monetary policy in response to high inflation and there is now an expectation that rates will be cut throughout 2024.
2.	Inflation is looking to have established a disinflationary trend but the process of getting inflation to central bank targets still has some way to go.
3.	Equity market and bond valuations have improved but will be further challenged in the period ahead if inflation proves to be sticky or if there is a recession.
4.	China's growth initially picked up in response to the end of zero-Covid and easing regulatory pressures. However, growth has since faltered, with the property sector being a notable drag on outcomes.
5.	The war in the Middle East is a stark reminder that geopolitical tensions are heightened across the globe and may contribute to elevated volatility in the years ahead.

Asset Class Positioning

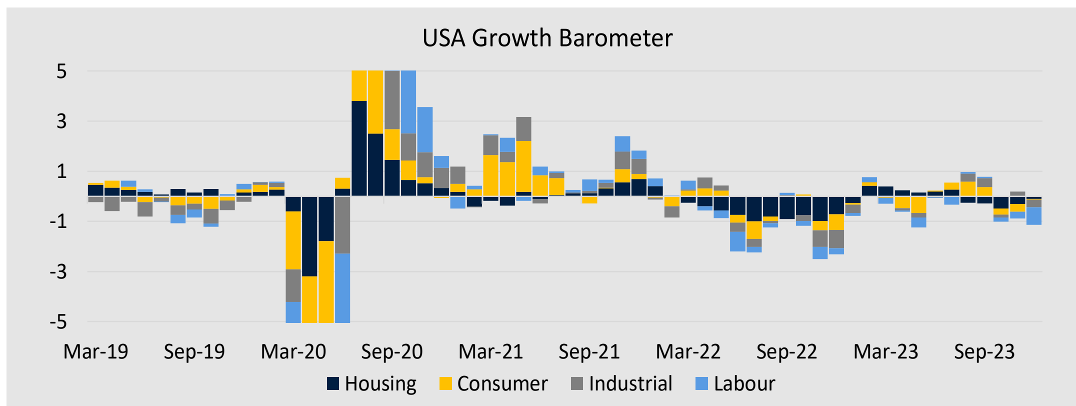
Change Over Month	Change	Strong Underweight	Underweight	Neutral	Overweight	Strong Overweight
Australian Equities	▬	○	○	●	○	○
Global Equities	▲	○	●	○	○	○
Property	▲	○	○	○	●	○
Infrastructure	▬	○	○	○	●	○
Global Alpha	▬	○	●	○	○	○
Government Bonds	▬	○	●	○	○	○
Corporate Debt	▬	○	○	○	●	○
Cash	▼	○	○	○	●	○
Total Growth vs Defensive	▲	○	●	○	○	○

Macroeconomic Overview

North America	
Asia	
Europe	
Australia	

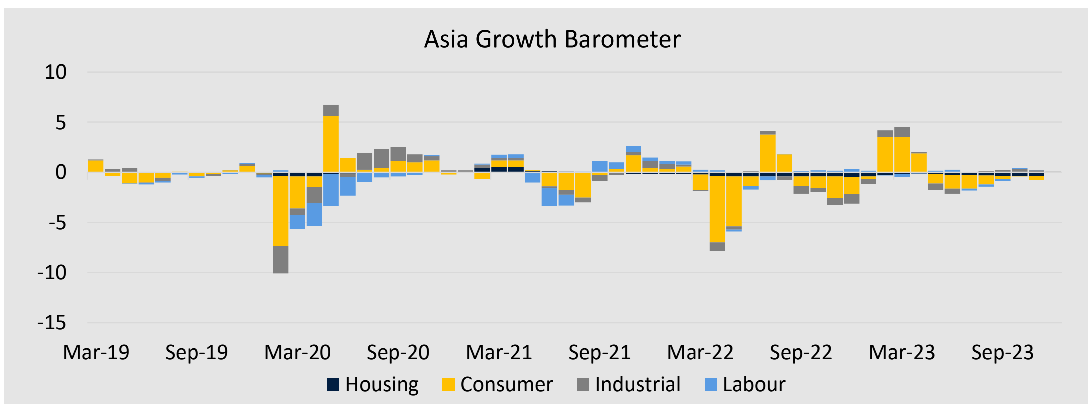
North America

US growth has ticked up so far this year, but we still expect growth to moderate in the year ahead as consumers are likely to start pulling back in 2024 as the long-anticipated headwinds of 'higher for longer' hit. We also expect a softening in capex. Whilst core inflation is now looking more likely to have established a downward trend, we still think the tightening to date is enough to cause a recession in H1 2024. Hence, our forecast of a mild recession remains, that is, one which sits between a soft landing, in which inflation is tamed without much upward movement in unemployment, and a traditional recession, where the unemployment rate rises at least two percentage points.



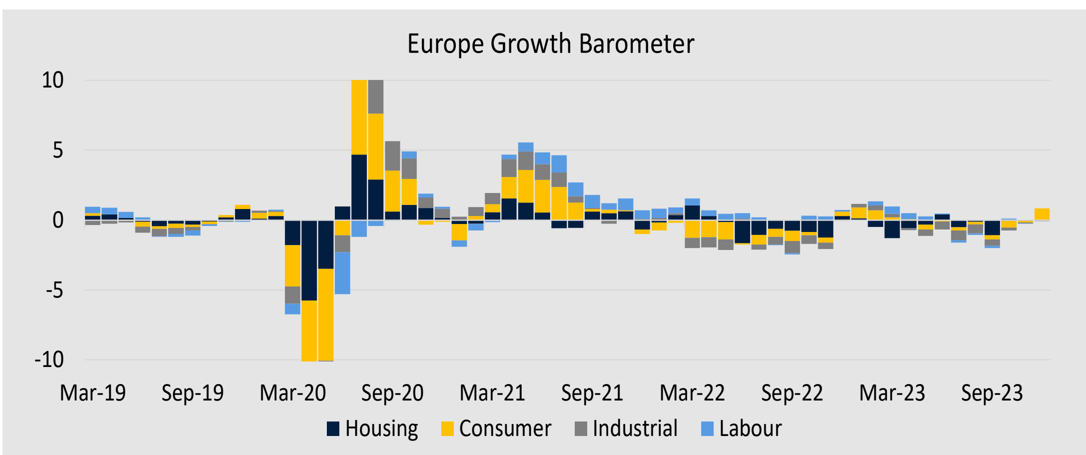
Asia

Growth in China recovered following the Government's abandonment of its zero-Covid policies as well as an easing in regulatory pressures. However, this has now lost steam as China data continues to disappoint, with the property sector again dragging on outcomes, despite the Government relaxing many of its regulatory restrictions on the sector. Manufacturing PMIs have also been falling. China recently surprised markets after they announced an additional 1 trillion-yuan central government bond issuance which could suggest the government is taking steps to support the economy. We will continue to monitor how any policy support may develop and what implications that may have for equity market performance.

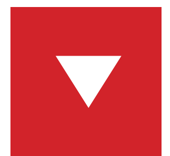


Europe

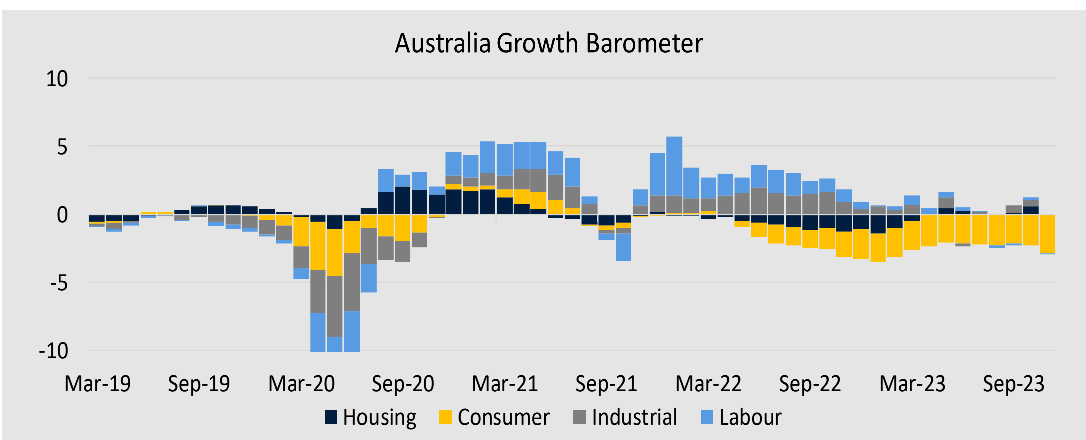
The ECB looks like it is now at a point where it can pause and assess the impact of its monetary tightening as macro and inflation data has softened. European banks have rapidly pulled back on business lending which poses risks for a broader credit crunch in the Eurozone. Moreover, the Bloc still faces significant challenges from Russia's invasion of Ukraine which is weighing on business sentiment. Interest rates are significantly higher than anyone thought possible two years ago and funding costs for heavily indebted governments could become a concern for financial stability. Accordingly, markets are now pricing nearly 125bps of ECB rate cuts by the end of 2024.



Australia



The Australian economy is still experiencing below trend growth and consumers are at GFC levels of pain as rate hikes are starting to bite. After a period of softening, national house prices rose around 8% in 2023. A rush in demand due to high levels of immigration and limited supply offset the negative impact of higher interest rates on house prices. Further softness in house prices does, however, remain a risk as interest rate rises continue to weigh.



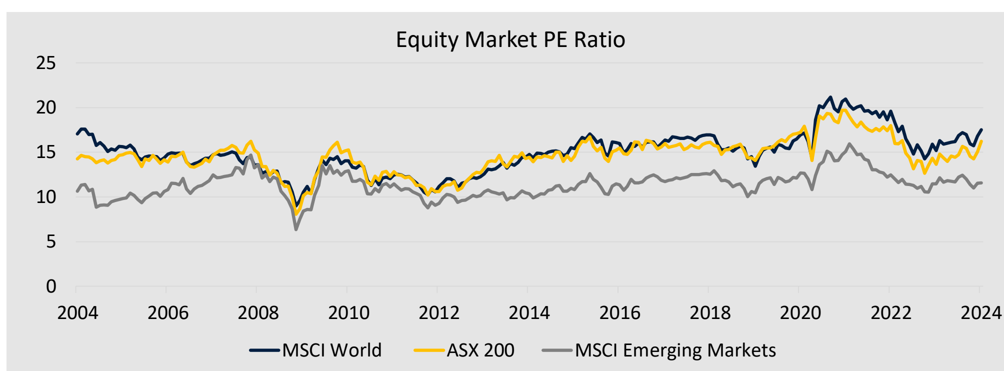
Asset Class Overview

Asset Class	Position
Equities	Underweight
Bonds	Underweight
Credit	Overweight
Infrastructure	Overweight
Property	Overweight
Global Alpha	Underweight

Equities

Underweight

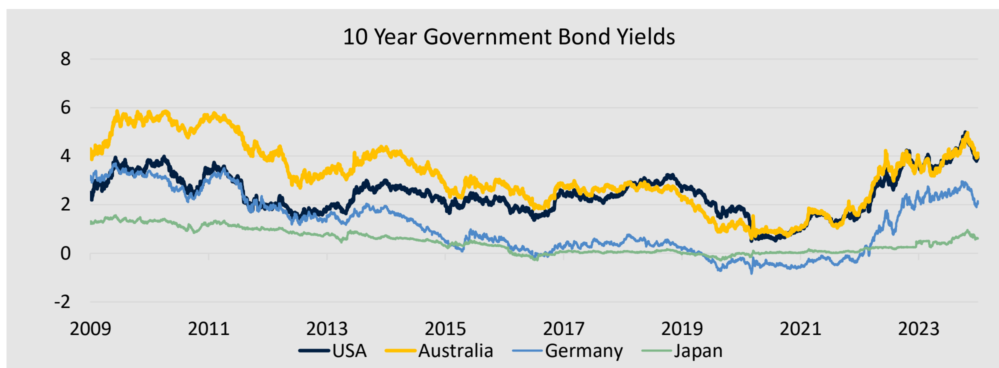
Global equities have performed well for the calendar year and are now pricing in the so-called Goldilocks scenario after inflation continued to slow whilst growth remained solid. The recent rally increases the risk of disappointment in the near term, either because markets shift as growth weakens, or that yields spike higher if economic growth stays robust. If anything, the recent rally has stimulated the economy and decreased the need for the Fed to ease monetary policy. Ultimately, any data that deviates from this narrative will contribute to market volatility. Given this, we remain modestly underweight global equities, which we think most appropriately balances the risk of recession in the US and a soft landing with current market pricing.



Bonds

Underweight

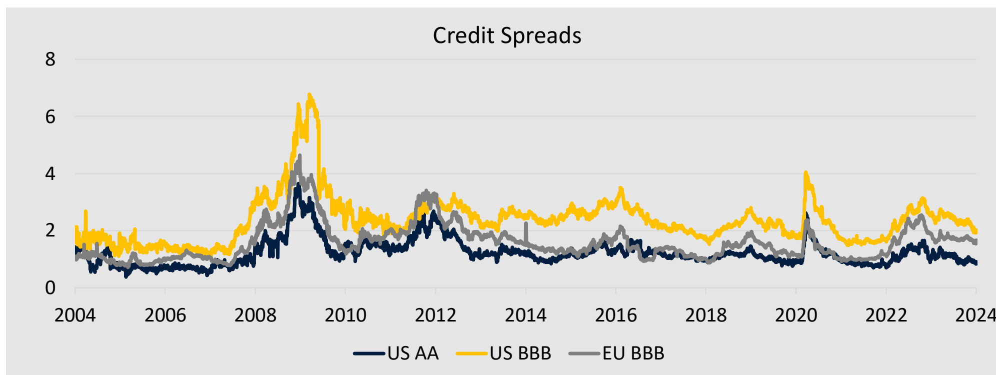
We reduced our exposure to global bonds early in Q3 as the sell-off in bond yields appeared set to continue with yields reaching highs last seen in 2007. This was led by 'real yields' pushing higher, likely mainly reflecting high debt issuance and a still strong US economy. More recently, government bonds have rallied strongly as the market decided that the Fed had won the war on inflation and will start cutting interest rates in the first half of 2024. We have maintained a neutral exposure to Australian government bonds which have less sovereign risk vis a vis global.



Credit

Global credit spreads ended 2023 at the tightest levels of the year whilst delinquencies and defaults are edging higher (albeit off a low base). We do view the current valuations as unreflective of the still uncertain economic backdrop and hence we remain cautiously positioned. However, we do believe the current yields available on Australian investment grade corporate debt (IG) are attractive versus cash and government bonds and we have continued to build exposure to this sector. Overall, we remain defensively positioned with a focus on quality.

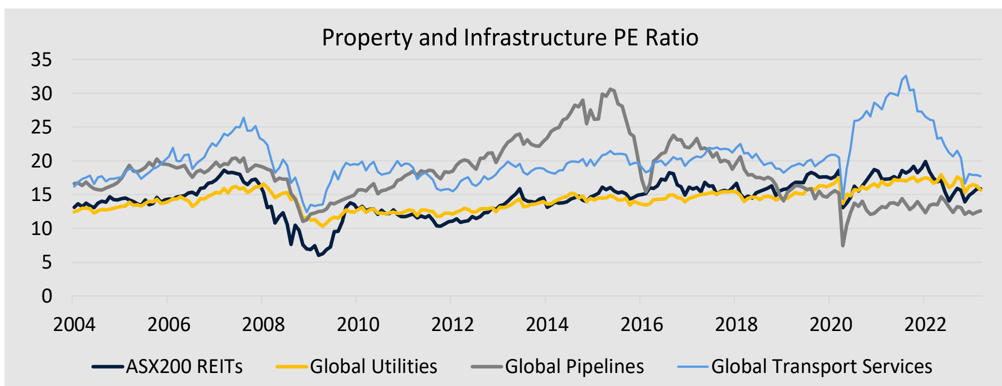
Overweight



Property / Infrastructure

We continue to favour the defensive qualities of infrastructure assets in this backdrop. Additionally, given the risk of rate hikes and higher inflation have dissipated recently, we added exposure to our existing property manager, Quay Global Real Estate, which was one of the asset classes most negatively affected by these trends since the rate hiking cycle began in 2022.

Overweight



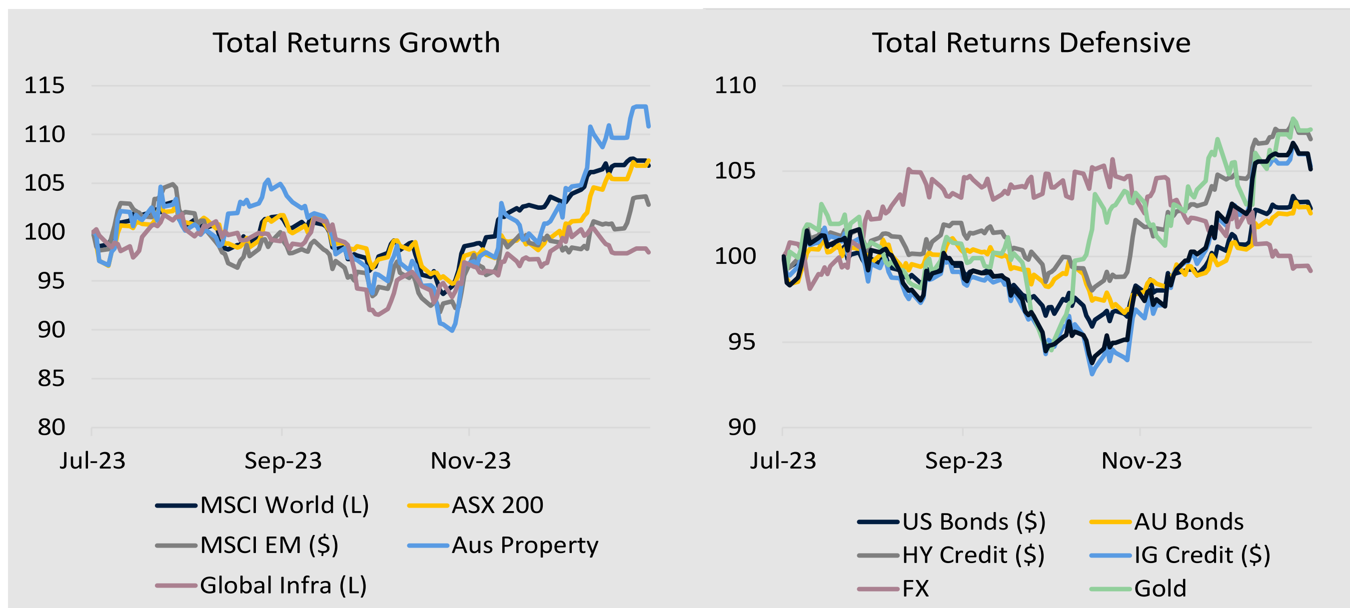
Global Alpha

We have progressively switched our 'Global Alpha' allocation into defensive IG credit this year as yields now offer more than 6.5% running yield for a fraction of the fee. An over or underweight allocation to this asset class will remain manager and strategy type specific.

Underweight

Asset Class Returns

	Latest Value 31/12/23	Weekly Performance	Monthly Performance	Quarterly Performance	Yearly Performance
MSCI World All Countries	869	1.3%	4.1%	9.5%	22%
S&P/ASX 200	7,591	0.8%	7.3%	8.4%	12%
MSCI Emerging Markets	1,024	2.7%	3.9%	7.9%	10%
Nasdaq Composite	15,011	1.6%	5.6%	13.8%	45%
Euro Stoxx	474	-0.2%	3.3%	7.9%	19%
Australian Property	85.5	1.7%	11.9%	16.2%	17%
Global Infrastructure	61	-0.3%	1.7%	5.0%	-2%
Australian Bonds	3.96%	0.6%	3.1%	4.0%	4%
US Bonds	3.87%	0.1%	3.4%	5.6%	4%
High Yield Credit (spread/return)	1.9%	0.2%	3.2%	7.1%	12%
Investment Grade Credit (spread/return)	0.9%	0.3%	4.9%	10.1%	9%
US $ / Australian $	0.68	1.0%	2.9%	5.9%	1%
Crude Oil-WTI	71.9	-2.7%	-4.9%	-20.8%	-10%
Gold Bullion Lbm $/T Oz	2,065	1.5%	1.4%	11.2%	14%



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