

May 2024

Portfolio Changes Update

Implemented Portfolio Changes

Partners Short Term Portfolio

No changes.

Partners Medium Term Portfolio

The role of global duration (government bonds) in the portfolio is to hedge the risk of a larger-than-expected slowdown in growth. As the risk of recession declines, we have reassessed the relative attractiveness of global bonds in the portfolio. With Australian investment-grade credit (corporate bonds) spreads and yields looking attractive, we have taken steps to trim any overweight positioning in global duration to neutral and reallocate the proceeds into Australian credit. To accommodate a meaningful allocation to the newly introduced credit strategy **Realm Short Term Income** – which invests in shorter-duration corporate bonds and mortgage-backed securities – and enhance diversification within the fixed interest of the portfolio, we reduced allocations to **iShares Global Bond Index** and **Betashares Australian Bank Senior Floating Rate Bond ETF**.

Extending this view on global duration, **Betashares Inflation-Protected US Treasury Bond ETF** was trimmed in favour of increasing the portfolio's exposure to international shares through core strategy **Ironbark Royal London Diversified Global Share**.

Partners Long Term Portfolio

With the global economy outperforming expectations, the risk of recession falling, rate cuts on the horizon, and small-caps trading at extreme valuation discounts to large-caps, our conviction in international small-caps has increased. To extend the portfolio's tilt towards international small-caps, **iShares International Equity Index** was trimmed and reallocated to **Yarra Global Small Companies**.

The growth outlook for Australia is less clear than in the US. We remain cautious about Australian small-caps – which are more exposed to the domestic cycle and are trading at a premium to Australian large-caps and international global small-caps – so we took the opportunity to trim Australian small-cap specialist manager **Yarra Australian Smaller Companies** in favour of larger-cap index exposure through **Macquarie True Index Australian Shares**.

Partners Multi-Asset Income Portfolio

Given the relative attractiveness of Australian investment-grade credit spreads and yield, floating rate bond strategy **Betashares Australian Bank Senior Floating Rate Bond ETF** was exited and replaced with short duration Australian credit strategy **Realm Short Term Income**.

New Funds

Realm Short Term Income Fund



The Realm Short Term Income Fund provides access to a diversified, actively managed portfolio of cash and short-term Australian fixed-interest securities, which aims to achieve an after-fee return of 1.5%-2.0% pa over the RBA Cash Rate while preserving capital. The Fund primarily invests in cash and cash-like liquidity instruments like term deposits and commercial paper, and short-dated domestic investment-grade credit securities like residential mortgage-backed securities, asset-backed securities, bank debt and corporate bonds.

Realm Investment House is a Melbourne-based boutique funds management firm specialising in fixed interest credit strategies. Realm was founded in 2012 by Andrew Papageorgiou and Robert Camilleri. The investment team is divided into three distinct segments, which operate independently on a day-to-day basis but come together in a weekly portfolio construction committee to provide a second review of insights and develop an agreed plan for portfolio changes. The three segments include bank and corporate credit, headed by Andrew; structured credit, led by Robert; and risk and strategy, managed by Ken Liow. The three fixed interest specialists have an average of almost three decades worth of industry experience and oversee the firm's investment strategies and processes. Three additional portfolio managers and seven analysts round out the experienced and stable team, which promotes a team-based approach to decision-making to ensure appropriate cognitive diversity is brought to portfolio construction. As a privately owned firm, the team are also strongly aligned to produce successful long-term outcomes for investors.

Realm's investment philosophy is based on the belief that fundamental investing, using proprietary quantitative tools to support investment decisions, is the most effective way of extracting favourable risk-adjusted returns from inefficiencies and mispricing opportunities in credit markets. Realm considers itself a contrarian investor, believing it can profit from the mean reverting nature of risk premia (outperformance over a risk-free rate of return) in its credit exposures over time. Realm's investment process centres around the portfolio construction committee, which brings together the top-down research conducted by the risk and strategy segment, with the bottom-up research undertaken by the bank and corporate and structured credit segments. The committee reviews and discusses this ongoing research and significant portfolio exposures, with the outcomes of these discussions guiding future portfolio changes to asset classes, hedging, and target interest rate duration settings.

Asset Allocation Positioning

Asset Class	Outlook & Positioning				
	Negative ←		→	Positive	
Growth Assets			Yellow		
Australian Shares			Yellow		
International Shares			Yellow		
Emerging Markets Shares				Green	
Property		Red			
Infrastructure				Green	
Value vs Growth Style Factor (Shares)			Yellow →		
Quality vs Cyclical Style Factor (Shares)				Green ←	
Small vs Large Cap Shares					Green →
FX Hedging (AUD view)				Green	
Defensive Assets			Yellow		
Australian Duration (Government Bonds)				Green	
International Duration (Government Bonds)			Yellow ←		
Australian Credit				Green →	
International Credit			Yellow		
Absolute Return (Fixed Interest)		Red			
Absolute Return (Diversified)			Yellow ←		
Cash		Red			

Remain neutral on Growth Assets

Financial conditions in the US continue to ease, the labour market remains tight but is showing signs of softening, and wage growth is declining slowly with core inflation. All indicators point to an improving economic backdrop and a greater likelihood of a soft landing scenario, which should be supportive of markets and constructive to our outlook for growth assets or shares.

However, we remain concerned that share market valuations are elevated both in absolute terms compared to historical averages and relative to bond yields, leaving little room for disappointment. The recent spike in bond yields only exacerbates this, with the equity risk premium now at extreme lows. We are cautious of a mild correction in share markets given this disconnect and believe it is prudent to wait for a more attractive entry point before up-weighting shares.

Remain neutral on Australian Shares

The growth outlook for Australia is less clear than in the US, although the Reserve Bank of Australia (RBA) is likely to follow the US Federal Reserve (Fed) in remaining patient regarding rate cuts, ensuring inflation is first contained. Valuations on Australian shares are high relative to historical averages, implying upgrades to company earnings and a much stronger economic outlook than current consensus estimates. Further risks to earnings keep us from adding to our neutral allocation to Australian shares with any conviction. We are cautious about Australian small-caps, which are more exposed to the domestic cycle and trading at a premium to Australian large-caps and international global small-caps.

Remain neutral on International Shares

Returns from international shares continue to be concentrated in mostly mega-cap technology growth companies, although there are signs of a broadening of the recent rally into other segments of the market. While the macroeconomic environment has improved and momentum in company earnings growth is building, we remain cautious about stretched valuations in international shares in absolute terms (against historical averages) and in relative terms versus bonds. We recommend a broadly neutral position to international shares (including neutralising any underweights), looking for upside opportunities in less expensive parts of the share market.

Relative valuations between growth and value are at extremes, but relative valuation alone has not been a reliable indicator of future outperformance. We prefer that portfolios are not overly biased toward growth but wait for a catalyst for a strong value recovery before making a material tilt to value. Our long-term preference is for a quality style bias due to its resilient downside characteristics and long-term outperformance. However, in the near term we acknowledge a very strong performance from quality, particularly in developed market large-caps, that has led to stretched valuations.

China is in an economic slump, and valuations reflect extreme pessimism. Emerging markets ex-China are a diverse group but, in aggregate, have improving earnings and signs of early-stage cyclical expansion. We maintain a modest overweight to emerging markets, with caution on China until sentiment and trends improve.

The Australian dollar (AUD) is trading at a discount to its estimated fair value. If Australian growth lags global growth and investors start to price in more RBA rate cuts earlier, the AUD could move lower from current levels. With value outweighing this risk, we remain positive on the AUD and recommend a mild overweight to FX hedging.

Extend a tilt to International Small-Cap Shares

With the global economy outperforming expectations, the risk of recession falling, rate cuts on the horizon, and small-caps trading at extreme valuation discounts to large-caps, our conviction in international small-caps has increased. We recommend extending a tilt to international small-caps.

Remain underweight to Property

The international property index has recently swung wildly with bond yields and has underperformed the broader share market by some distance over the past 12 months. Forward dividend yields for Global Real Estate Investment Trusts (REITs) remain close to the same level as the yield on the two-year US Treasury (allowing for forward expectations of the cash rate). The historical relationship between this spread and subsequent returns suggests that property may face continued valuation headwinds into the future.

Remain modestly overweight to Infrastructure

We believe the long-term outlook for infrastructure is better than that for its real asset counterpart, property. However, international infrastructure has also been left behind in the recent rally as higher bond yields weigh on valuations. We see infrastructure as fairly priced and remain positive about its defensive role in portfolios.

Retain a modest overweight allocation to Australian Duration (Government Bonds)

Government bond yields traded sideways over the first quarter of 2024 as local rate expectations remained stable. Australian duration remains near fair value, albeit still offering greater upside and protection in a hard landing scenario.

Reduce to a neutral allocation to International Duration (Government Bonds)

We see international duration as near fair value with a greater upside in a harder landing scenario. Given the declining likelihood of a global recession and, therefore, less upside via yield compression, we recommend trimming any larger overweight positions and reallocating to Australian credit that offers attractive spreads and yield. Breakeven rates are at levels that support an allocation to US Treasury Inflation-Protected Securities (TIPS), which remain attractive relative to nominal (fixed-rate) bonds if the 'final mile' of inflation normalisation is slower than expected.

Increase to a modest overweight allocation to Australian Credit

Australian investment-grade spreads and structured credit yields are attractive relative both to historical levels and relative to US investment-grade credit with lower levels of risk. Greater exposure to underperforming financial and property sectors and declining demand from global investors are two possible explanations for this divergence in spreads between Australian and US investment-grade credit. We recommend trimming any overweight positions to international duration and reallocating to Australian credit.

Remain neutral on International Credit

Although fundamentals are improving, international and US high yield credit spreads are too tight to compensate for default risk. International investment-grade credit spreads are also tight compared to Australia and are therefore less attractive.

Remain modestly underweight to Cash

Cash rates and term deposits now offer reasonable returns for investors, but we see a greater upside for duration and high-quality credit.

Invest Blue Pty Ltd ABN 91 100 874 744 ('Invest Blue') is the sponsor of the Partners Portfolios. Invest Blue is an Australian Financial Services Authorised Representative (AFSAR No. 000257496) of AMP Financial Planning Pty Limited ABN 89 051 208 327 AFSL No. 232706 ('AMP Financial Planning'). This document is confidential and must not be copied, either in whole or in part, or distributed to any other person. The information in this document does not take account of your objectives, financial situation or needs. Before acting on this information, recipients should consider whether it is appropriate to their situation. We recommend obtaining personal financial, legal and taxation advice before making any financial investment decision. To the extent permitted by law, none of Invest Blue, AMP Financial Planning or any of their related entities accepts any responsibility for errors or misstatements of any nature, irrespective of how these may arise, nor will it be liable for any loss or damage suffered as a result of any reliance on the information included in this document. If this document contains any performance data, then performance is not a reliable indicator of future performance.