MARKET MATTERS

INVEST

MONTHLY REPORT | DECEMBER 2023 | ACTIVE INCOME

PORTFOLIO DETAILS

Portfolio Name	Active Income
Structure	Separately Managed Account
Benchmark	RBA Cash +4%
Management Fee	0.85% incl GST
Platform	Open Wealth | Praemium
Included Assets	Equities, Hybrids, Trusts, ETFs
Portfolio Manager	James Gerrish
Annual Performance	9.34%*

OBJECTIVE

The objective of the Market Matters Active Income Portfolio is to provide a high level of regular tax-effective income with lower volatility than the underlying share market. This is achieved by actively managing a portfolio of high-yielding equities combined with ASX listed income securities that offer diversification benefits to both Australian equities and cash or term deposits.

**Inception Date 05.07.2017*

MARKETS & PERFORMANCE

The Market Matters Active Income Portfolio advanced by 4.63% in December, outperforming its RBA Cash +4% benchmark which increased 0.70%. The portfolio has returned 12.32% for the rolling 12 months, against the benchmark return of 7.87% and 11.42% per annum for 3 years, 4.78% per annum above its benchmark.

PERIOD	1 MONTH	3 MONTH	6 MONTH	1 YEAR	2 YEAR PA	3 YEAR PA
PORTFOLIO %	4.63	3.86	6.38	12.32	9.17	11.42
BENCHMARK %	0.70	2.05	4.08	7.87	6.48	5.61
RELATIVE %	3.93	1.81	2.30	4.45	2.69	5.81

Benchmark: RBA Cash Rate +4%

Calendar 23 was a solid period for the portfolio with its higher skew towards floating-rate income securities benefitting from higher interest rates and when combined with equities produced a portfolio return in line with the equity market, but with less risk. The portfolio has produced outperformance on all 1, 3 and 5-year time frames.

This month we're stepping back and looking at CY23 for markets and how the Market Matters Portfolios performed throughout.

Locally, stocks had a solid but not spectacular calendar year when compared to other major benchmarks, with the ASX 200 advancing by 12.42% net of dividends versus the US S&P 500 which logged a more substantial gain of over 20%, largely thanks to the higher proportion of technology stocks in that index. The less-tech-stock-sensitive Dow Industrials (16.18%) and Russell 2000 (16.93%) also enjoyed strong returns in 2023, but relatively underperformed the Nasdaq (55.13%) and S&P 500 (26.29%). Notably, the index performance for the calendar year 2023 was the opposite of 2022, where we saw the Nasdaq and small caps decline substantially more than the ASX 200 and S&P 500.

MARKETS & PERFORMANCE CONTINUED

By market capitalization, small caps outperformed large caps towards the end of the year thanks to those surging rate cut expectations, as lower rates are typically most beneficial for smaller companies. For the year, however, large caps handily outperformed small caps as the higher rates for the majority of 2023 weighed on smaller company performance.

From an investment-style standpoint, growth significantly outperformed value, with the reasons being familiar ones: Artificial intelligence enthusiasm powered tech-heavy growth funds early in 2023 while in the December quarter expectations for rate cuts were seen as positive for growth stocks. Growth outperforming value is also the opposite of 2022, where higher rates and recession fears resulted in value outperforming growth.

All ASX sectors ended 2023 with gains, not surprisingly, the influence of expected lower rates was dominant towards the end of the year with Real-Estate being the best-performer in the December quarter, although for the full year, Technology (31.43%), Consumer Discretionary (23.85%) and Materials (18.27%) were hard to beat as expectations for stable economic growth rose on telegraphed future rate cuts.

Looking at sector laggards, defensive sectors including Consumer Staples (2.60%) and Utilities (4.04%) lagged as economic growth was more resilient than expected while higher rates (for most of 2023) reduced the demand for high dividend paying areas - Healthcare (3.96%) was hit by sector-specific concerns over weight loss wonder drugs.

The December rally was clearly a significant one and accounted for over half of the yearly gain for local stocks thanks to a surprise dovish pivot by the US Central Bank, which combined with solid economic activity and declining inflation to push stocks sharply higher both here and abroad.

Internationally, overseas markets were generally strong headed by the US, although stellar gains were also achieved from stocks in Europe. Emerging markets lagged as increased geopolitical tensions in the Middle East and on continued lacklustre Chinese economic growth which saw mainland Chinese equities actually down over 12% for the year – proving a tough place to be again in 2023.

Commodities were a mixed bag during the year as weakness in oil, which was driven by reduced geopolitical fears and rising global economic growth worries, offset a solid gain in gold. Gold rallied on a falling U.S. dollar and hit a new all-time high in early December. Iron Ore was a standout rallying more than 16% in CY23 on robust Chinese steel production and generally bearish investor sentiment and positioning, while Copper prices remained resilient to mildly positive for the period.

In fixed-income markets, the Bloomberg AusBond Composite Bond index had a positive year, up 5.06% as falling inflation and expectations for rate cuts in 2024 pushed bonds higher.

Longer-duration bonds outperformed those with shorter durations in the final 3 months as bond investors reacted to lower-than-expected inflation and priced in future Fed rate cuts, however, for the full year, shorter-duration debt outperformed longer-term bonds as high inflation readings through much of 2023 weighed on the long end of the yield curve.

2023 was ultimately a year of surprises for the markets as the expectations for a recession never materialised, inflation fell faster than forecasts, corporate earnings proved resilient and central banks surprised markets by pivoting to a more dovish future policy. The result was solid gains for equities broadly, with some pockets of substantial gains, particularly from US technology stocks that rebounded from a weak 2022.

PORTFOLIO POSITIONING

The portfolio held 19 positions at the end of December with a forecast yield of 5.74% plus franking. The portfolio is weighted approx. 50% in Equities, 40% in Hybrids/Fixed Income, 6.5% in property and 3.5% cash.

Having been active in prior months, we took a more wait-and-see approach in December having minimal portfolio turnover, however, we expect this will change early in 2024 given the extent of the market rally.

For the full year, we got more things right than wrong, but it was still a challenging year none-the-less.

At a high level, the portfolio saw a maximum drawdown of 5% for the year which happened in March while an annual standard deviation of 7% shows the low variability of returns in this more defensive portfolio. Equities accounted for 8.45% of the return, while fixed income was 2.35% and the balance from property. Income accounted for approx. 67% of returns while capital gains contributed 33%.

What we got wrong...

In a bullish market, being too conservative can detract from returns, and that is one aspect we arguably got wrong during the year. That said, the portfolio displayed significantly less volatility than the market, averaged less than 60% exposure to equities, a higher yield and kept pace with the gains of the ASX 200.

Major detractors of returns were limited, but included **APA Group (APA)** -0.39% and **Metcash (MTS)** -0.23%, although no singular position detracted more than 0.4% from portfolio returns.

What we got right...

The main portfolio contributors came from a large cross-section of the market which is pleasing. **AGL Energy (AGL)** added 1.86% and took top spot, **BHP Group (BHP)** added 1.38%, **Wesfarmers (WES)** 1.28%, **Commonwealth Bank (CBA)** 1.08% and **National Bank (NAB)** 1.01%.

PORTFOLIO STOCKS	
NO. OF HOLDINGS	19
ESTIMATED YIELD (%)	5.74
TOP 5 POSITIONS (% OF AUM)	33.08
TOP 10 POSITIONS (% OF AUM)	59.89

STOCK	CONTRIBUTION (%)
MAGELLAN FINANCIAL GROUP (MFG)	0.89
CENTURIA CAPITAL (CNI)	0.71
BHP GROUP (BHP)	0.67
NATIONAL BANK (NAB)	0.60
COMMONWEALTH BANK (CBA)	0.46

STOCK	DETRACTION (%)
NEW HOPE CORP (NHC)	-0.05

%	JUL	AUG	SEP	OCT	NOV	DEC	JAN	FEB	MAR	APR	MAY	JUN	YTD
FY24	2.79	-0.44	0.09	-3.32	2.67	4.63							**6.42**
FY23	4.22	0.30	-3.64	3.31	4.82	-0.07	3.49	-1.61	0.06	2.16	-2.01	2.07	**13.10**
FY22	0.10	3.04	0.58	-1.58	-1.31	3.01	-2.45	4.05	4.25	-0.09	-1.80	-6.54	**1.26**
FY21	1.16	2.22	-1.21	-0.17	9.29	1.46	0.47	0.96	2.73	2.79	1.91	2.39	**24.00**
FY20	1.54	-0.57	2.90	-4.54	1.16	-0.51	1.78	-3.97	-15.53	7.33	6.24	1.94	**-2.23**
FY19	1.35	0.76	-0.62	-3.09	-0.61	-0.40	2.42	3.92	-0.21	1.17	3.13	1.37	**9.19**
CUMULATIVE													**51.74**

LOOKING AHEAD

What a difference a year makes.

At this time last year, the market was struggling as central banks globally were in the midst of the most aggressive rate hike campaign in decades, inflation was above 7% and concerns about an imminent recession were dominating the news flow.

Now, as we begin 2024, the market outlook couldn't be much more positive. Central Banks look done with rate hikes and cuts are on the way, likely in early 2024 for the US and later in the year locally. Economic growth has proven more resilient than most could have expected and fears of a recession are all but dead. Inflation dropped substantially in 2023 and is not far from central bank targets while corporate earnings growth is expected to resume in the coming year.

Undoubtedly, that's a more positive environment for investors compared to the start of 2023, but just like overly pessimistic forecasts for 2023 proved incorrect, as we look ahead to 2024, we must guard against complacency because at current levels both stocks and bonds have priced in a lot of positives in the new year.

Starting with the most important macro-economic influence globally, Fed policy. Fed officials are forecasting three rate cuts in 2024 but investors are currently pricing in six rate cuts in 2024 with the first one occurring in March or May. That's a very aggressive assumption and if it is incorrect, we should expect an increase in volatility in both stocks and bonds.

Regarding economic growth, it's foolish to assume just because the economy was resilient in 2023 that it will stay resilient. Obviously, that's the hope, but hope isn't a strategy. The longer rates stay high (and they are still high) the more of a drag they create on the economy. Meanwhile, all the remnants of pandemic-era stimulus are gone and there is some economic data that's starting to point towards reduced consumer spending. Point being, it is premature to believe the economy is "in the clear" and a slowing of growth is something we will be on alert for as we start the new year, because that would also increase market volatility.

Inflation, meanwhile, has declined sharply but it still remains above central bank targets. Many investors expect inflation to continue to decline while economic growth stays resilient, a concept traders coined "Immaculate Disinflation." However, while that's possible, it's important to point out it's extremely rare as declines in inflation are usually accompanied by an economic slowdown.

Finally, corporate earnings have proven resilient but companies are now facing margin compression as inflation declines and economic growth potentially slows. Earnings results and guidance have not been as strong as earlier in 2023 and if earnings are weaker than expected, that will be another potential headwind on markets.

Bottom line, while undoubtedly the outlook for markets is more positive this year than it was last year, we won't allow that to breed a sense of complacency because as the past several years have shown, markets and the economy rarely behave according to expectations, and the influential macro-economic environment is a fluid one.

As such, expect a greater level of activity around portfolio positioning to start the year, and while we are prepared for the positive outcome currently expected by investors, we are also conscious of the many risk factors still permeating through markets and we will not hesitate in playing a more defensive stance should it be warranted.

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