MULTI-ASSET REVIEW

Russell Investments

PERFORMANCE

Here our Multi-Asset Team discusses Russell Investments' performance in the June quarter and their outlook for 2024.

What drove markets during the second quarter of 2024?

The June quarter saw mixed performances across growth and defensive assets as investors continued to assess the outlook for global interest rates.

Several events helped shape market movements over the period:

1. European Central Bank cuts interest rates. The European Central Bank (ECB) cut interest rates in June; the Bank lowering its main refinancing rate by 0.25% (to 4.25%). In its post-meeting statement, the ECB noted that, based on an updated assessment of the inflation outlook, the dynamics of underlying inflation and the strength of monetary policy transmission, it is now appropriate to moderate the degree of monetary policy restriction after nine months of holding rates steady. However, officials gave no indication of the timing of its next move, saying only that it will continue to follow a data-dependent and meeting-by-meeting approach to determine the appropriate level and duration of restriction, and that the Bank isn't pre-committing to a particular rate path. The latest figures showed headline inflation in the region rose 2.6% in the 12 months to 31 May, which was up on the 2.4% rise we saw in the previous month. Core inflation, which strips out volatile food and energy prices, rose 2.9% for the same period; up from 2.7% in April. Inflation in the euro-zone peaked at 10.6% in October 2022. At the time of writing, the market was fully priced for another rate cut in October. We also saw the Swiss National Bank, Sweden's Riksbank and the Bank of Canada all cut interest rates in June. Meanwhile, the US Federal Reserve (Fed) left rates on hold throughout the period. Speaking after the Bank's June gathering, Chairman Jerome Powell said that while inflation has eased considerably from its peak, it nonetheless remains too high, and that policymakers do not yet have the confidence to begin lowering rates. Interest rates also remained on hold in the UK and Japan.

2. Reserve Bank of Australia leaves rates on hold. The Reserve Bank of Australia (RBA) left the official cash rate unchanged at a 12-year high of 4.35% throughout the period. In its latest (June) post-meeting statement, the RBA noted that despite having fallen considerably since its peak in 2022, inflation is proving somewhat persistent. According to officials, the economic outlook remains uncertain and recent data has demonstrated that the process of returning inflation to the Bank's 2-3% target range is unlikely to be smooth. The RBA's central forecasts, published in May, were for inflation to return to the target range in the second half of 2025 and to the midpoint in 2026. Since then, there have been indications that momentum in economic activity is weak, including softer growth in gross domestic product, a rise in the unemployment rate and slower-than-expected wages growth. At the same time, revisions to consumption and the savings rate, together with the persistence of inflation, suggest that risks to the upside remain. The Bank added that there are uncertainties relating to growth in household consumption, the lag effects of monetary policy and the overseas outlook, with growth in most advanced economies appearing to have troughed. The RBA concluded its June gathering by saying that whilst recent economic data has been mixed, it has reinforced the need for the Bank to remain vigilant to upside risks to inflation. Officials also reiterated that the path of interest rates that will best ensure inflation returns to target in a reasonable timeframe remains uncertain and the Bank is not ruling anything in or out. Moving forward, the RBA said it will continue to rely upon economic data and the evolving assessment of risks. In doing so, officials will pay close attention to developments in the global economy, trends in domestic demand and the outlook for inflation and the labour market.

Global shares rose 0.3%[1] in the June quarter. Australian shares underperformed their global peers, returning -1.2%[2]. Much of the local market's decline was driven by expectations domestic interest rates will remain higher for longer amid stubbornly high inflation. Stocks were also impacted by higher bond yields, a series of mostly softer economic data and mixed performances across the major banks and miners, which together comprise a large part of the index. Emerging market equities gained 2.6%[3] for the quarter, outperforming their developed counterparts over the period.

[1] Global shares measured by the MSCI World ex Australia Net Accumulation Index in AUD.

[2] Australian shares measured by the S&P/ASX 300 Accumulation Index.

[3] Emerging markets measured by the MSCI Emerging Markets Index Net (in AUD).

The Australian dollar (AUD) rose in the second quarter, with the Australian Trade-Weighted Index closing the period up 2.9%[4].

Interest rate sensitive assets were mostly weaker, with global and domestic listed property and global and Australian bonds all recording negative absolute returns over the period. In contrast, global listed infrastructure generated good gains.

Credit markets were weaker, with spreads on US and European investment-grade and high-yield debt widening over the period. Local currency emerging markets debt also underperformed, while hard currency emerging markets debt made modest gains.

How did Russell Investments' active multi-asset portfolios perform in the June quarter? What was rewarded by the market and what wasn't?

Absolute returns. The Russell Investments Balanced Fund returned -0.5%[5] for the quarter on a net of fees and tax basis. Performance was driven primarily by negative total returns from the Fund's Australian equity and traditional fixed income exposures. Partly offsetting this were the Fund's exposures to emerging markets equities and floating rate debt.

Returns relative to fund benchmark. The Russell Investments Balanced Fund underperformed its strategic benchmark by 0.6% on a net of fees and tax basis.

Positive contributors included:

- Exposure to emerging markets equities, which outperformed their developed counterparts.
- Positive returns from the Russell Investments Australian Floating Rate Fund and Metrics Credit, which outperformed cash and traditional fixed income assets.

Negative contributors included:

- Stock selection amongst the Fund's global equity managers.
- Exposure to interest rate sensitive assets like US Treasuries and Australian government bonds.

What is Russell Investments' outlook for 2024? How is it impacting your active multi-asset positioning?

Markets have faced multiple concerns over the past 12 to 24 months. In particular, higher inflation driven by post-COVID economic abnormalities and several major geopolitical events saw central banks aggressively raise interest rates, which in turn led to a material increase in market volatility. Despite these concerns, the US economy has to date proven remarkably resilient, and markets are pricing in a 'soft landing' as inflationary pressures continue to ease and unemployment remains low. This has contributed to strong equity and credit market returns, with valuations now appearing stretched. We're seeing several leading economic indicators that suggest caution is warranted. As a result, we believe recessionary risks in the US are elevated; though the risk has reduced gradually as continued migration has allowed inflation to moderate without materially impacting the labour market.

Our composite contrarian indicator, which measures overbought versus oversold levels for the US S&P 500 Index via a range of technical, positioning and survey indicators, is pointing toward overbought conditions. This is a key factor in our cycle, valuation and sentiment process for portfolio positioning, and is being watched closely.

Non-US developed equities are relatively cheaper than US equities from a valuation perspective and likely to benefit from weakness in the US dollar (USD) should the Fed become less hawkish. However, given the threat of a US recession and the USD's traditional 'safe haven' characteristics, we maintain a neutral preference for non-US developed equities.

For fixed income assets, we believe US, UK and German government bonds offer reasonable value. In the US, the spread between two- and 10-year government bond yields remains negative; though not nearly as negative as it was midway through last year. We've seen expectations for US interest rate cuts change significantly since the beginning of the year when the market was anticipating as many as eight throughout 2024. Markets now expect closer to one. Contributing to this shift in rate cut expectations have been stronger economic growth, a resilient labour market and higher than expected inflation readings. We believe that at current levels, exposure to government bonds, including US Treasuries, remains attractive from a valuation perspective. Bonds also provide diversification benefits should the global economy weaken.

In the currency space, the USD at current levels appears expensive in real, trade-weighted terms. The Japanese yen looks attractive from a cycle, value and sentiment perspective, while the euro appears significantly undervalued in terms of purchasing power parity.

Concerns over slowing growth and the potential for an aggressive Fed to cause a recession have eased considerably over the past year as US core inflation continued to trend lower. The key question now is how long will it take for core inflation to settle closer to the central bank's target? Fears that US monetary policy will remain too restrictive for too long have softened due to the recent decline in core inflation, however until we see core inflation reach the Fed's target, markets may remain volatile.

[4] The trade-weighted index for the AUD is an indicator of movements in the average value of the AUD against the currencies of our trading partners. Source: Reserve Bank of Australia.

[5] Source: Russell Investments. Past performance is not a reliable indicator of future performance.

QUESTIONS?

Please contact your Russell Investments Representative:
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ABOUT RUSSELL INVESTMENTS

Russell Investments is a leading global investment solutions partner providing a wide range of investment capabilities to institutional investors, financial intermediaries, and individual investors around the world. Since 1936, Russell Investments has been building a legacy of continuous innovation to deliver exceptional value to clients, working every day to improve people's financial security. Headquartered in Seattle, Washington, Russell Investments has offices worldwide, including Dubai, London, New York, Paris, Shanghai, Sydney, Tokyo, and Toronto.