# MULTI-ASSET REVIEW Q1 2024

Russell Investments

*Here our Multi-Asset team discusses Russell Investments' performance in the March quarter and their outlook for 2024*

## What drove markets during the first quarter of 2024?

The March quarter was a mostly positive one for both growth and defensive assets as investors bet that central banks will begin cutting interest rates later this year.

Several events helped shape market movements over the quarter:

**1. Japan raises interest rates, abandons yield curve control program**. The Bank of Japan (BoJ) raised interest rates for the first time in 17 years in March amid signs of healthy inflation; the Bank lifting the overnight call rate to a target range of between 0.00% and 0.10%. Interest rates in Japan had stood at -0.10% since early 2016 to encourage bank lending, help boost economic growth and combat deflation. The decision, which had been widely anticipated, also ended the world's last remaining negative interest rate regime. Despite the move, BoJ Governor Kazuo Ueda said he expects monetary policy to remain broadly accommodative for the time being. Core inflation in Japan climbed 2.8% in February, which was up on the 2.0% outcome we saw in January but in line with analysts' expectations. The BoJ also abandoned its yield curve control program, which had allowed it to purchase longer-dated bonds to ensure the yield on the country's 10-year government bond didn't exceed 1.0%. Elsewhere, the US Federal Reserve (Fed) maintained its benchmark fed funds rate at a target range of between 5.25% and 5.50% throughout the period; in line with market expectations. The Fed also reaffirmed that it expects to cut interest rates three times this year. Both the European Central Bank and the Bank of England also left interest rates on hold over the quarter, however both banks hinted at rate cuts later this year. Elsewhere, the Swiss National Bank became the first major central bank to cut interest rates since the COVID-19 pandemic, lowering its key policy rate by 0.25% (to 1.50%). The move came after annual inflation in Switzerland fell to just 1.2% in February.

**2. Reserve Bank of Australia leaves rates on hold**. The Reserve Bank of Australia (RBA) left the official cash rate unchanged at 4.35% throughout the quarter. The Bank met twice over the period – in February and again in March. In its February post-meeting statement, the RBA noted that whilst recent economic data suggested inflation was easing, it remained high and it would be some time yet before it was sustainably within the Bank's 2-3% target range. The RBA also said at the time that the path of interest rates that will best ensure inflation returns to target in a reasonable timeframe would depend upon the data and the evolving assessment of risks, and that a further increase in interest rates could not be ruled out. At its March gathering, the Bank reiterated its message that while recent economic data indicates inflation is easing, it's still too high. However, the RBA adopted a slightly less hawkish tone, saying 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. This language marked a shift away from the explicit tightening bias we saw in February. For now, the RBA's central forecasts are for inflation to return to its target range in 2025, and to the midpoint in 2026. The RBA concluded its latest (March) gathering by saying that returning inflation to target within a reasonable

timeframe remains its highest priority. Moving forward, the Bank said it will continue to 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 10.2%[1] in the March quarter. Australian shares were also stronger; though they did underperform their global peers, returning 5.4%[2]. Much of the local market's gains came toward the end of the period after the RBA adopted a slightly less hawkish stance on interest rates in March. Stocks also benefited from a series of surprisingly robust earnings results and a strong lead from major overseas markets. Emerging market equities gained 7.1%[3] for the quarter, underperforming their developed counterparts over the period.

The Australian dollar (AUD) fell in the first quarter, with the Australian Trade-Weighted Index closing the period down 1.8%[4].

Interest rate sensitive assets were mixed, with domestic listed property, global listed infrastructure and Australian bonds generating positive absolute returns over the period, while global listed property and global bonds recorded modest declines.

Credit markets were positive, with spreads on US and European investment-grade and high-yield debt narrowing in what was a largely 'risk on' market environment. Hard currency emerging markets debt also made good gains, while local currency emerging markets debt underperformed.

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

**Absolute returns**. The Russell Investments Balanced Fund returned 5.6%[5] for the quarter on a net of fees and tax basis. Performance was driven primarily by strong absolute returns from the Fund's equity exposures, which performed well as markets continued to price in optimism surrounding the outlook for the global economy.

**Returns relative to fund benchmark**. The Russell Investments Balanced Fund underperformed its strategic benchmark by a modest 0.1% on a net of fees and tax basis.

**Positive contributors included:**

- Strong excess returns from our Australian equity exposure.
- Exposure to the strong-performing Australian real estate investment trust sector.

**Negative contributors included:**

- Negative excess returns from our global equity exposure.

## 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. But despite these concerns, the US economy has to date proven remarkably resilient, with markets pricing in a 'soft landing' as inflationary pressures continue to ease and unemployment remains low. In saying that, we are seeing several leading economic indicators flash warning signs, which suggests to us that the US economy is likely to slow in 2024. We believe this cycle may be a case of 'this time is longer' rather than 'this time is different' with regard to the lagged effects of aggressive Fed rate hikes on the US economy.

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 territory due to the continued, strong rally in equity markets.

The main uncertainty for markets is the outlook for the US economy. Whilst economic data has so far proven more resilient than markets initially expected, we believe the risk of a recession in the US over the next 12 to 18 months remains elevated.

[1] Global shares measured by the MSCI World ex Australia Net Accumulation Index (in local currencies)
[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)
[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.

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. The yield curve has steepened in recent months, which we had anticipated given that this tends to happen when the Fed finishes raising interest rates and markets start looking toward rate cuts. Easing inflation in the US and other regions has meant bond yields have fallen, which has been a positive for longer-duration exposures within the fixed income space. Meanwhile, Japanese government bonds look expensive despite the BoJ's recent announcement regarding their yield curve control policy and the end to their negative interest rate regime.

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.

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