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MANAGED PORTFOLIO NEWSLETTER

HELPING YOU MAKE INFORMED
INVESTING DECISIONS





MARKET UPDATE & VIDEO

Markets climb despite the noise

The past few months have been a timely reminder that markets do not always move in line with the evening news. Headlines have been unsettling, dominated by the Iran war, oil prices, supply chain issues and interest rates.

But investors looked through the immediate uncertainty, pushing sharemarkets higher as they focused on company earnings and the resilience of the U.S. economy, in particular.

The U.S. sharemarket recovered its initial decline from the outbreak of war in less than three months, reaching a record high of 7609.77 on 2 June¹. The 14.9%² gain in global shares over the quarter outstripped a still solid 4.1%³ gain in Australian shares.

The main driver of global shares has been a super cycle for company profits. Over the past three years, forecast earnings for companies in the U.S. S&P 500 index have compounded at a rate of roughly 16% annually. That is a pace exceeded in recent decades only by the market rebounds that occurred after recessions.

The U.S. \$75 billion SpaceX float – the largest ever in history – captured the imagination of some investors too. All eyes are now on the potential floats of OpenAI and Anthropic, and the combined impact these mega offerings could have on market dynamics.

Pressure points

Risks remain though. If the Middle East conflict drags out, it could impact households and businesses via higher petrol prices, freight costs, food prices and energy bills – all of which could hurt company profits. However, the global economy is less exposed to oil shocks than it was in past decades. Energy efficiency has improved, households spend a smaller share of income on energy, and renewables are providing a greater share of power in places like Europe.

There are other reasons to be cautious too. Supply chain pressures have begun to build again, and similar disruptions from COVID contributed to the last inflation surge. Expectations about whether interest rates will rise or fall are changing regularly, though Russell Investments believes rates will be on hold for some time.

In Australia, the picture is more measured. The economy is likely to grow more slowly than its long-term average as higher interest rates weigh on household spending and confidence. Productivity remains a challenge, and local company earnings may struggle to match the strength seen offshore, which could result in lower returns for local share investors. At the same time, government bonds continue to offer diversification benefits, while the Australian dollar appears close to fair value.

The takeaway is that markets have proven resilient to a series of stress tests – but are not risk-free. For investors, the sensible approach is to avoid reacting to every headline and instead remain diversified, review portfolios regularly and stay focused on their long-term strategies.

In this [short video](#), we share insights into investment markets, performance and the outlook for the Russell Investments Managed Portfolios.

¹ S&P500 index price high intra quarter, Bloomberg

² MSCI ACWI A\$ Hedged, Bloomberg

³ S&P/ASX 300, Bloomberg



HOW YOUR PORTFOLIO PERFORMED

Investment in U.S. and emerging market shares drove more solid gains for the portfolios

The flagship Russell Investments balanced portfolio returned 6.63%⁴ in the June quarter driven by double-digit returns from its investments in international sharemarkets. The Iran war temporarily slowed market momentum before global shares regained their mojo to reach record highs.

The biggest gains for Russell Investments investors came from the portfolio's larger-than-usual tilt towards both U.S. shares and emerging stockmarkets like South Korea and Taiwan. The latter jumped as demand for the AI chips produced by companies such as SK Hynix, Samsung and Taiwan Semiconductor soared.

Gains from global shares, though, weren't just about technology this time. The share prices of U.S. healthcare, financial and industrial companies performed better as some giant tech stocks cooled. U.S. small companies also had a bumper quarter.

Capturing returns

The construction of the Russell Investments portfolio meant it was well-placed to capitalise on this shift as much of its assets are split between "active funds" and "passive funds".

Active funds take deliberate positions in individual stocks instead of owning every company in a stockmarket index. That means they can outperform others when those stock selections pay off, though the opposite may be true if their decisions prove incorrect. The active funds in the Russell Investments portfolio enabled it to capture the gains in global sectors outside technology over the quarter.

Long-term focus

Our direct shareholdings in around 30 Australian companies – which make up 16.3%⁵ of the flagship Russell Investments portfolio – underperformed the broader sharemarket slightly over the quarter for a couple of reasons. Firstly, it held relatively larger positions in some companies which lost value, such as gold companies Ramelius Resources and Newmont. Secondly, it didn't have any stake in some of the market's better performing stocks over the quarter (including Computershare and Qantas).

However, over the longer term our direct shares continue to do better than the market overall by gaining 1.66%⁶ in the three years to June 30.

The fixed income component of the Russell Investments portfolio served its role as a defensive investment by delivering steady returns, even though higher interest rates everywhere crimped the performance of bond and credit markets.

Looking ahead, the portfolio still has a moderate bias to global shares and a slightly underweight position in credit markets. The biggest risk to investors is that inflation will spike further, taking interest rates with it. The portfolio's diversification across shares, bonds and alternative investments is intended to create a ballast if this risk (or any others) materialises.

⁴ Russell Investments, Morningstar Direct

⁵ Russell Investments, Morningstar Direct

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WHY WE OWN BHP & RIO TINTO

Australia's best-known miners are well-placed to tap into trends driving the global economy

Australia's two best-known mining companies, BHP Group and Rio Tinto, are both long-term holdings in a parcel of around 30 direct shares that sits within the flagship Russell Investments portfolio.

Both miners tap into long term trends driving the future of the global economy. BHP's increased focus on copper production, for example, means it's well placed to profit from growth in AI data centre demand, electric vehicles and sustainable infrastructure.

Copper prices per tonne have risen by almost half since April last year, and BHP's share price rose alongside it to record highs, though the company recently told investors it expects its copper production to dip in the year ahead.

Like Rio Tinto, it is also an iron ore producer that feeds China's demand for steel used in construction and manufacturing. China's appetite for iron ore has remained more resilient than some forecasts, which is a positive for both companies.

As a reminder, Russell Investments' parcel of direct shares is created by a quantitative model which uses algorithms to pick assets. The model identifies stocks to trade based on characteristics that our research shows are more likely to deliver returns over the long term. These five characteristics – or “factors” in technical terms – are value, quality, low volatility, momentum and growth.

The underlying principle is that a selection of shares which each display some of these characteristics can be brought together in a parcel of holdings which outperforms over time.

BHP Group qualifies for inclusion because it offers both quality and momentum characteristics – and makes up around 11.5% of our direct shareholdings. Rio Tinto also fits into those categories, as well as into the value category. It comprises around 2.6% of the direct shares in our flagship portfolio.



MEET THE MANAGER

How this activist investor uncovers value in the sharemarket for Russell Investments investors



James Hawkins
Partner & Head of the
Catalyst Fund
L1 Capital

What is your connection with Russell Investments?

I'm Partner and Head of the L1 Capital Catalyst Fund. That fund is part of the investment mix in the Russell Investments portfolios.

We invest differently from other fund managers in that we can only hold 10 companies at any one time. The stocks we choose offer a compelling combination of value and quality, plus a catalyst we believe will push their share price higher.

We are an "activist" investor – which simply means we engage with companies to bring ideas and a shareholder's perspective to their boards and management. In other words, we are "hands-on" owners. You can think of us as being similar to private equity investors in publicly listed equities.

As at June 30, our biggest holdings of the Catalyst Fund include building product group James Hardie, BlueScope Steel and Mineral Resources.

The fund recently celebrated its fifth birthday and ranks as the best performer since inception in its category in Australia, according to research house Morningstar. It has returned around 13% per annum over that period (compared to the ASX200 Accumulation Index of approx. 8%).

What are your qualifications and experience?

I studied commerce and law, majoring in finance, at Monash University in Melbourne, and initially worked as a solicitor at Clayton Utz early in my career.

I then switched to investment banking for 20 years, working at firms including Macquarie Group (in Melbourne and New York) and also the independent corporate finance adviser Flagstaff Partners.

I joined L1 Capital just over five years ago in order to launch the L1 Capital Catalyst Fund.

What is the biggest lesson you've learned in your career?

The world is becoming more unpredictable, particularly from a geopolitical standpoint. That uncertainty continues to increase and makes our job much more dynamic. By that I mean the macroeconomic outlook today may be quite different to the backdrop that applies tomorrow.

We therefore need to constantly reassess the macro backdrop to make sure we're making the optimal decisions on behalf of our investors.

How do you relax outside work?

I have two children, 12 and 14, who are my primary focus outside of work. Other than that, I love sport (particularly AFL) and play a lot of tennis. I'm the son of two PE teachers, so I've been taught that sport is an important and enjoyable part of life.

IMPORTANT INFORMATION

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Please contact your platform or adviser for details of your performance or current holdings in the Managed Portfolio.

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