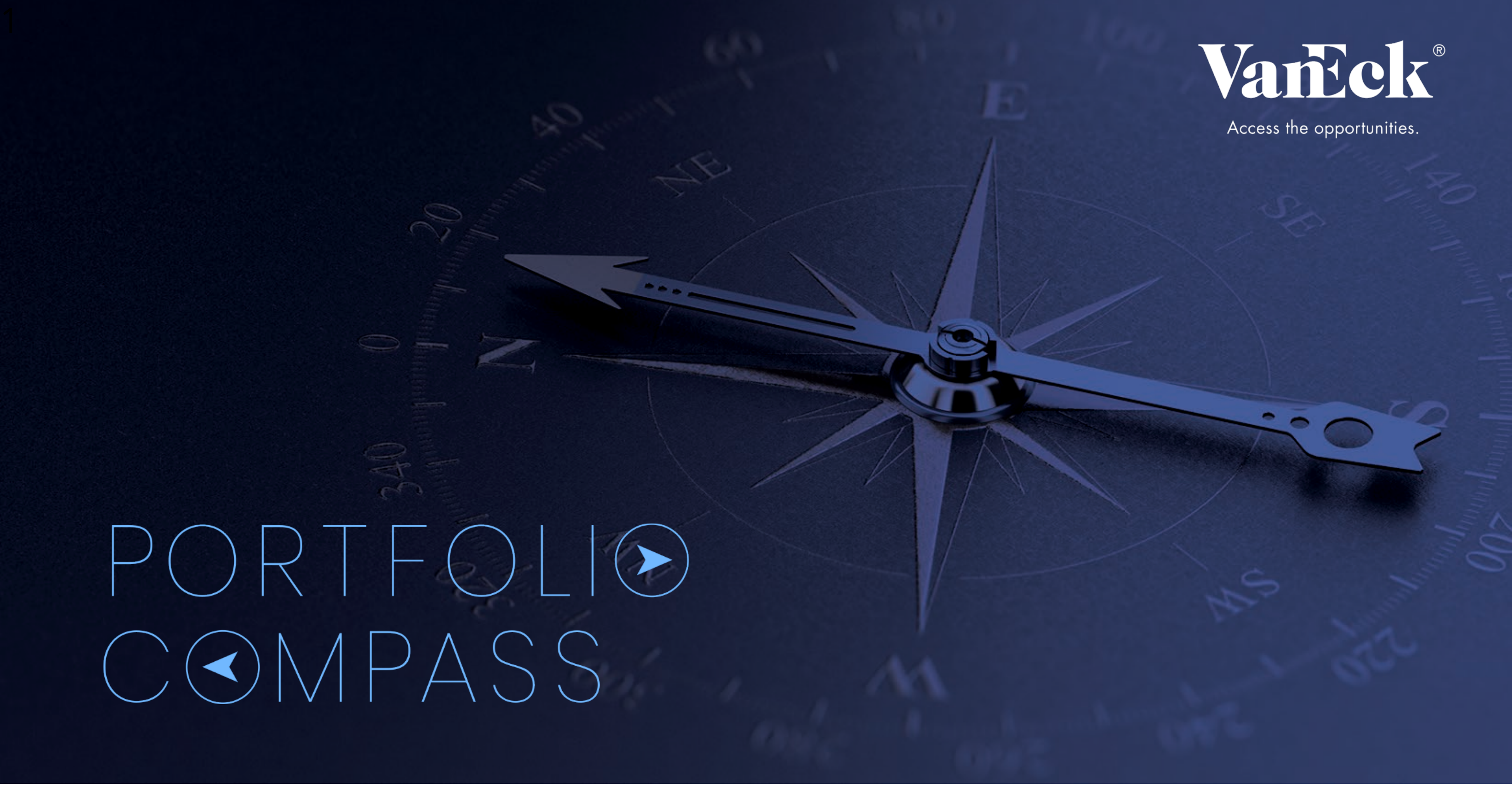


Asset Allocation Outlook

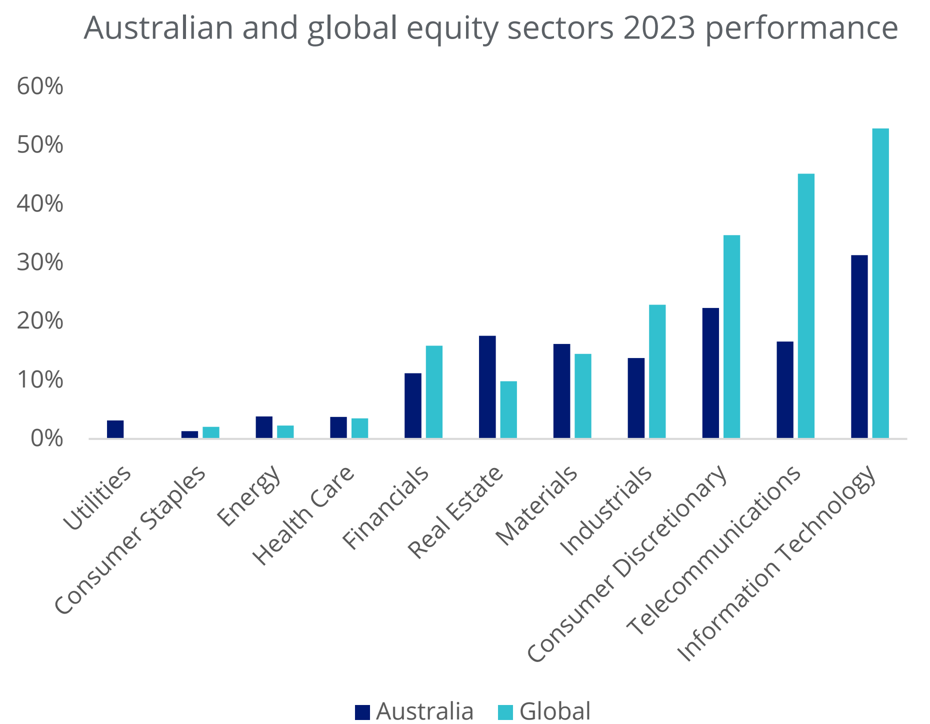
January 2024

Executive summary

If the past year taught investors anything, it's that being selective and diversified is key to riding the economic cycle. Had investors avoided risk assets on the back of many economists calling the "most anticipated recession" that never happened, they would have missed the artificial intelligence boom that sent the S&P 500 and the MSCI World ex Australia Index up more than 20 per cent. One of the riskiest asset classes, private equity as represented by LPX 50 index returned more than 35 percent.

As we turn the page on another year, VanEck's 2024 Asset Allocation Outlook dissects our views on inflation, policy rates, economic growth and exogenous risks as the lagged effect of the one of the sharpest rate hike cycles hits hardest this year. On balance, Australia and US should avoid a recession without the need for central bank policy rate cuts to smoothen the landing. Inflation will prove to be stickier than the market anticipates which reaffirms our tightening bias.

Stay the course and seek quality exposure across all risk asset classes including equities and fixed income. Emerging market equities, small caps, listed private equity and gold are cheap from a valuation standpoint. Investment grade and select government bond exposures are attractive.



Source: Bloomberg, 1 January 2023 to 31 December 2023, returns in Australian dollars. Utilities is MSCI World Utilities Index / S&P/ASX 200 Utilities Index, Industrials is MSCI World Industrials Index / S&P/ASX 200 Industrials Index, Materials is MSCI World Materials Index / S&P/ASX 200 Materials Index, Consumer Staples is MSCI World Consumer Staples Index / S&P/ASX 200 Consumer Staples Index, Consumer Discretionary is MSCI World Consumer Discretionary Index / S&P/ASX 200 Consumer Discretionary Index, Financials is MSCI World Financials Index / S&P/ ASX 200 Financials Index, Energy is MSCI World Energy Index / S&P/ASX 200 Energy Index, Healthcare is MSCI World Heath care Index / S&P/ ASX200 Heath care Index, Telecommunications is MSCI World Telecommunications Index / S&P/ASX 200 Telecommunications Index, Information Technology is MSCI World Information Technology Index / S&P/ASX 200 Information Technology Index, Real Estate is MSCI World REIT Index / S&P/ASX 200 AREIT Index. Past performance is not a reliable indicator of future performance.

Macro views

1. Disinflation pace to slow

- Although US inflation has fallen sharply, we expect the pace of reductions to slow as US services inflation remains elevated.
- Australia has a ‘homegrown’ inflation problem

2. Rates higher for longer

- Market overestimating the likelihood and speed of central bank cuts in US and Australia
- There is still a chance the RBA hikes again in Q1 2024

3. Soft landing in Australia and USA

- Monetary tightening policy to hit hardest during the middle of the year but both countries will avoid a recession
- Migration surge supports economic growth in Australia

4. Exogenous risks

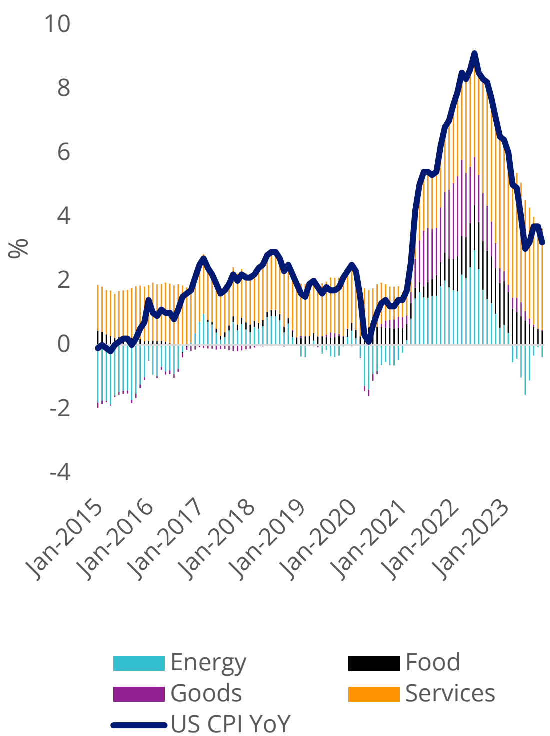
- Economic ‘break’ risk heightened in wake of tightening
- Geopolitical tension elevates risks of inflation shocks

Disinflation pace to slow

USA: Services inflation elevated and 'sticky'. It will be a slow burn to unwind.

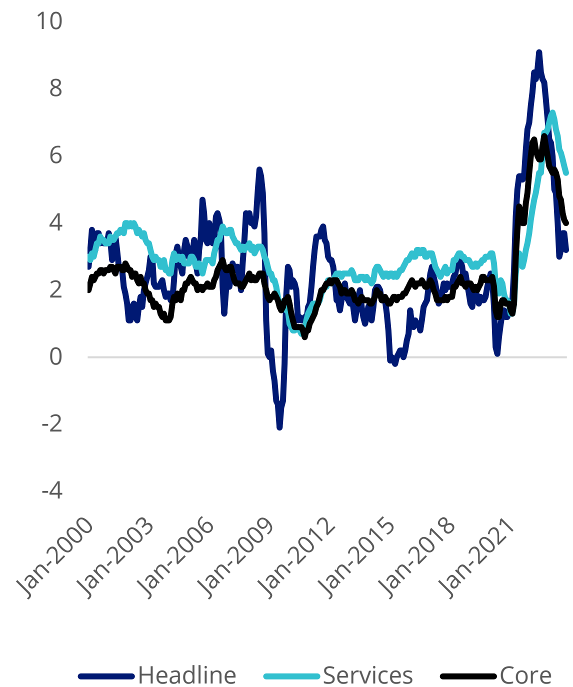
US CPI year on year contribution

Services contribution ~1.5x above pre-COVID trend



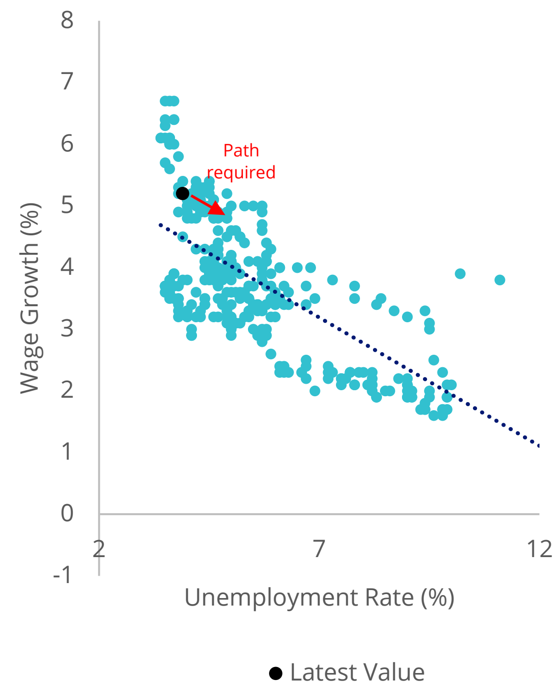
US CPI year on year

Slow burn to unwind services inflation



US unemployment vs wages growth

Non-accelerating inflation rate of unemployment ~4.5%

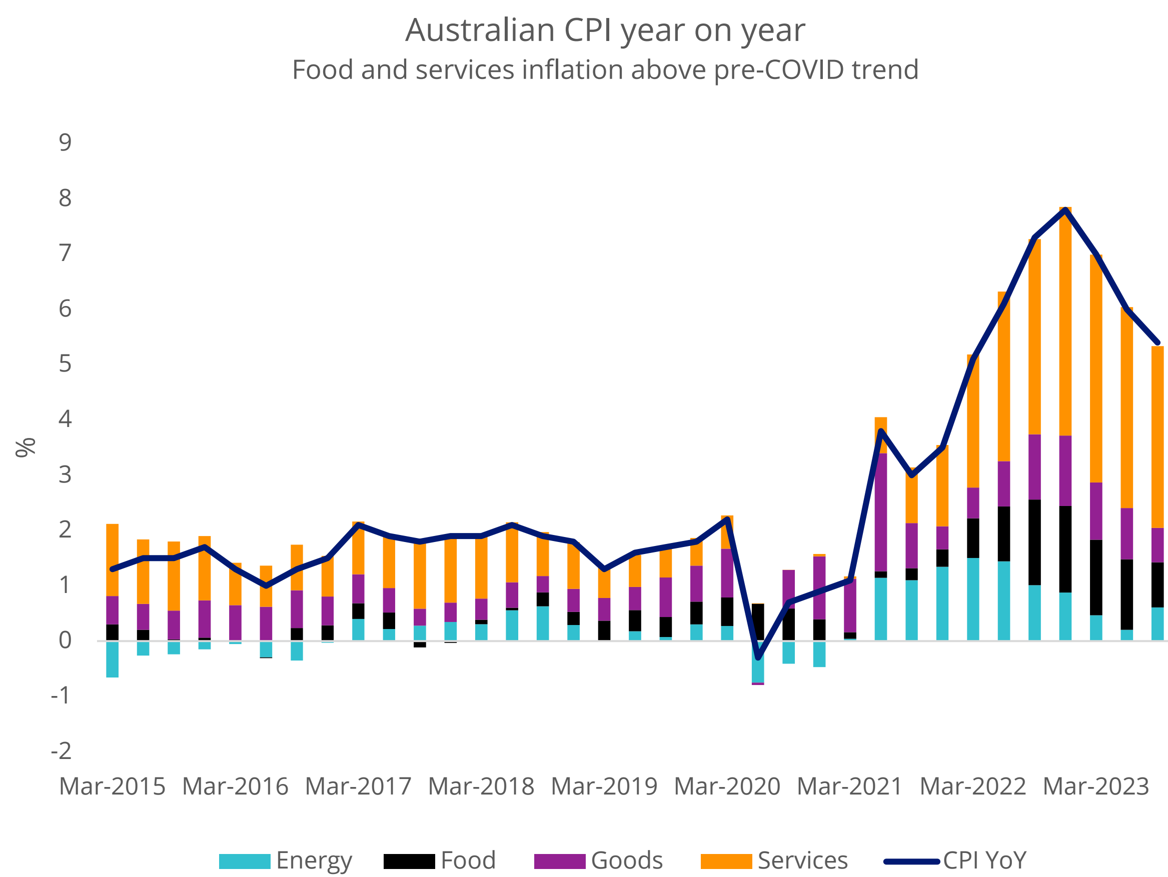


Source: Bureau of Labour Statistics. Federal Reserve Bank of Atlanta. As at 30 November 2023.

Disinflation pace to slow

Australia: inflation 'homegrown'.

- Inflationary components are supply side driven which risks broader inflation expectations increasing.
- Services inflation is high due to accelerating rental prices and wages growth.
- Food inflation is elevated due to higher operating costs and minimum and award wage increases.
- Energy prices have picked up with producers pushing through ~20% increases in July. However, headline figure would have been higher if not for the introduction of the Energy Bill Relief Fund rebates from July 2023.

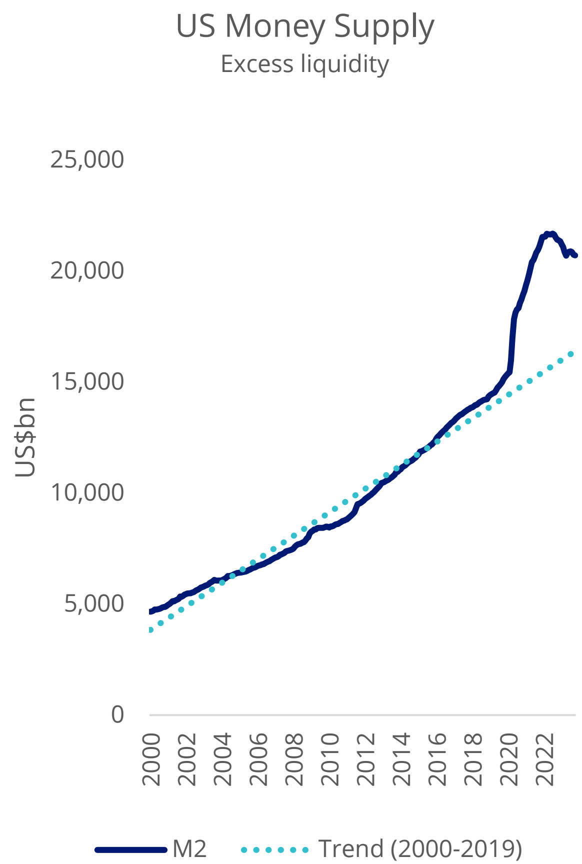


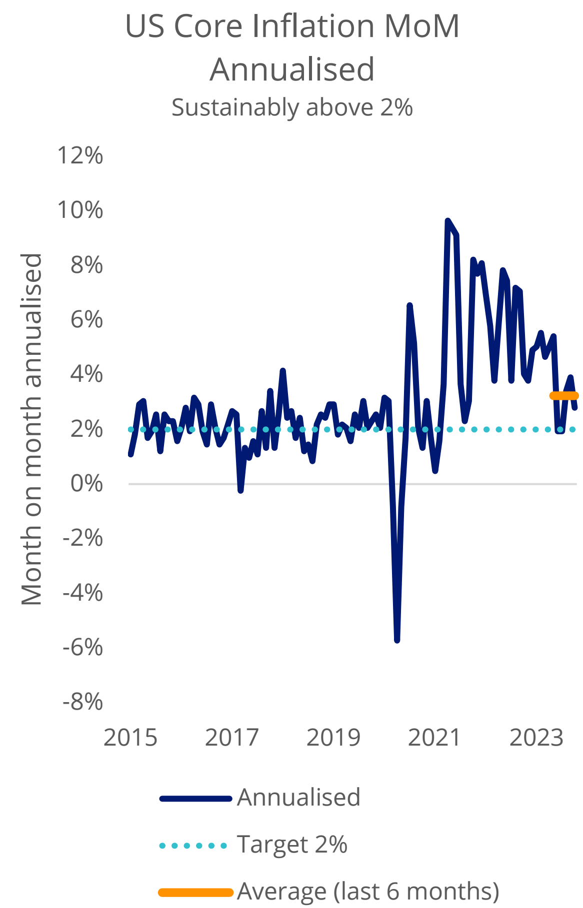
Source: Australian Bureau of Statistics, as at 30 November 2023.

Rates higher for longer

USA: Market overestimating the likelihood and speed of Fed cuts.

- The Federal Funds futures curve is forecasting 6 rate cuts by December 2024. First cut in May (as at 20 December 2023).
- It is too premature to be calling for rate cuts this soon for several reasons.
- Core inflation is above the Federal Reserve's target rate of 2%.
- Excess liquidity will continue to support economic growth and demand side inflationary pressures.
- Federal Reserve is unlikely to see core inflation sustainably below 2% in the near term barring a systemic crisis which reaffirms our tightening bias.
- Federal Reserve is reluctant to pre-emptively 'pivot'. Does not want a repeat of 1970s where a second inflation wave emerged.



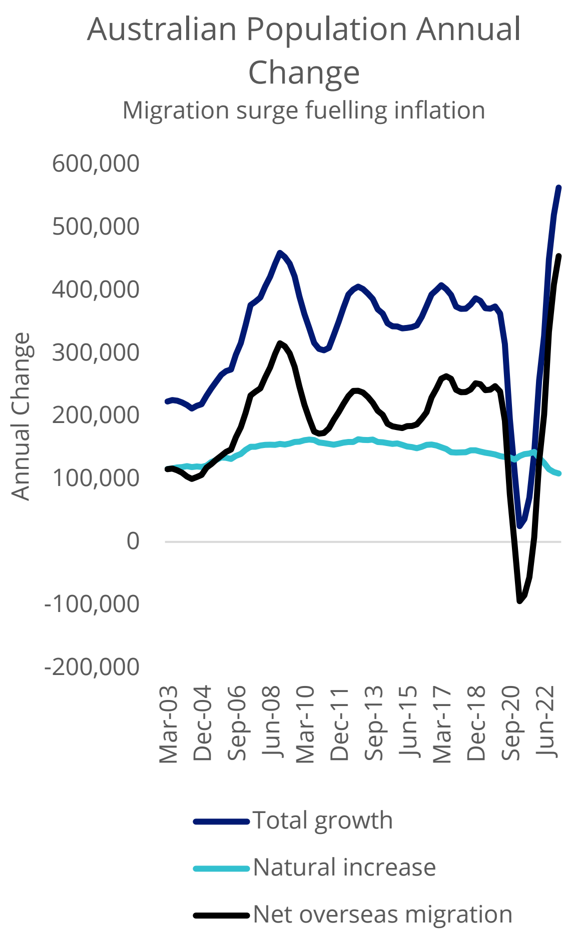


Source: Bureau of Labour Statistics, Federal Reserve, As at 30 November 2023.

Rates higher for longer

Australia: RBA hike likely in Q1 2024. No pivot this year. Contending with supply side constraints.

- Migration surge has fuelled inflation.
- Rental inflation which is the highest contributor to services inflation is the highest since 2009 and shows little sign of easing.
- It took 4 years for rental inflation following the Global Financial Crisis (GFC) to return to a 2-3% range.
- Rental vacancies at all time low and new housing supply scarce.
- Inflation drivers are structural, limiting monetary policy effectiveness and reinforces tightening bias next year.



Source: Australian Bureau of Statistics, as at 30 November 2023.

Soft landing in Australia and USA

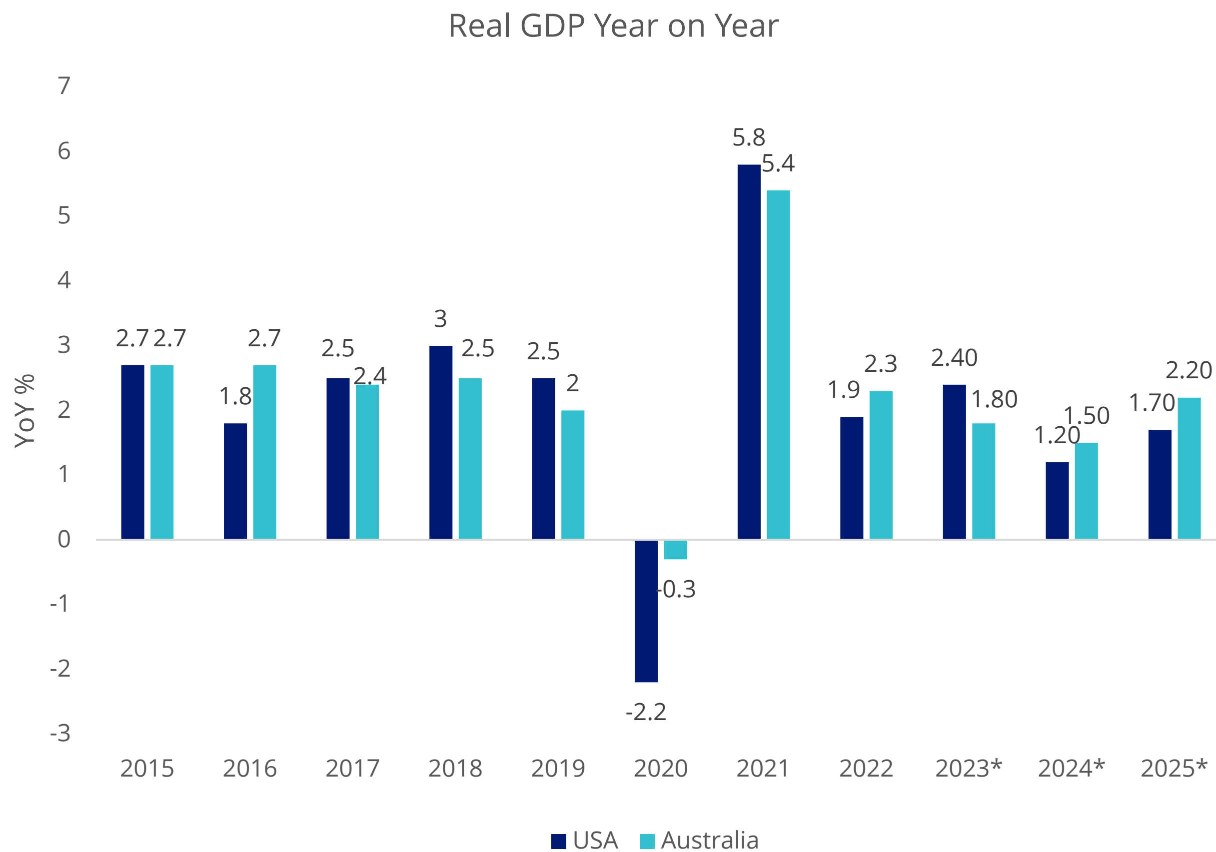
Tightening policy to hit hardest middle of the year.

Australia

- Migration adding inflationary pressures but beneficial for growth in the medium term.
- Real income declining but the new dual RBA mandate of "achieving full employment versus unemployment" increases the chance of a soft landing.

USA

- US economic resilience to shine again.
- At the final stage of the inflation cycle.
- Monetary tightening effect to hit hardest in both countries during the middle of the year.



Source: *Bloomberg consensus forecast, Bloomberg, as at 30 November 2023.

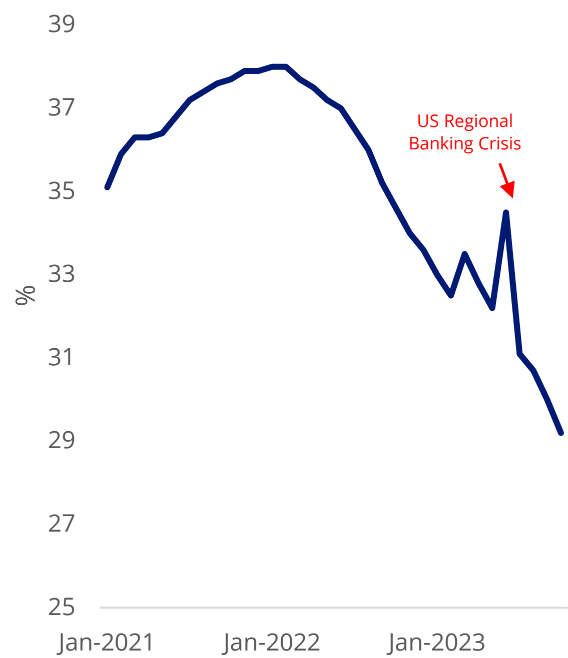
Exogenous risks

Watch out for economic ‘breaks’ and inflation shocks.

- Risk of an economic ‘break’ heightened in wake of the tightening cycle.
- Central banks will be swift to address but likely turn to targeted measures before policy rate adjustments. Inflation is too high and central banks don’t want to risk triggering another wave of inflation. We saw this following US regional banking crisis.
- Geopolitical tension elevates risks of inflation shocks. Natural gas prices spiked following Russia invasion of Ukraine.

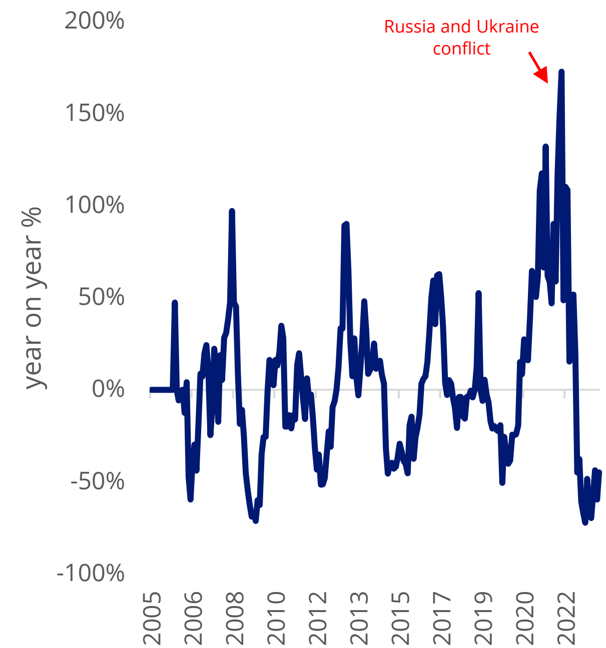
Fed balance sheet - % of GDP

Targeted liquidity following US regional banking crisis



Natural Gas Price YoY

Spiked following Russia invasion of Ukraine



Source: Federal Reserve, Generic 1st 'NG' Future, Bloomberg, 30 November 2023.

Market Views

Equities

- Central bank pause historically good for equities
- Stay the course and be selective

Fixed Income

- Disinflation and central bank pause positive for rates
- Investment grade credit attractive

Currency

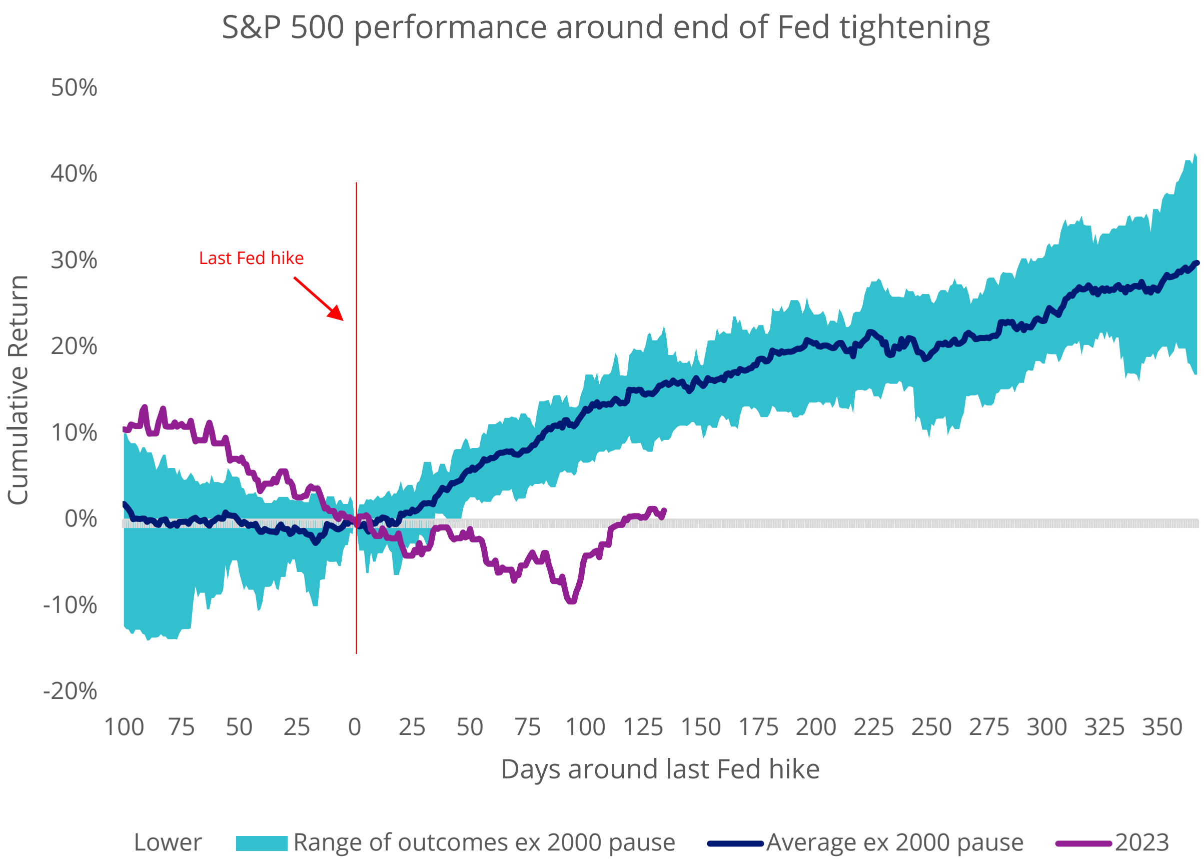
- We could see AUD strength in Q1 2024 if RBA hikes
- Longer term, we forecast AUD weakness as economic growth slows

Alternatives

- Listed private equity undervalued
- Geopolitical tensions and economic weakness supports gold

Equities

Central bank pause historically good for equities.



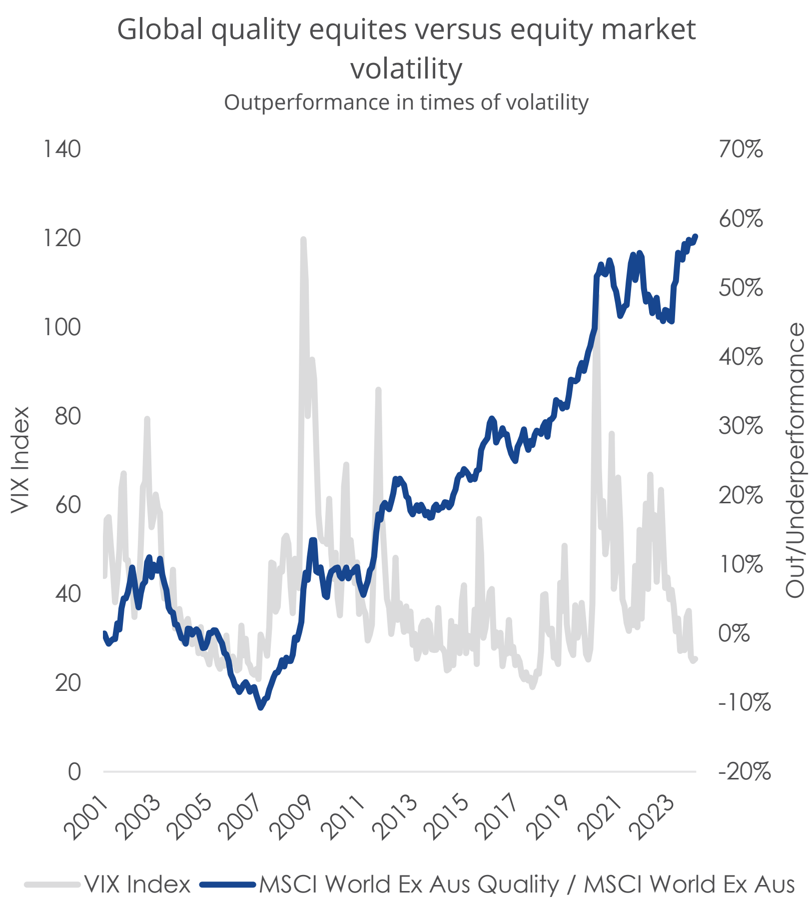
POSITIONING

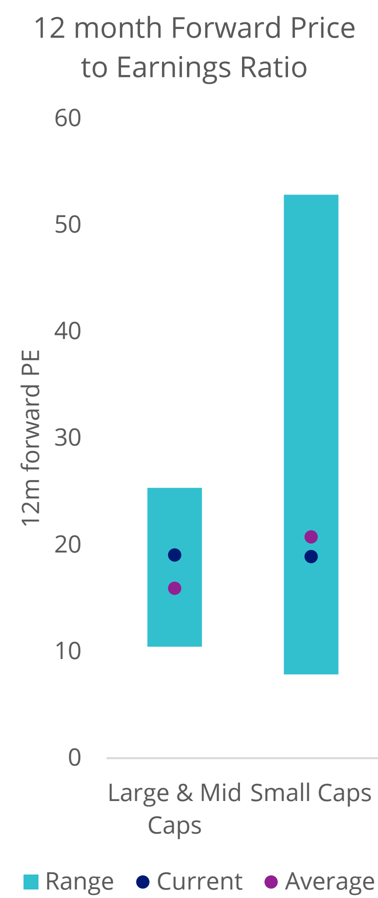
- Equities have historically rallied following a rate pause. It is roughly 130 days since the Federal Reserve last hiked in July 2023.

Source: S&P, Bloomberg. Fed pauses (1989, 1995, 1997, 2006, 2018 & 2023), 2023 performance to 30 November 2023. Past performance is not indicative of future performance.

Equities

Stay the course and be selective





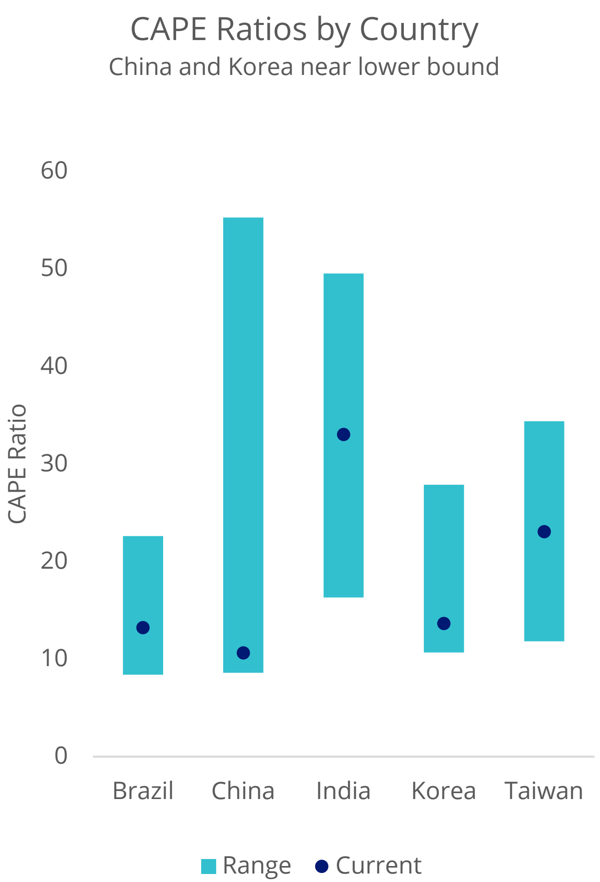
POSITIONING

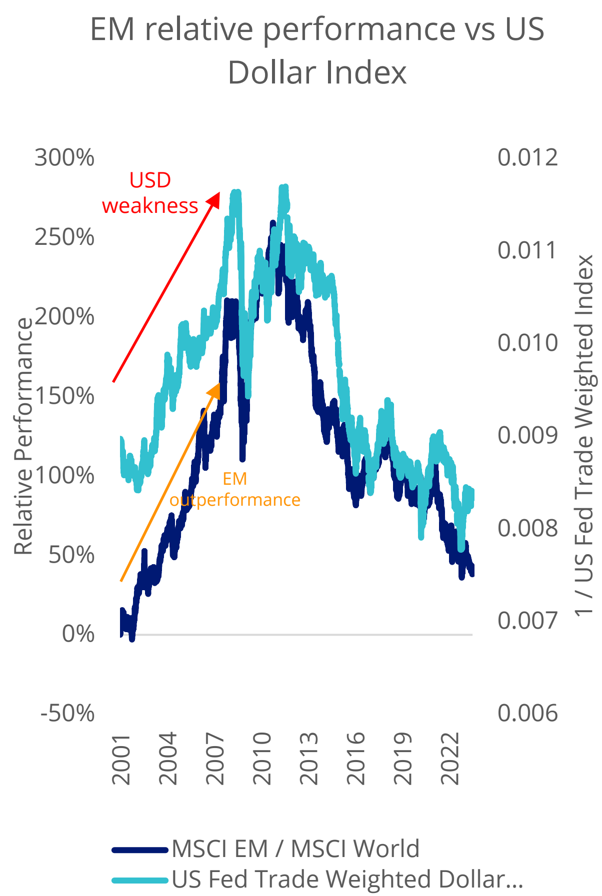
- Equity market volatility at risk of returning, triggering a 'flight to quality'.
- We prefer exposure to defensive assets such as quality companies.
- Avoid highly leveraged and 'junk' assets.
- Small caps undervalued.

Source: Bloomberg, As at 30 November 2023, Large & Mid Caps as MSCI World Index, Small Caps as MSCI World Small Caps Index. Past performance is not an indicator of future performance.

Emerging market equities

Valuations attractive. USD weakness supports asset class performance.





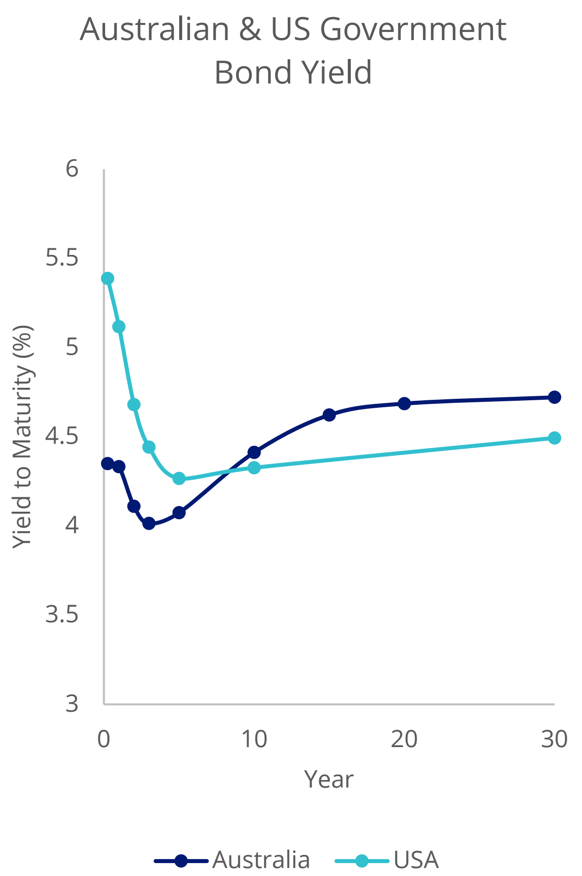
POSITIONING

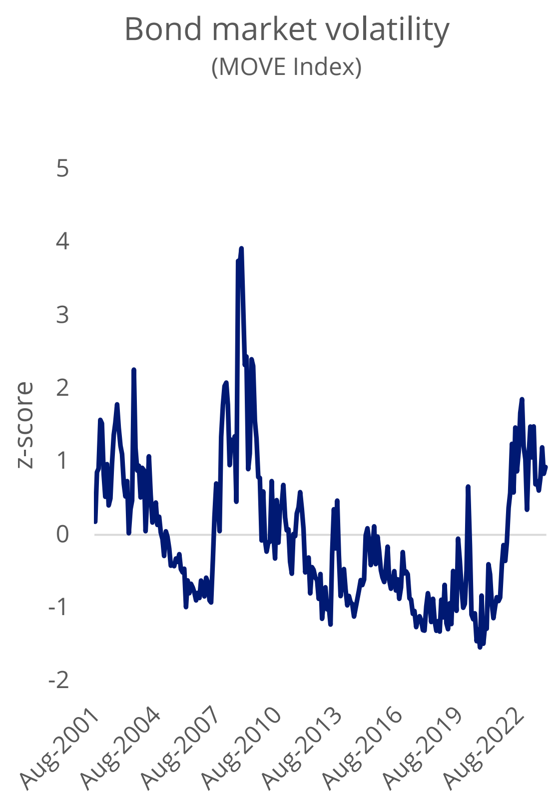
- Emerging market valuations attractive. China and Korea CAPE ratios currently trading at the lower bound. Brazil, India and Taiwan at or just below their respective historical average.
- A soft landing, in which rates decline but with a gentle and non-inflationary decline in demand, is an ideal scenario for emerging markets. If global demand is acceptable, rates and EM currencies should rally.

Source: MSCI Country Indices. Federal Reserve, As at 30 November 2023. Past performance is not an indicator of future performance.

Fixed Income

Disinflation and central bank pause positive for rates.





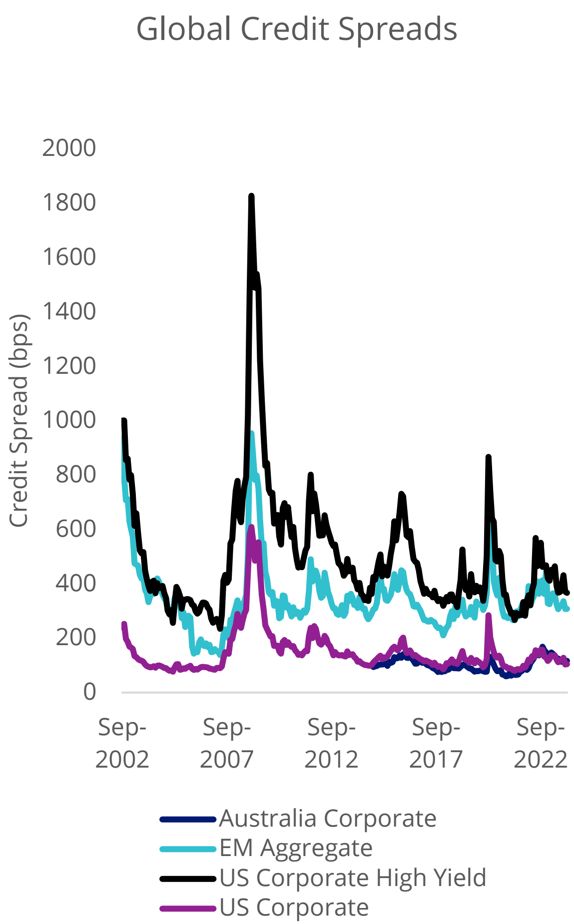
POSITIONING

- Bond volatility to 'normalise' as we enter the last stage of the inflation wave.
- Long duration attractive offshore. Economic weakness and disinflation path puts downward pressure on yields.
- Neutral on adding duration locally. Prolonged period of elevated inflation puts upward pressure on long dated yields. The maturity term premium is also low.

Source: ICE, Bloomberg, As at 30 November 2023. Yield measures are not a guarantee of future income.

Fixed Income

Investment grade credit attractive.



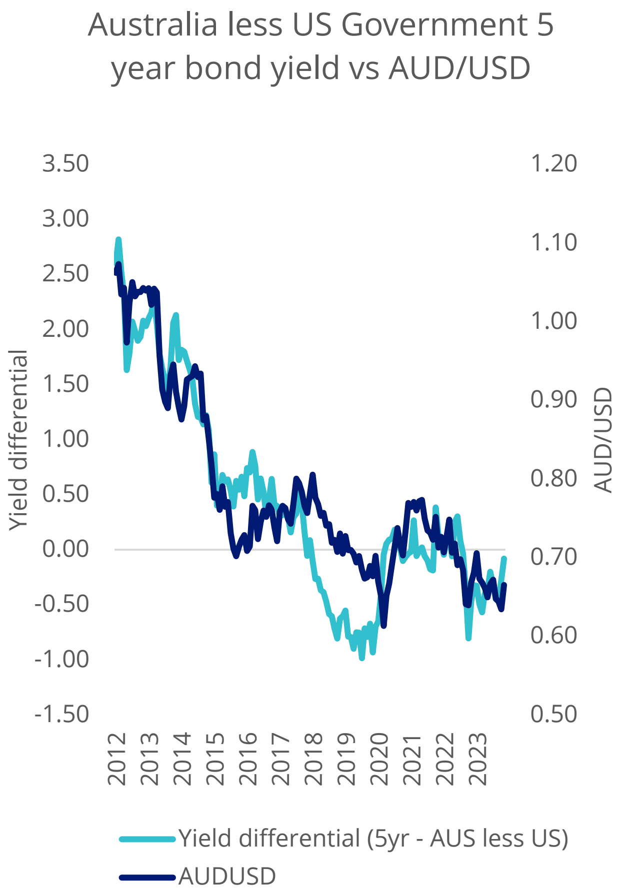
POSITIONING

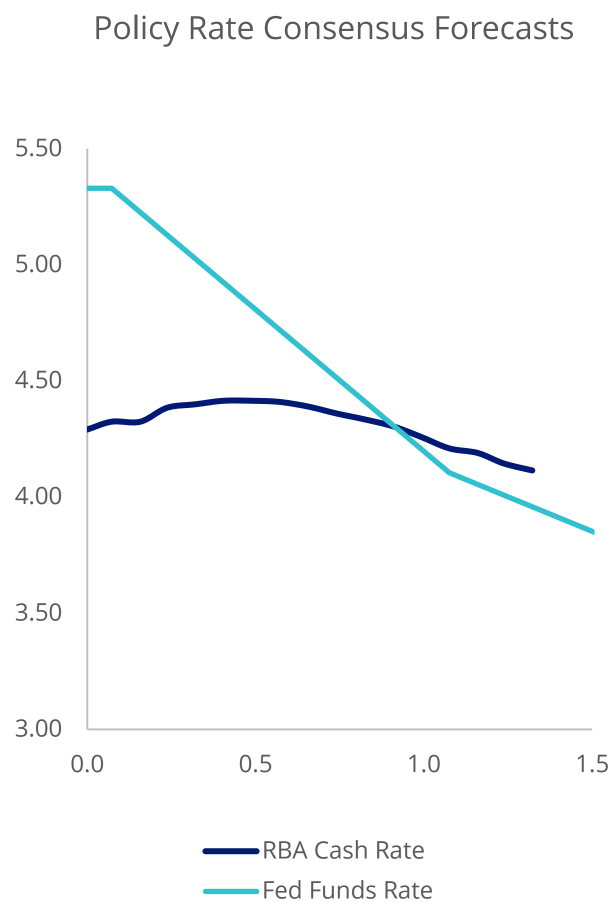
- Investment grade bond exposure is attractive. Credit spreads at the historical average. Markets have priced in forecast mild economic weakness.
- We preference investment grade over high yield. "Higher rates for longer" environment could challenge debt serviceability of lower quality instruments.
- AUD floating rate exposure is attractive. Yields ~5% and ~6% for senior unsecured and subordinated debt respectively.

Source: Australia Corporate as Bloomberg AusBond Credit 0+ Yr Index, US Corporate as Bloomberg Barclays US Corporate Index, US Corporate High Yield as Bloomberg Barclays US Corporate High Yield Index. EM Aggregate as Bloomberg Barclays EM Aggregate Index.

Currency

AUD strength spurred by RBA hike next year.





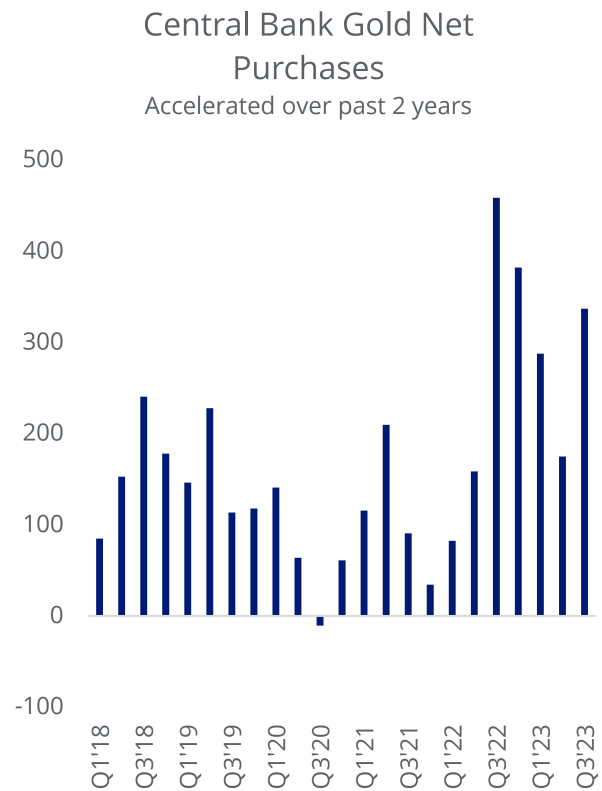
POSITIONING

- We could see AUD strength in Q1 2024 if the RBA hikes. This would reduce the government bond yield differential between Australia and USA.
- However, longer term, we forecast AUD weakness as economic growth slows.
- China's subdued economy could put downward pressure on Australia's resources demand and AUD.

Source: Bloomberg, as at 30 November 2023.

Alternative assets

Opportunities beyond traditional asset classes.



POSITIONING

- Listed Private Equity: Undervalued with some managers issuing buybacks.
- Gold price: Heightened geopolitical tensions, central bank buying and economic weakness performance catalysts

Source: World Gold Council, LPX Group. LPX 50 Index last price versus NAV. As at 30 November 2023.

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