Paradigm Market Update..

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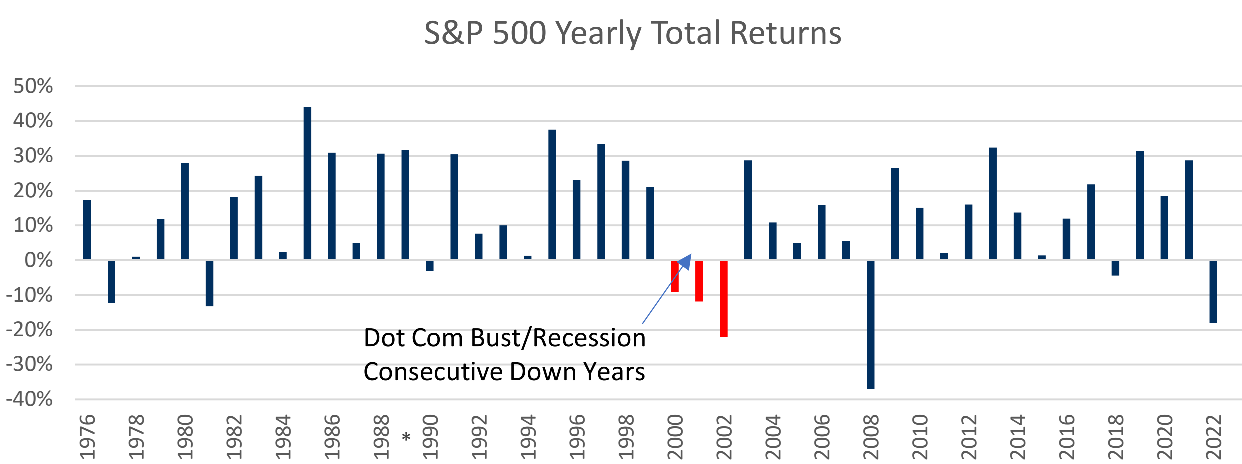
Post 2022 Recovery Well Underway

The year ending 30th June 2023 finished with a strong recovery from the lows of September 2022. The top 500 companies in the US (S&P 500) rallied 8.3% for the quarter and 23.7% since the lows of September 2022. In Australia, the rally was more modest, with the index of the top 200 companies (ASX 200) rising 1.0% and 11.3% respectively over the same periods.

Financial markets continue to be focused on inflation. The reason for this is that inflation data feeds directly into interest rate policy. Broadly speaking, if inflation is above the expectations of Central Banks or is not falling fast enough to acceptable levels, interest rates are likely to remain high or rise further. Pleasingly US inflation dropped to 3.6% (year-on-year) in August 2023, from a high of 9.1% in June 2022. US monetary policy remains tight with the 11th consecutive rate hike in July bringing the federal fund rate to 5.5%. Australia's inflation is following a similar pattern with a half-year lag behind the US, having fallen to 6% in the second quarter of 2023 from its high of 7.8% in forth quarter of 2022. The RBA has kept rates steady at 4.1% since early June.

After the uncertainty of 2022, pleasingly 2023 is so far tracking significantly better. It's a reminder that time does assist in smoothing returns after a bad year. When things look bad, it is hard to be optimistic. Stories of periodic big losses litter history books, like the 1929 crash, 2008 GFC, Covid-19 and more recently last year's fall. It doesn't help that the media makes money by selling fear as it's the only thing that makes people read. In the case of the Black Monday crash of October 1987, as hard as the market fell (by over 20% in one day), the market actually recovered in the following months to end the year higher than before the crash. Historically it is also rare for market to fall for two consecutive years, with the dot-com boom and subsequent recession, the exception. This year so far (S&P 500 +11%) looks set to continue this trend barring any unforeseen events. .

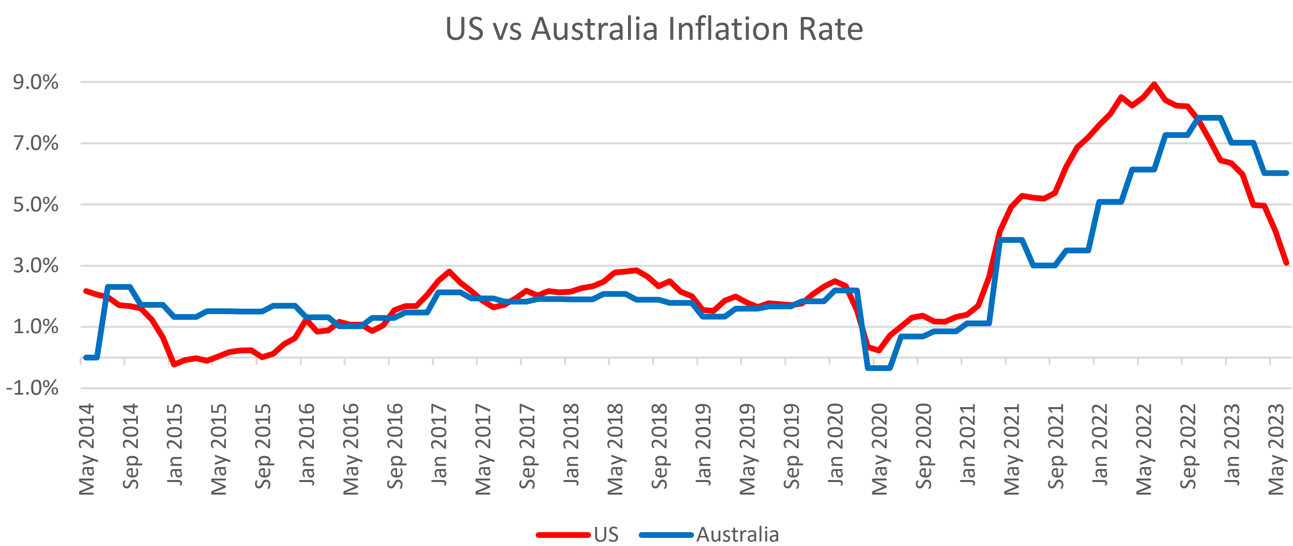


* Data pre 1989 is using price return as total returns weren't available.

Lots to Look Forward to

The general market sentiment has been on a roller coaster, from how much and fast interest rates will rise, to how long they will be kept at elevated levels now, to when they will start dropping. In the fight against inflation, the RBA is projecting inflation to come down to 3.25% by end of 2024 and back to the 2-3% range by 2025.

There has been one asset class that stands out now, with the benefit of higher rates. The Paradigm fixed income portfolio is well positioned (composed mostly of floating-rate bonds whose market value are insensitive to interest rate changes) to take advantage of this high interest rate environment providing a yield of 6.1%. We are ready to lock in this attractive yield when interest rates drop which will set us up nicely for years to come. When interest rates do start dropping, we will also expect to see a rally in equity portfolios across the board as this indicates more money supply in the wider economy, which should see stock prices rise. There is a lot of upside room for portfolios to move when you look at the significance of how inflation has fallen and the likelihood that we are at or close to the peak in the current interest rate cycle.



China does remain the indeterminant factor. Its reopening from zero-covid lockdown has not lived up to the hype of most analysts' expectations. The recovery has been slow due to the damage to the economy from lockdown where a lot of local and small businesses could not trade and have collapsed. The spending habits of Chinese consumers has been trimmed and unemployment has risen. Youth unemployment (ages 16 – 24) has soared, reaching an all time high of 21% in June 2023. The self-popping of the property bubble by the government has led to the implosion of property developers. Despite all this gloom about China's economy, the flip side to all this means that the Chinese Communist Party (CCP) is now forced to implement a solution to get its economy back on track. According to many China-experts this will most likely be announced by the end of this year and will come in the form of an economic stimulus with loose monetary policy or initiation of new infrastructure projects driving the masses back to work. Together, these should create demand for natural resources which will help support Australia's economy. Also, recent bilateral and trade relations between Australia and China have seen some major improvements as tariffs on Australia barley exports to China, placed in 2020, being removed with more easing on the way as negotiations continue.

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Manager in focus – Baillie Gifford

The Paradigm Investment Committee (IC) have been invested in Baillie Gifford Long Term Global Growth Fund (BG) since September of 2020 but with only a small 8% of the international portfolio. BG has a reputation to produce tremendous returns by investing in high growth potential companies which is also subject to greater risk of price volatility. This was seen in 2022 where geopolitical risk from the war in Ukraine led to inflation which led to drastically changed monetary policy that hurt growth stocks.

In our investment process we look to choose fund managers in which to invest that have a repeatable process with attractive returns, and solid risk management in place. With the impact of Covid-19, it was easy for some managers to lose their nerve, try something different, time the market or abandon their core strategies and processes. In such instances, faith can be lost in a manager's lack of conviction, and as a result it would be most likely that we would divest that manager. During the period, despite the volatility, BG has held true to their strategy, accepted and rode out that volatility, and subsequently generated a 30% return for the year ending June 2023. Major holdings in Nvidia (a trillion-dollar US multinational and a dominant supplier of AI hardware and software), Amazon, Tesla, and ASML (the worlds leading supplier for the semiconductor industry) make up the top 20% of their portfolio.

We don't try to time the market and instead look for high quality fund managers in which to invest that offer different strategies that benefit in different circumstances. We expect our fund managers to have the confidence to stick to their strategies. In this case we are confident that BG will continue to deliver us above market returns in the long run.

Investment Philosophy

BG looks to outperform the MSCI All Country World Index with Net Dividends Reinvested in AUD over rolling five-year periods.. They take a long-term growth position in exceptional growth companies around the world.