



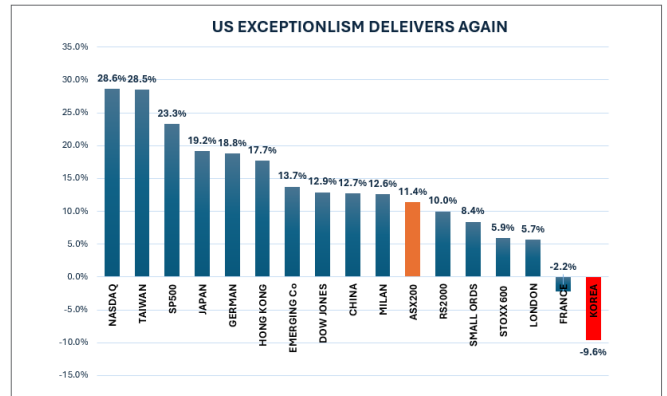
Q2 2025 - TRUMP EUPHORIA

Despite pessimism of higher interest rates and cost of living pressures impacting business and consumers it was another good year for investors as the bull run for equity markets continued.

Major global central banks including the US, UK and Europe all started a rate cutting cycle while US exceptionalism (above trend economic and earnings growth) and secular tailwinds from Artificial Intelligence (AI) boosted major global technology stocks.

Notwithstanding a few (albeit brief) wild swings on markets as global inflation resurged in April and Japan surprised by lifting interest rates in August (for the first time in 17 years) that resulted in modest maximum drawdown of 6.5% for the year on the Australian market volatility was generally subdued.

Conversely, bond markets wavered but surged nearly 1% from its September lows (just before the US Federal Reserve's first interest rate cut) as investors abandoned aggressive bets on future monetary easing as employment is robust and inflation remains sticky.



Mag 7 Delivers Again

December a historically positive month for US markets underwhelmed to see the S&P500 fall 2.5%, Dow Jones shed 5.3%, MidCap Russell 2000 crater 8.4% (reversing +10% November Trump bump) while the Nasdaq bucked the trend to be 0.5% higher.

Trump euphoria faded, some tax loss selling was partially to blame on what was another banner year for US stocks as the broader S&P 500 rose 23% a similar rise to last year and this caps a two-year gain of 53%, the best since 1997-98.

The Nasdaq surged 28% while the old economy Dow Jones Index rose a healthy 13%. As has been the case for much of the past 2 years those Magnificent Seven (Apple, Amazon, Google, Meta, Microsoft, Nvidia, and Tesla) and their relatively large index weightings delivered more than half the S&P500 gains (excluding them the SP500 would have risen 11.45%).

While tech earnings growth is expected to grow at a slower pace after a significant infrastructure (data centre) investment phase monetising these large investments to convince investors the investments will pay off lays ahead.



America First

Donald Trump's decisive election victory in November that promises corporate tax cuts, deregulation, immigration curbs, and an America First (anti-China) agenda drove US shares higher.

Somewhat surprisingly Australian shares also moved higher in November but it's hard to see how our economy benefits from this given 25% of exports head to China.

Trump euphoria faded, and global markets softened in December as the US Federal Reserve hinted at its last meeting of the year to a slower pace of rate cuts ahead (in line with market pricing) given the resilient US economy and the unknown inflationary impacts of Trump policies.

European shares were broadly stronger in December, but UK and France lagged over the year as investors shunned those regions due ongoing political turbulence.

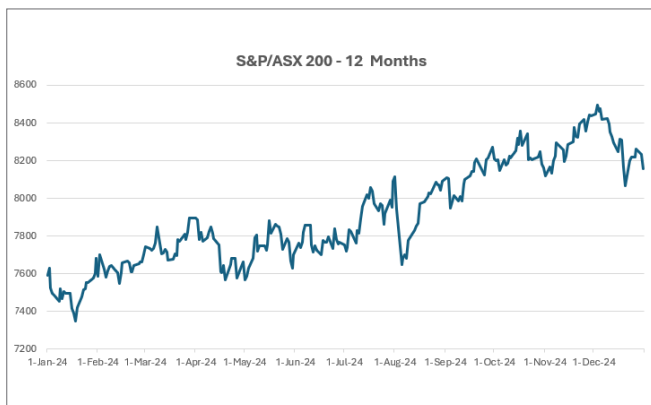
Asia was a mixed bag as Taiwan rose 3.5% for the month (28.3% for the year) as their greater tech exposure that includes the world's largest pure chip maker TSMC drove stronger returns.

Hong Kong stocks rose 18% and mainland China's CSI300 rose 15% for the year snapping respective 4 year and 3 year losing streaks on expectations that greater fiscal and monetary support will deliver China's 5% annual growth target.

Political drama in Japan subsided following the first-rate hike in 17 years in August and as the Yen(¥) resumed its downward trajectory (benefiting exporters) the Nikkei recovered 4.4% for the month to end the year 19% higher.

Conversely, political chaos in Korea took centre stage in December with Prime Minister Yoon declaring martial law (lasted just 3 hours) after being dissatisfied with the oppositions anti state activities.

Moves towards his arrest are ongoing and the Kospi consequently lagged falling 2% for the month and ~10% for the year on another bizarre 2024 political event.



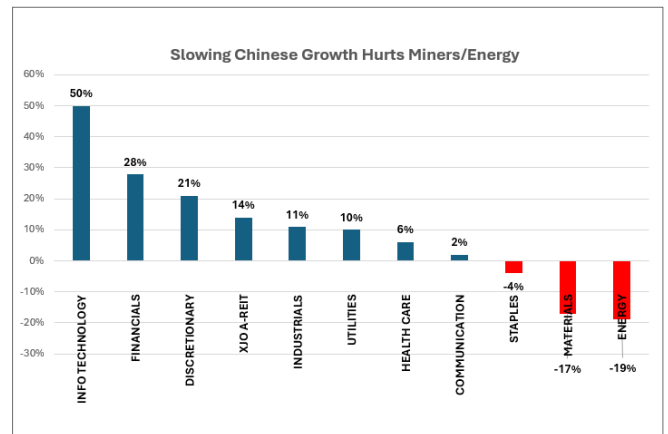
Herd Buying in Vogue

Looking at the sectoral performance on the Australian market it was skewed towards Growth and Momentum (herd buying) as investors paid more to be in winners while shunning losers.

Our best performing sectors were Technology (+50%) led by the AI craze, Financials (+28%) on higher yields and this sector contributed a whopping 84% of total index returns thanks to the large index weights of our major banks.

Despite cost-of-living pressures the Consumer Discretionary sector rose (+21%) as a larger workforce, higher wages, and meaningful tax cuts lent support.

On the back of slower Chinese growth, a stronger \$US and broadly weak investor sentiment due to trade protectionism (tariffs) the Material Sector (-17%) as iron ore shed 27%-to-2-year lows. The Energy Sector (-19%) as Oil slipped 3% on increased global supply.

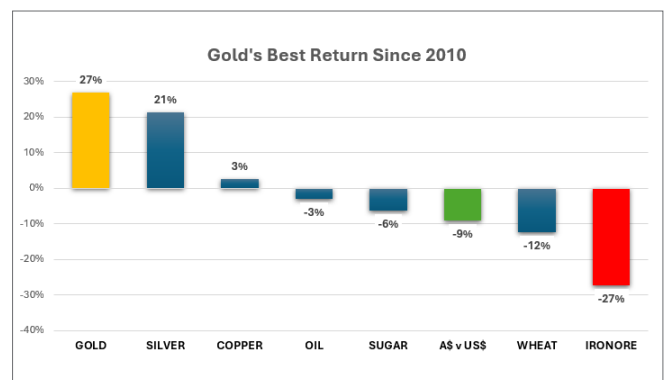


Gold was the star rising 27% (its best year since 2010) on its appeal as a hedge to growing US debt levels and to inflation & /geopolitical risks.

Large caps generally continued to be favoured over Small Cap stocks due to their pricing power over smaller businesses and stronger balance sheets to curb higher funding costs.

For the month interest rate sensitive Property Trusts shed 7% (as US10yr yield rose 30bp or 7%) while we saw some profit taking in growth and momentum stocks within the IT, Financials and Comms Services sectors.

Defensive sectors that lagged for much of the year (Staples & Utilities) fared better in December and the unloved Energy Sector improved in-line with oil's modest recovery into the end of the year.



Interest Rate Relief on the Horizon

Locally, the Australian market shed 3% in December its worst month for the year yet rose a healthy 11.5% (7.5% capital & 4% dividends) to register similar gain to 2023.

End of year weakness came following the US Fed's December meeting that confirmed market pricing that fewer interest rates' cuts (now just 2 not 4 cuts) were on the agenda in 2025 following 1% of interest rate cuts in 2024 to 4.35% - in-line with current Reserve Bank of Australia (RBA) settings.

In December, the RBA opened the door to future interest rate easing citing some (not all) of the recent data had been a bit softer than expected and while a February cut is now a line ball decision a first-rate cut is fully priced for April.

The timing of interest rate cuts will be interesting in the context of the upcoming Federal Election with the government being the largest driver of economic activity and playing a more noticeable role in the economy.

Investors will be wary to their future policy moves given their historic accommodative spending with the prospects of an earlier election than the May 17 deadline rising.



It was, nevertheless, the US Fed chair Jerome Powells comments that took the wind out markets late in the month with him saying, 'the US economy has been remarkable' despite slowing growth and inflation troubles around the globe.

Simply, having front loaded cuts ahead of US election uncertainty (despite robust growth and stalling disinflation) the Fed is set to pause on cuts especially given the unknown impact of future Trump policy to boost growth (deregulation, tax cuts, tariffs, curbs on immigration) which all appear largely inflationary.

Earnings need to Deliver

2024 gains can largely be attributed to P/E expansion with analysts suggesting 60% of the stellar 23% rally on the S&P500 has come from P/E expansion and 40% from earnings growth. Conversely, in Australia >90% of the price returns (7% of the 7.5%) were P/E expansion so just 0.5% was earnings growth while dividends added 4%.

Resilient earnings for the Finance Sector (Banks, Insurers and Capital Markets) attracted investor funds at the expense of Resources to see the performance gap balloon nearly 50% between the two - so rotation opportunity is becoming more compelling as we head into 2025.

General Insurers re-rated on improving earnings quality and excess capitals (that's likely to be redirected towards higher dividends) but it was the Banking sector that was the chief culprit of P/E expansion in our market.

The Banks re-rate has valuations now looking more stretched to see the 2y forward P/E 18.8x v 10-year average 12.9x (>+2 standard deviations). Recent Australian Bureau of Statistics data shows that while retail and overseas investors reduced Bank exposure on valuation grounds over the past year the major Superannuation Funds (that control \$4trillion of Aussie household savings) were the net buyers and their holdings have surged. The Super Funds now own 30% of Bank equity/ debt and this has been noted as a systemic and stability risk by regulators.



Notwithstanding broadly expensive global market valuations (that can remain so for an extended time should earnings hold up) we are cautiously optimistic on further gains, albeit at a slower pace, as the bull market enters its third year following two above average years - ASX200 +25% and the US markets S&P500 53% 2-year rally.

Alpha economy the US is expected to deliver 15% earnings growth in 2025 (after 10% last year) and will continue to see investment inflows despite the S&P500 trading on 22x forecasts earnings and above its 10-year average of 18.5x. In Australia, the forward multiple has pulled back from 18.3x in November to 17.4x (albeit still above 10-year average of 16x) and while offering better relative value a stronger earnings contribution is also required to build on recent gains.

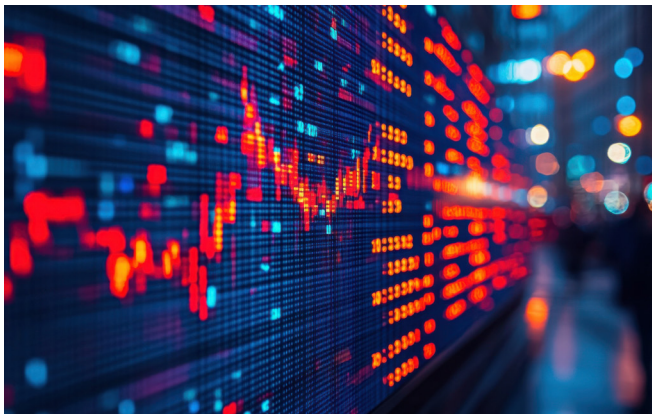
Higher Volatility Ahead

Investors, therefore, need to be selective as you are paying a lot to own stocks and more broadly history tells us that should earnings slow (or not achieve forecasts) then multiples compress, and lower future returns are likely.

Much of this longer-term cautious outlook stretches out beyond 2025 but post covid we have been reminded of much sharper shorter cycles.

Investors will need to be nimble as volatility is expected to rise given the unknown size and timing of Trump/China policy shifts and how central banks adjust to this fluid situation.

Given the modest drawdown on the local market last year corrections of 5-10% are often common at least once (or twice) a year and we feel a better entry point to deploy funds for investors is on the horizon should volatility rise.



Timing is always difficult to forecast, and investors need to be pragmatic that there is political will by all governments wishing to lower interest rates (to ease cost of living pressures) while concurrently having looser (debt funded) fiscal stimulus - so there remains a supportive cushion under equity markets.

The only certainty right now is uncertainty and while sentiment post Trump election win hit euphoric levels (a contrarian sell signal) weakness in December that leads into a historic seasonally softer (yet positive) 1Q25 for markets means opportunities may come sooner rather than later for investors.



Attractive Opportunities Abound

Valuations look stretched against some softening economic fundamentals - Australian 0.8% GDP growth rate the slowest since the pandemic.

Value abounds in out of favour sectors and blue-chip stocks in Healthcare, Property, Materials and Energy - where energy transition fears are overblown.

Meanwhile value in small caps that have missed on the gains of their larger peers still have some catching up to do.

Overall, there are attractive opportunities for 2025, but they are distributed unevenly across regions and sectors and we see a more balanced portfolio positioning for both Offence (secular growth stories and emerging winners from US policy) and Defence (given lagging returns in out of favour sectors) while money markets offering over 4.5% at call remains attractive (dry powder) as we move through a more volatile phase of the bull market this year.