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Q4 2025 – TACO TRADE

Global markets weathered bouts of volatility to rise strongly despite geopolitical tensions and macroeconomic uncertainty continuing to pose a risk for markets.

The Federal election also saw surprising yet resounding victory while markets remain attentive to the pace not direction of interest rates as globally central banks become universally more accommodative. Tariffs threats have been the dominant theme over the past six months that could see the average US tariff rise to nearly 19% (from 2.4% last year) the highest rates in almost a century.

Bond markets got a bit yippy in April as a seismic tariff shift had recession risks rising resulting in a 20% swoon on global markets.

Subsequently, the TACO term was born (Trump Always Chickens Out) as US tariff rates were wound back, negotiated, or delayed, and a 90 day pause (until July 9th) provided some clean air for markets to swiftly recover on optimism that tariffs would not derail the interest rate cutting cycle.

The broader ASX200 benchmark closed out a turbulent financial year just 1% below its yearly highs to be up 10% in price terms or 13.8% in total returns once dividends are accounted for. This marks the third straight year of double-digit total returns for Australian stocks 14.8% (2022), 12.1% (2023), 13.8% (2024) which is above the ~9% p.a. 10-year average an excellent outcome for equity investors.

Despite a risk on tone for markets investors continued to shun Small Caps. The Emerging Companies Index (ex ASX300 companies with average market cap $272m) rose a modest 6.7% instead investors favoured the perceived safety of Large Caps.

Banks Trump Miners

Solid credit growth, low bad debt expenses and strong bank balance sheets supports modest dividend growth of our largest (Financial) sector.

Meanwhile a stable iron ore price near US$100 a tonne and an Australian Dollar (A$) at historically low levels around 64c suggests major Mining and Agricultural exports remain competitive despite trade uncertainty.

The largest gains were driven by Financials (+24%) led by a 46% surge in Commonwealth Bank shares who alone added a whopping third of the index gains for the year.

Information Technology (+24%), Communications (+23%), Industrials (+22 %) and Consumer Discretionary sectors (+18%) were also standout sector contributors.

The major detractors were Energy (-13%) and Materials (-6%) sectors, as global supply/demand balance indicates an oversupply in many commodities while a sluggish Chinese property recovery and ongoing tariff uncertainty softens the global demand outlook.

While broader sector moves often belie a trend Gold is forecast to be Australia's third largest value export this year and was the bright spot of Materials sector.

The S&P/ASX All Ordinaries Gold sub Index (XGD) rose a whopping 57% this year (up 37% the past 6 months) as central banks continue to diversify away from the US$ while speculative interest remains strong.

Higher gold prices are encouraging further exploration and drilling programmes from juniors and once unprofitable projects are again looking more attractive should the good times last.

The momentum factor (tendency of winning stocks to continue performing well and losers continue to be sold in the near term) has done exceptionally well despite an increasingly uncertain global economic backdrop.

At the expense of value, growth and quality (fundamental) investing those losing sectors continued to be punished and many large caps leaders in those abovementioned winning sectors (Commonwealth Bank, Wesfarmers, Telstra, JB Hi-Fi etc) pushed the market to historically expensive earnings multiples.

As we close out the financial year the ASX 200 trades on 18.9x forecast earnings versus the long run average 14.7x with contrarian investors punished for being under exposed to this year's market darlings.

Mean reversion (prices eventually return to their long-term average) suggests last year's relative losers (Materials, Energy and Small Caps) offer better value in an otherwise expensive market.

On expectations interest rates continue to ease over the next year and economic growth stabilises Small Caps stand to benefit from a cyclical recovery given their sensitivity to interest rate changes.

Mag 7 Still Dominant

Overseas markets were broadly positive as lower interest rate expectations, and the prospect of further debt funded government fiscal spending (US 'Big Beautiful Bill', European Defence and Australian Infrastructure/Defence) continues to be a supportive backdrop for risk assets.

Despite a turbulent last six months US markets reclaimed record highs to see the S&P500 rise 13% for the year.

The Top 10 US companies (Magnificent 7 technology stocks) now account for a record 40% share of the US index's market cap suggesting gains are yet to truly broaden out.

In the same way, to the Australian market the Russell 2000 Small Cap index rose 6% lagging their large cap peers. European equities were mixed but broadly positive as investors funds flowed into the region on US trade concerns.

The broader Stoxx 50 (largest 50 stocks in Europe) rose 12% while in Asia the MSCI Asia (ex-Japan) index rose 15% whereas Japanese stocks rose a modest 5% as trade friction and a relatively stronger Yen on interest policy divergence hurt exporters.

Savings Buffers Build

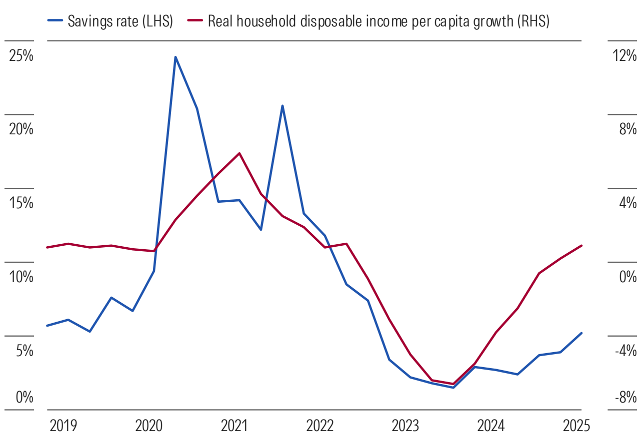
In Australia, whilst not immune from the global uncertainty we're well placed with inflation lower (although elevated), unemployment low, growth positively rising (GDP projected to rise to 2.3% from 1.3% last year) and room for further interest rate easing means the economy is turning the corner.

From a consumer perspective the near-term outlook is improving, and consumption is expected to rise as two interest cuts already in this cycle and the prospect for another three cuts before Christmas could take the cash rate to around 3% from 3.85% presently.

To date consumers, have prioritised saving over spending (interest rate savings sitting in offset accounts) and additional easing should provide greater impetus for consumers to spend as the savings to income ratio has returned to more normal levels of 5.2% from below 2% in 2023.

Households Prioritize Saving More Before Consuming More

Quarterly savings rate. Rolling 12-month disposable income per capita versus the PCP.



Investment Universe Shrinks

Broadly, the outlook for lower interest rates will help equity valuations and boost confidence in dealmaking while deregulation in many markets should boost activity while the weaker A$ adds appeal from offshore acquirers.

Many public and private companies are sitting on dry powder (cash), and we saw a surge in merger activity while a lack of major new floats and a consistent flow of companies delisting shrunk the listed market more 3% this year as tariff uncertainty delayed many IPO's.

US firm CoStar agreed to buy Australia's Real Estate listings platform Domain for $3bn while two major South Australian stocks are currently subject to takeovers.

Firstly, in February, a $7.40 per share cash takeover of Mayne Pharma by US Cosette Pharmaceuticals valued the company at $672m while in June, energy giant Santos granted due diligence to XRG a consortium of Abu Dhabi National Oil Company and US Private Equity firm Carlyle which have proposed $8.89 per share cash takeover valuing the company at $30bn.

Santos shares trade at a significant 13% discount to the offer on concerns the deal may get blocked on national interest grounds.

Whilst not an IPO per se the reverse takeover of Sigma Pharmaceuticals by Chemist Warehouse creates a circa $30bn ASX Top 50 company with a market cap just above supermarket heavyweight Coles ($28bn). Merger activity was highest in the Materials sector as Rio Tinto's ($10bn) Arcadium Lithium deal further increases their exposure into critical minerals while several mid-tier gold miners consolidated.

Strategic acquisitions of US Berry Group ($13bn) by suitor Amcor and James Hardie ($14bn) acquisition of US Azek further consolidate their respective packing and home building positions in US markets.

Wall of Worry

Uncertainty in the world economy remains elevated and the final scope of US tariffs and policy responses in other countries remains unknown, financial market prices have rebounded with an expectation that the most extreme outcomes are likely to be avoided.

Trade policy developments are nevertheless still expected to have an adverse effect on global economic activity, and there remains a risk that households and firms delay expenditure pending greater clarity on the outlook.

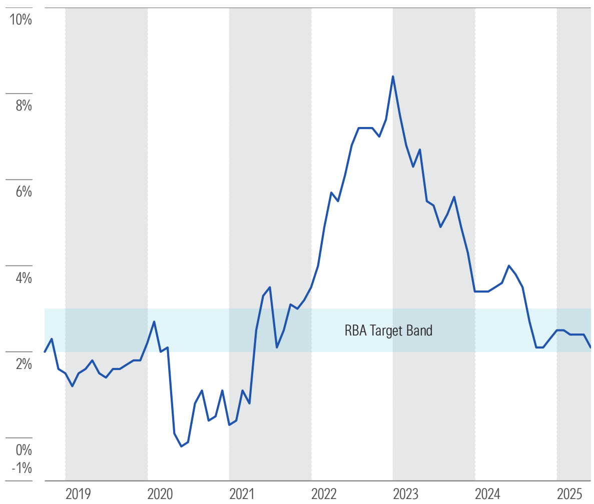
Governments do, however, stand ready to act and the labour market has been remarkably resilient.

It's no longer a case if the RBA will ease but when with a neutral interest rate likely to be at or just below 3%.

The wall of worry is crumbling as earnings trend higher for global markets and broadly higher fiscal stimulus, more stable inflation and interest rates trending lower remains a favourable backdrop for stocks that should continue to forge higher over the remainder of the year.

Headline Inflation Flirts With Bottom of Target Band

Monthly inflation indicator (annual growth).



While volatility is expected to remain high, we would use any trade inflicted weakness (buy the dip TACO trade) to add to select equity exposures as the outlook for lower interest rates and better earnings over the next year should see lower returns on cash and term deposits than investors have enjoyed over the past year.