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Portfolio Perspectives

Insights from the CIO Office

September 2024

Key Messages for Investors

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- At the headline level, ASX100 corporate earnings grew 3.7% in FY24, with a modest uptick in growth expected in FY25 (+4.6%).
- EPS revisions in Australia have been negative year to date (YTD), in contrast to Developed Market peers.
- Lower commodity prices have dragged forward earnings estimates down.
- Valuations for Australian equities remain elevated, while growth expectations remain subdued.
- Developed market equities currently offer a superior growth outlook over FY25

Outlook for Australian equities remains challenged

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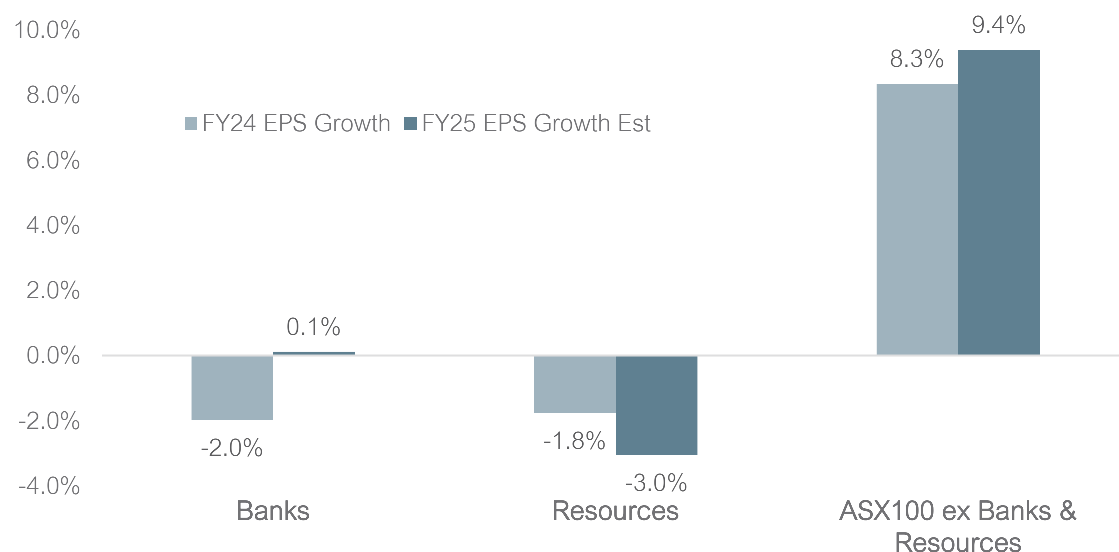
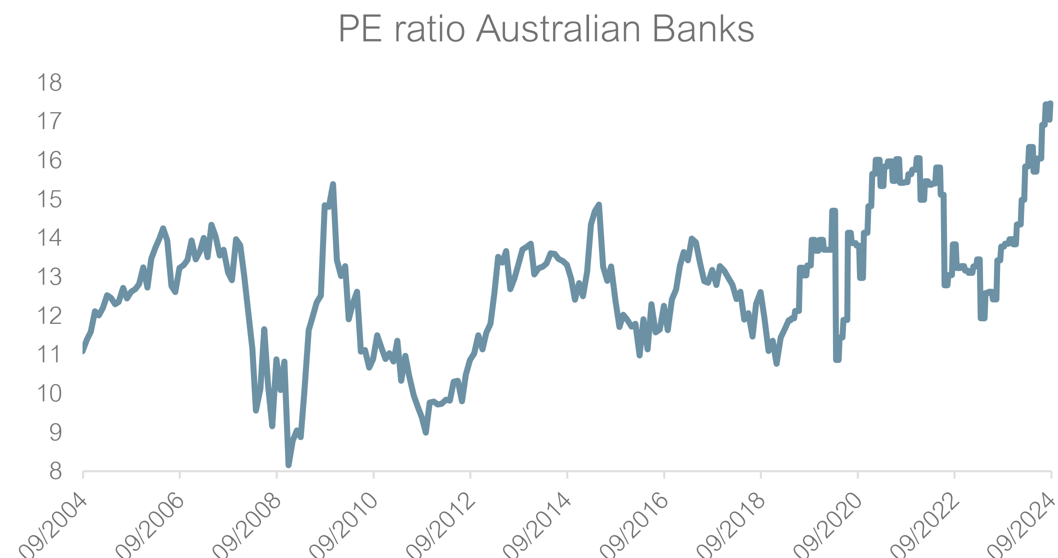
Low earnings growth from the Banks and Resources is the major headwind for Australian Equities

FY25 will mark the second year of stagnant growth from banks and resources



- Earnings across the ASX100 grew 3.7% in FY24, dragged down by lower profits from the banks and resources.
- Earnings growth on the ASX has been dominated by the industrial universe (ex-banks and Resources).
- This trend is expected to continue in FY25, with earnings across the industrial universe forecast to grow 9.4%.

Major banks are trading at peak multiples despite lacklustre earnings growth



- The major banks have gained 47% since the end of October 2023, carrying the ASX to an all-time high.
- Earnings upgrades have not backed up the strong returns from the banks, with the sector reporting peak earnings in FY23.
- This has driven the sector valuation to an all-time high – a forward PE ratio of 18x.
- A continuation of low bad debts, benign asset quality, RBA rate cuts, and the prospects for capital management will support bank earnings in FY25; however, this appears priced in at current levels.

Source: Refinitiv, Lonsec estimates.

The case for Global Equities

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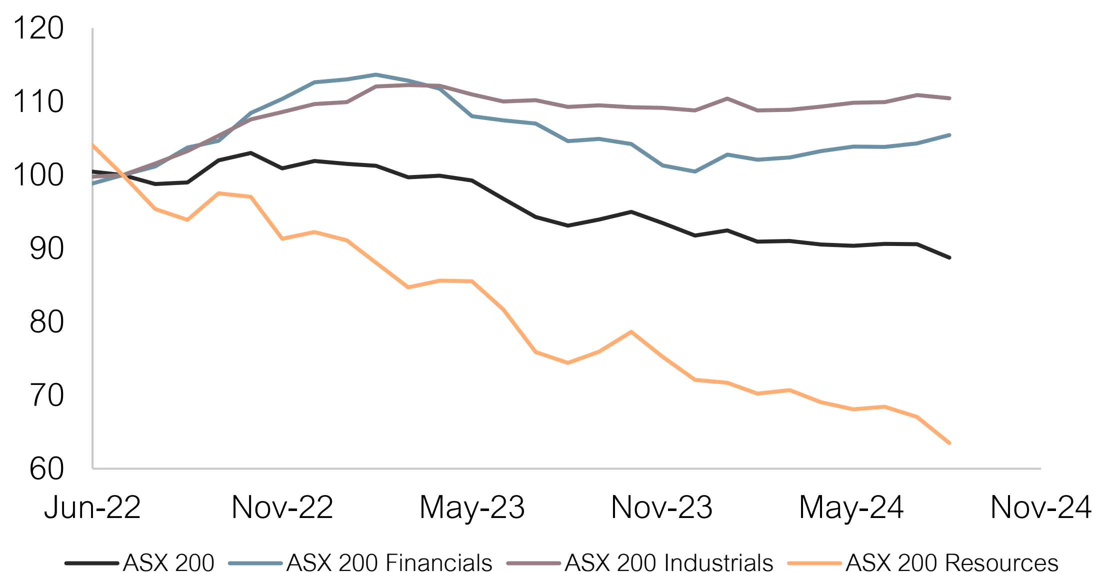
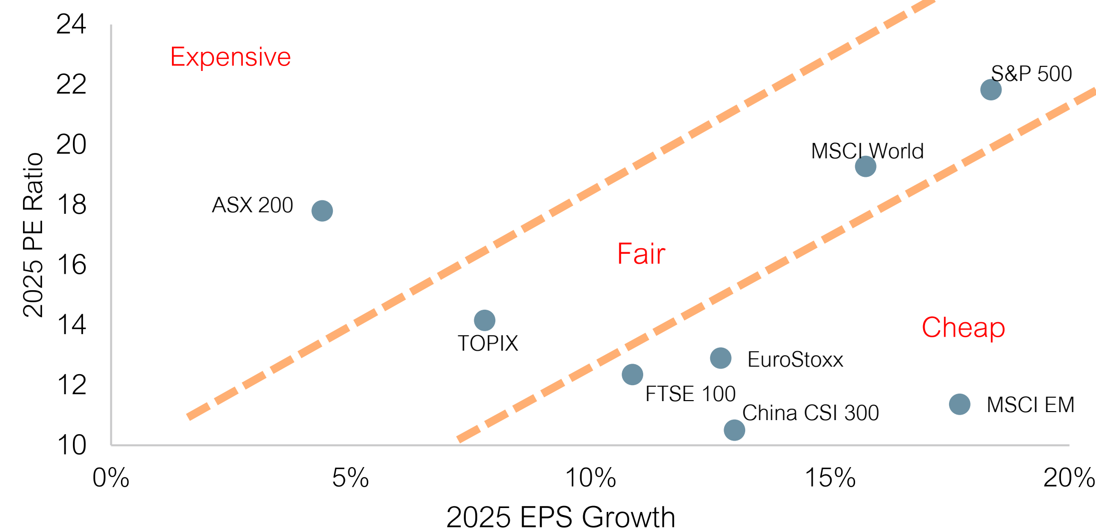
Absolute growth rates and earnings momentum favour Global Equities in FY25

ASX200 12-Month Forward Earnings Expectations rebased to June 2022



- Negative earnings revisions for the Resources sector have been the major roadblock for the ASX.
- Lower commodity prices, including iron ore, energy, and lithium, have dragged down earnings estimates for FY25.
- A recovery in earnings would most likely need to be driven by the Resources sector, supported by an economic recovery in China, which may push the recovery out to FY26, given the current uncertainty around China and its growth outlook.

PE Ratio vs EPS Growth



- Post the August reporting season, the ASX remains an outlier when comparing current valuations and growth expectations for 2025.
- The US looks fair value given the current earnings trajectory. The Q2 reporting season was encouraging, with initial signs of a broadening in earnings delivery. Market EPS growth, excluding the Magnificent 7, turned positive for the first time since the fourth quarter of 2022.
- EM and Europe look cheap, given the forecasted profit growth. However, risks remain elevated regarding earnings delivery in 2025, particularly in China.

Source: FactSet, Bloomberg, Lonsec estimates.

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Outlook and Positioning

Becoming constructive on risk. Overweight DM Equities preferring Europe, Japan and US Small Caps. Reducing Cash. Don't ignore your Fixed Income allocations because risks remain.

Growth Assets	Underweight			Neutral	Overweight		
Australian Equities				●			
Large Caps				●			
Small Caps				●			
Developed Market (DM) Equities					●		
Large Caps				●			
Small Caps					●		
Emerging Market (EM) Equities				●			
Australian Listed Property				●			
Global Listed Property				●			
Global Listed Infrastructure			●				
Growth Alternatives				●			

Defensive Assets	Underweight			Neutral	Overweight		
Australian Bonds					●		
Global Bonds				●			
Diversified Income				●			
Conservative Alternatives				●			
Cash			●				

Growth Assets

- DM Equities. We are taking a constructive approach to risk and bringing the overall Growth/Defensive split back to Neutral by overweighting DM Equities funded by a reduction in Cash.
- DM Equities. The distortion caused by the Magnificent 7 in the US has us preferring Europe and Japan given more attractive valuations.
- DM Equities. DM Small Caps typically move ahead of the turn in the economic cycle, and US Small Caps, in particular, could move with the Fed starting its easing cycle. This leads to a Slight Overweight DM Small Caps with a preference for US over ex-US Small Caps.
- Global Listed Infrastructure. We see better risk/return opportunities in other asset classes for those seeking yield or capital appreciation.

Defensive Assets

- Australian Bond yields are now offering good value and bonds can once again play a defensive role in diversified portfolios. Focus on long-duration assets.
- Global Bonds. Supply/demand imbalances in the US treasury market remain a focus, reducing their relative preference versus Australian government bonds. The end of YCC policy in Japan should lead to an extended period of relative underperformance in Japanese Government Bonds.
- The potential start to an easing cycle reduces the relative attractiveness of floating rate yields.
- We maintain an allocation to gold which acts as a risk-diversifier against a further deterioration in economic conditions or escalation in geopolitical tensions.

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