Portfolio Perspectives

Insights from the CIO Office

December 2024

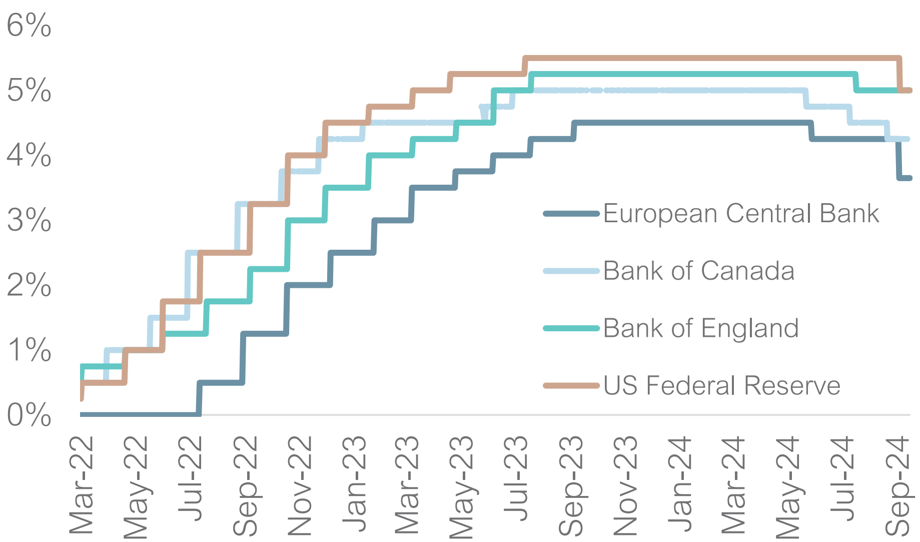
Key Messages for Investors

- 2024 was marked with conflict and a political shift to the Right
- Global equity markets saw strong gains in 2024; the Australian share market lagged global peers
- It remains too early to predict the economic impact of Donald Trump's victory
- Early indicators suggest that the next economic cycle may already be underway
- Australia is lagging the economic cycle and must look to China for a potential catalyst

The interest rate cycle has turned

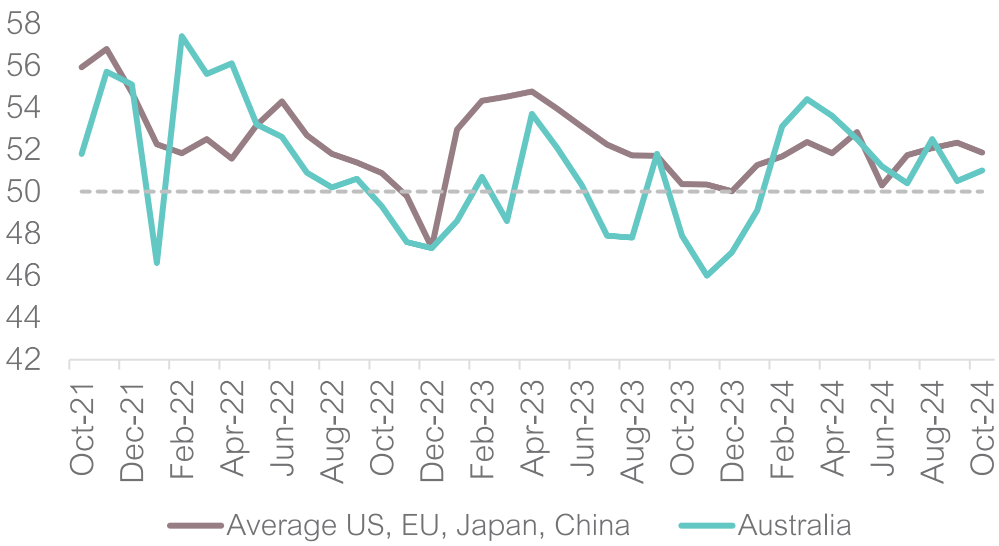
Loosening monetary conditions lubricates capital making it cheaper and boosting the economy

Major Central Banks have begun to cut their key policy rate



- The interest rate cycle has turned, the 0.75% reduction by the US Federal Reserve (Fed) solidified this view, in our opinion.
- Major Central Banks that have begun cutting their key policy rate: US Federal Reserve, European Central Bank, Bank of Canada, Bank of England, Swiss National Bank, Riksbank (Sweden), and Reserve Bank of New Zealand.
- This presents a promising opportunity for growth in the real estate and infrastructure sectors, making it an optimistic time to reconsider these assets for portfolios.

Services Purchasing Manager Index remains above 50



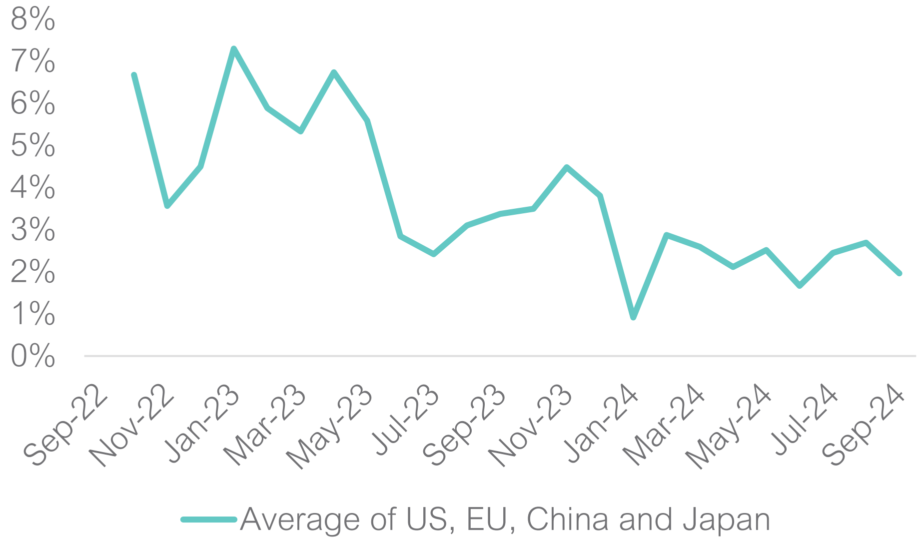
- The direction of the Services portion of the economy is pivotal for its outlook. A simple average of the Services Purchasing Managers Index (PMI) of the US, Eurozone, Japan and China remains above 50, the critical threshold demarking expansionary or contractionary conditions.
- Recall that the services portion of US, EU, Japan and China on average makes up around 2/3 of their respective economies – services is the driver of growth.
- This measure has only dipped below 50 once since at least 2021. While the current average is only a modest 51.8, even a soft expansion in the services sector can underpin global growth.

Source: Factset, Bloomberg, Lonsec estimates.

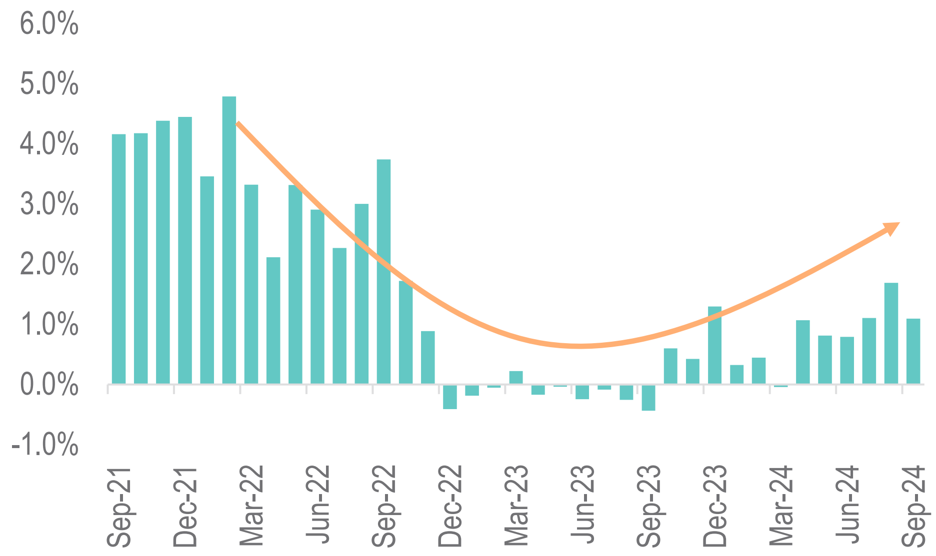
The macroeconomic environment is reasonable

Potentially shifting into the next cycle

Retail sales



Global Industrial Product growth has rebounded and is trending higher



- Household consumption is the fuel for the services sector.
- Retail sales are a good proxy for household spending.
- Retail sales across the US, Eurozone, China and Japan have averaged 2% year-to-date.
- Will improved consumer sentiment see retail sales push higher?

- After a period of contraction through much of 2023, global industrial production is growing again.
- With the services economy already inching higher and now joined by manufacturing, the direction of travel for the global economy seems higher from here.

Source: Factset, Lonsec estimates.

The case against Australia

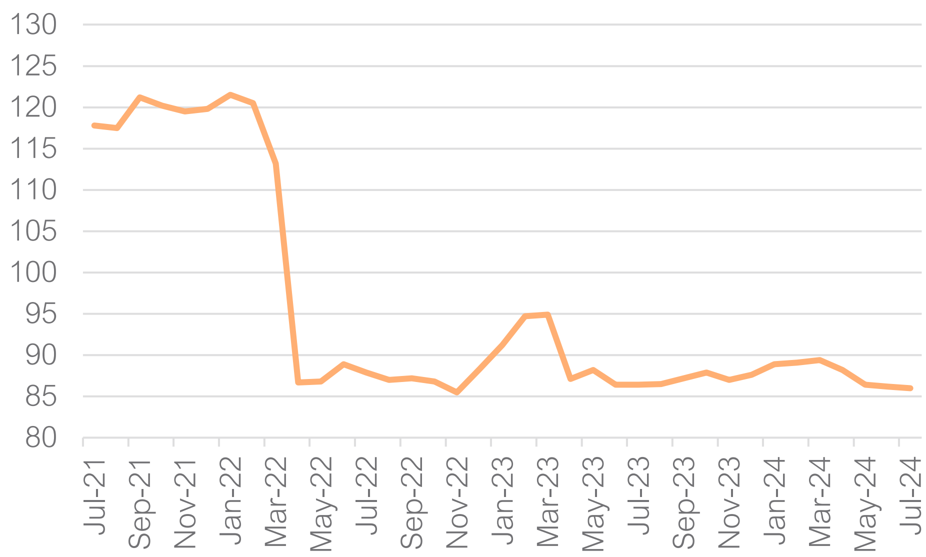
Absent a catalyst, what takes the Australian equity markets higher?

The Australian stock market can be broken down into 3 broad sectors – 50% of the market faces earnings growth challenges

Sector	% of Market	FY25 Forecast Profit Growth	FY25 PE Ratio
Financials	30%	2.0%	20x
Resources	20%	-9.8%	13x
Industrials	50%	8.6%	32x
Market	100%	3.3%	22x

- Financials primarily exposed to the slow-moving residential mortgage market. Benefit of solid credit quality already reflected in profits, there are no material levers for the banks to improve their outlook dramatically.
- Resources have been held back by the slowing economy in China.
- The growth expected in Industrials seems largely reflected in the 29x multiple.

Chinese consumer confidence remains near all-time lows



- Recent Chinese stimulus package resulted in a sharp rally in commodity-related stocks. Measures are a step in the right direction.
- Consensus believe the Chinese authorities have reprioritised the economy's health but with a focus on supply-side factors.
- Unless companies and households have the confidence to put risk assets to work, we are sceptical of the longevity of this current rally in China and resources stocks.

Source: FactSet, Bloomberg, Lonsec estimates.

Outlook and Positioning

Lonsec

The interest rate cycle has turned creating a tailwind for equity markets. Overweight Global Listed Property as there is more to the sector than Office. Australia's profit growth relative to peers is challenged.

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

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

We are taking a constructive approach to risk with the overall Growth/Defensive split just above Neutral

Growth Assets

- Aust Small. China's slowdown is holding back demand for resources, which should disproportionately impact junior miners with make up a large portion of the Small Caps sector vs Large Caps.
- DM Large. Interest rate easing cycle should be a tailwind for equities.
- DM Small. DM Small Caps typically move ahead of the turn in the economic cycle, and US Small Caps, in particular, have responded positively to the Fed starting its easing cycle. This leads to a preference for US over ex-US Small Caps.
- EM Equities. Uncertainty around China and its growth outlook, risks continue to be slightly elevated leading to Slight Underweight.
- Global Listed Property. Slight overweight as the sector should benefit from the turn in the interest rate cycle.

Defensive Assets

- Australian Bond yields are now offering good value. Bonds 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.
- Start to easing cycle reduces the relative attractiveness of floating rate yields.
- Maintain an allocation to gold as a risk-diversifier against further deterioration in economic conditions or escalation in geopolitical tensions.

Lonsec

Important Notice: This document is published by Lonsec Investment Solutions Pty Ltd (LIS) ACN: 608 837 583, a corporate authorised representative (CAR number: 1236821) of Lonsec Research Pty Ltd ABN: 11 151 658 561 AFSL: 421 445 (Lonsec Research). LIS and Lonsec Research are owned by Lonsec Holdings Pty Ltd ACN: 151 235 406. LIS creates the model portfolios it distributes using the investment research provided by Lonsec Research but has not had any involvement in the investment research process for Lonsec Research. Please read the following before making any investment decision about any financial product mentioned in this document.

Disclosure at the date of publication: Lonsec Research receives a fee from the relevant fund managers or product issuers for researching financial products (using objective criteria) which may be referred to in this document. Lonsec Research may also receive a fee from the fund manager or product issuer (s) for subscribing to research content and other Lonsec Research services. LIS receives fees for providing investment consulting advice, approved product lists, model portfolios to financial services professionals and other advice to clients. LIS' and Lonsec Research's fees are not linked to the financial product rating(s) outcome or the inclusion of the financial product(s) in model portfolios. LIS, Lonsec Research and/or their associates may hold any financial product(s) referred to in this document, but details of these holdings are not known to the analyst(s).

Warnings: Past performance is not a reliable indicator of future performance. Any express or implied rating or advice presented in this document is limited to “general advice” (as defined in the Corporations Act 2001 (Cth)) and based solely on consideration of the investment merits of the financial product(s) alone, without taking into account the investment objectives, financial situation and particular needs (“financial circumstances”) of any particular person. Before making an investment decision based on the rating or advice, the reader must consider whether it is personally appropriate in light of their financial circumstances or should seek independent financial advice on its appropriateness. If the advice relates to the acquisition or possible acquisition of a particular financial product, the reader should obtain and consider the Investment Statement or the Product Disclosure Statement for each financial product before making any decision about whether to acquire the financial product.

Disclaimer: LIS provides this document for the exclusive use of its clients. It is not intended for use by a retail client or a member of the public and should not be used or relied upon by any other person. No representation, warranty or undertaking is given or made in relation to the accuracy or completeness of the information presented in this document, which is drawn from public information not verified by LIS. Financial conclusions, ratings and advice are given on reasonable grounds held at the time of completion (refer to the date of this document) but subject to change without notice. LIS assumes no obligation to update this document following publication. Except for any liability which cannot be excluded, LIS and Lonsec, their directors, officers, employees and agents disclaim all liability for any error or inaccuracy in, misstatement or omission from, this document or any loss or damage suffered by the reader or any other person as a consequence of relying upon it.

This report is subject to copyright of LIS. Except for the temporary copy held in a computer's cache and a single permanent copy for your personal reference or other than as permitted under the Copyright Act 1968 (Cth), no part of this report may, in any form or by any means (electronic, mechanical, micro-copying, photocopying, recording or otherwise), be reproduced, stored or transmitted without the prior written permission of LIS. This document may also contain third party supplied material that is subject to copyright. Any such material is the intellectual property of that third party or its content providers. The same restrictions applying above to LIS copyrighted material, applies to such third-party content.

Copyright © 2024 Lonsec Investment Solutions Pty Ltd