Lonsec Investment Solutions

Portfolio Perspectives

Insights from the CIO Office
March 2025

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Key Messages for Investors

- EPS revisions in Australia have been broadly neutral YTD.
- ASX100 corporate earnings are expected to grow by 3.4% in FY25.
- Valuations for Australian equities remain elevated, while growth expectations remain subdued.
- Looking ahead to FY26, earnings are currently expected to grow by 9.2%, however, this is largely dependent on commodity prices.
- Developed market equities currently offer a superior growth outlook over 2025.

Australia's Reporting Season

The February 2025 reporting season in Australia was one of the most volatile reporting periods in recent memory. It featured a mixed set of results, confirming our concerns regarding the market's lacklustre growth prospects in 2025.

Market growth expectations, in aggregate, have been trending lower over the past year, heavily impacted by a sharp contraction in earnings in the Resources and Energy sectors due to lower commodity prices and input cost inflation. The ASX100 is now expected to deliver EPS growth of ~3.4% over FY25, with lacklustre growth from Financials and Resources offset by strong growth expectations for the Information Technology and Healthcare sectors.

In terms of themes, a resilient consumer, moderating inflation, stabilisation in the labour market, the prospect of US tariffs, the lagging impact of wage growth and the impacts of recent tax cuts and energy rebates dominated discussions and outlook statements over the reporting period.

The results from discretionary retailers and banks provided clear evidence of the positive impacts of Stage 3 tax cuts and energy rebates on domestic consumers over the first half. CBA, the country's largest bank, called out the stimulatory effect of these measures, which is evident in its customers' increasing savings and spending profile. This led to a 15% reduction in the number of hardship cases over the December half.

We expect this trend to continue over the second half, driven by the start of the Reserve Bank of Australia's (RBA) rate-cutting cycle and the lagged impacts of wage growth over 2025. This outlook is supported by the second-half trading updates from retailers so far this year, with positive like-for-like sales growth momentum continuing in January 2025, ahead of the RBA rate cut in February.

However, the favourable tailwinds in the consumer segment are not moving the dial from an earnings perspective for the Australian stock market. Banks and Resources dominate the market's earnings trajectory, and the outlook here appears to be challenged. Bank earnings are expected to grow by 2.2% in FY26, with the prospects of capital management initiatives taking a back seat after weaker-than-expected quarterly updates from NAB, ANZ and Westpac.

Earnings from the Resources sector are expected to fall 10.5% in FY25 before returning to growth in FY26, but this is at the mercy of commodity price fluctuations and the pace of the recovery in the global economy and China, notwithstanding the knock-on impacts from escalating US tariffs on major trading partners.

On a positive note, iron ore prices have remained resilient and above $100 per tonne despite the 2% decline in Chinese steel output in 2024. This does provide some upside risk to earnings for the major miners, with current mark-to-market earnings projections about 16% higher for BHP in FY26. However, earning visibility remains poor given the lack of meaningful production growth from the majors and elevated geopolitical risks over 2025.

The growth outlook for the industrial universe on the ASX (ex-Banks and Resources) remains much more appealing in FY26. Earnings are expected to grow by 13%, driven by double-digit growth from higher-growth sectors, including Healthcare and Information Technology. This seems appealing at face value; however, a forward PE multiple of 30x for this cohort more than captures the forward growth trajectory. In our view, this leaves a narrow path for Australian equities to outperform and reinforces our relative preference for Developed market equities in 2025.

Tariff Update

We believe that broad-based tariffs will significantly and negatively impact global growth. The Trump administration continues to pepper the headlines with policy changes that are difficult to comprehend. As of the time of writing this update, once again, Canadian and Mexican tariffs that started on March 4 have been deferred. The administration ordered a one-month reprieve for all goods from the new tariffs that met the 2020 free trade deal (the USMCA, which then President Trump secured). This is good news from an economic perspective as orderly trade flows will continue; however, the uncertainty it brings for investors has seen broader stock markets continue to retreat from the optimism during the initial months of President Trump's second term.

Outlook and Positioning

We have not made changes to our current Dynamic Asset Allocation (DAA) position.

We maintain that investors should lean into their Strategic Asset Allocation (SAA) during this period of uncertainty. Balanced risks to the upside and downside prevail. Recent soft and hard macroeconomic data have weakened but remain positive (good retail sales, greater than "50" Purchasing Managers Index Services index readings, low unemployment), suggesting macroeconomic conditions continue to drift higher. However, this can abruptly turn with the implementation of widespread, punitive tariffs and ongoing policy uncertainty.

We remain alert to shifts in the fundamental economic data while avoiding the heightened noise surrounding the daily news flow. We expect greater clarity in the coming months as distortions from the California wildfires, unseasonally cold weather, material inventory building in the US ahead of the potential new tariffs and US economic policy becomes clearer.

Growth Assets	**Underweight**			**N**	**Overweight**		
Australian Equities – Large Cap				●			
Australia Equities - Small Caps			●				
Developed Market Equities – Large Caps				●			
Developed Market Equities - Small Caps			●				
Emerging Market Equities			●				
Global Listed Property					●		
Global Listed Infrastructure				●			
Growth Alternatives				●			

Defensive Assets	**Underweight**			**N**	**Overweight**		
Australian Bonds						●	
Global Bonds				●			
Diversified Income				●			

Defensive Alternatives				●			
Cash			●				

Growth Assets

Asset Class	Position	Rationale
Australian Equities – Large Caps	Neutral	Australian equity valuations look stretched and require a re-rating in bank and resource earnings which does not seem forthcoming. Population growth and a resilient consumer continue to support the economy. Inflation is receding, paving the way for Reserve Bank of Australia (RBA) cuts. While Australia does not yet appear to be in Trump's sights for tariffs owing to our trade surplus with the US, second order impacts (particularly in relation to China) cannot be ignored.
Australian Equities – Small Caps	Slight Underweight	Supply-side focused stimulus measures in China are not likely to drive economic growth materially and, by extension, resume their appetite for Australian natural resources. The prospect of an all-out trade war further complicate the outlook. This should disproportionately impact junior miners who make up a large portion of the Small Caps sector vs Large Caps.
Developed Market Equities – Large Caps	Neutral	With valuations already stretched and the US Federal Reserve more circumspect given the potential for higher inflation, we see a scenario where current tailwinds turn into headwinds as the year progresses should a global trade war escalate.
Developed Market Equities – Small Caps	Slight Underweight	With the US Federal Reserve likely to pause its easing cycle we have moderated our view on global small caps slightly. Valuations remain somewhat attractive and small companies tend to be more insulated and domestically focused, shielding them from the worst of a global trade war.
Emerging Market Equities	Slight Underweight	While valuations look attractive on a relative basis, the growth outlook for China in particular remains challenged. Recent China stimulus has not yet translated to improved business and consumer sentiment. With the prospect of tariffs also looming, some caution is warranted.
Global Listed Property	Slight Overweight	Attractive subsector valuations warrant an active approach to this sector. Office sector remaining structurally challenged but rental growth and healthy fundamentals are appearing in other areas of the sector (age care, data management, supply chains).
Global Listed Infrastructure	Neutral	With key policy rates lower than this time last year, a key headwind to the sector is gone. Valuations are attractive versus long term averages.

Defensive Assets

Asset Class	Position	Rationale
Australian Bonds	Overweight	Australian bond yields offer good value and provide safety from overseas volatility. Positive supply/demand dynamics in play with budget deficit likely to be less than government forecasts.
Global Bonds	Neutral	The size of the US fiscal deficit is a headwind given the need for funding, however safe-haven buying provides some support. Japan is still in hiking mode.
Diversified Income	Neutral	Floating rate public credit still offers relatively attractive yields as uncertainty remains around the timing of Reserve Bank of Australia (RBA) interest rate cuts.
Conservative Alternatives	Neutral	Gold acts as a risk-diversifier against a further deterioration in economic conditions or escalation in geopolitical tensions.
Cash	Slight Underweight	Cash is a balancing item.