April 2025

Market Outlook.

Embracing uncertainty during market turbulence.

Foreword

At the start of 2025, optimism regarding the strength of the equity market was high. However, less than three months later, fear and volatility started to take centre stage. Geopolitical uncertainty, mixed with persistent inflation and looming (now real) tariffs unsettled global markets. Realised and implied volatility spiked, and investor sentiment shifted from optimism to pessimism. The S&P 500 dropped 10% in three weeks, and the ASX 200 also experienced significant declines from its February-highs to mid-March. These moves, while common in the long-term context of equity markets, felt particularly jarring due to the relative calm of recent years.

As sentiment turned, assets that had been winners in 2024 were an easy target for investor selling. The declines in US tech stocks, including the "Magnificent Seven" have resulted in improved valuations, as the broader market narrative has become less positive. Improved valuations create a healthier and more sustainable backdrop.

The risk of an economic downturn in the US has, however, risen over the quarter. This followed a series of disruptive announcements from President Trump which has unsettled markets and sentiment more broadly. High equity ownership among US households amplified the stakes. Wealth effects create feedback loops between disruptive policy, share market volatility, consumer sentiment and ultimately unemployment. These factors all could be beneficial for the economy when equity markets are strong (like we saw in 2023 and 2024) but can work in reverse if equity markets exhibit prolonged weakness. It's these feedback loops which have the potential to provide a natural limit to how long the disruptive policy is likely to persist.

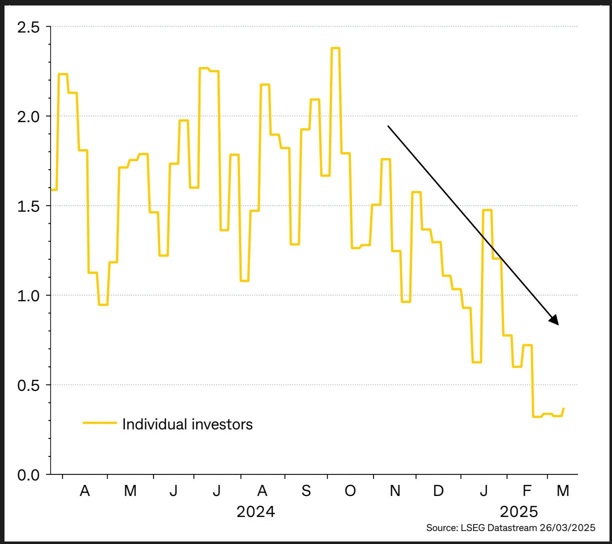
Against this backdrop, we should still acknowledge that the range of outcomes has widened and, thus, diversification matters. Preparation, not prediction, is the key in these situations.

That means resisting the impulse to do something rash and taking a measured and calm approach. Holding assets across a portfolio which can benefit from multiple scenarios can also bolster resilience. Two examples of diversifying assets include alternatives and fixed income. Alternatives can play an important role to complement equity and fixed income allocations and bolster diversity. Fixed income can also be a useful ballast to equity exposures. Long-term government bond yields above 4% in Australia and the US mean there's ample scope for fixed income to provide capital growth if the backdrop darkens, due to the way in which bonds are priced.

Finally, successful investing often requires looking beyond prevailing sentiment to assess where the market may land once the dust settles. The chaotic news flow can create a fertile environment to identify favourably valued investments. In these environments, active management is key. Volatility allows active management to move towards and away from assets as prices oscillate around fair value. Markets can be short-sighted and narrative-driven, but dispersion, volatility, and confusion can create investment opportunities.

Investor sentiment has turned

All Ratio of Bullish to Bearish Investors



Global Economics:

At cruising altitude, but possible turbulence ahead

The global economic outlook has changed dramatically in just a few short weeks with the pace of policy announcements coming from the Trump administration upending the expectations for US growth. Fuelled by equity market volatility and 10%- plus corrections impacting the growth outlook and confidence with consumers and investors.

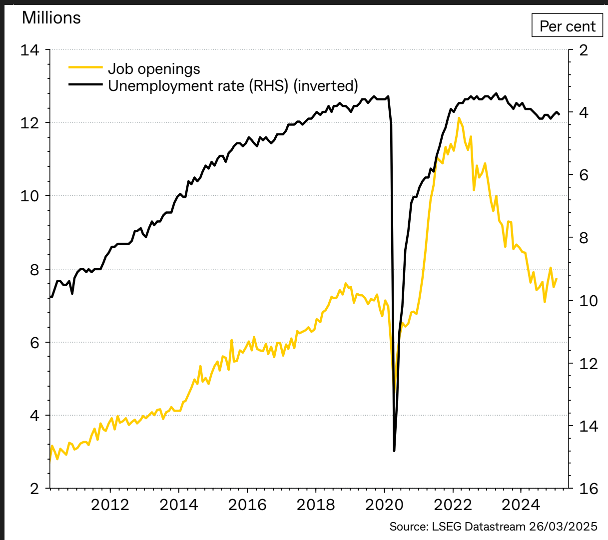
Confidence matters to consumption and investment, and it has been shaken with drops in consumer, business and investor confidence, leading to lower GDP forecasts, as rising inflation expectations and stagflation potential clouding the outlook. However, a closer look at the data suggests that much of the concern may be overblown and likely to be reversed once there is some certainty on policy.

Soft recent economic data has largely been due to temporary factors, such as extremely cold weather or front-loading imports ahead of anticipated tariffs. Consumer spending is moderating following nine months of strong annualised gains. Employment data on the other hand remains encouraging, the three-month average of payroll growth now stands at 200k, whilst job openings increased by somewhat more than expected in January 2025 to 7.74m.

February core CPI rose 0.23% month-over-month, below expectations, and the year-on-year (YoY) rate ticked down to 3.12%. This meant the March Federal Open Market Committee (FOMC) meeting was largely in line with expectations, Chair Powell's comments were seen as somewhat dovish as he reiterated that the FOMC is well positioned to wait for further clarity and not in a hurry to cut again. However, left the forecast of two cuts this year unchanged.

Employment still a tail wind

US unemployment & job openings



Source: LSEG Datastream 26/03/2025

In contrast, the European Central Bank (ECB) cut policy rates by 25bp, as widely expected with the accompanying statement amended to state that monetary policy is "becoming meaningfully less restrictive," however the Governing Council maintains data-dependent with a meeting-by-meeting approach. At the same time growth projections were revised down -0.2% to 0.9% for 2025 while headline inflation was revised up 0.2% to 2.3% in 2025.

The German parliament passed a EUR 500bn off-budget fund (11.6% of GDP in 2024) for additional infrastructure and climate investments. This fund is to be disbursed over 12 years.

In China, January-February activity data broadly came in stronger than market expectations, via industrial production, fixed asset investment and retail sales although the magnitude of beat was modest. Beijing also unveiled a "special action plan" to boost domestic consumption aimed at turning the economic slowdown around to ensure the recently announced 5% GDP target is achievable for 2025.

Australia Economics:

Small green shoots but subpar growth and global uncertainty persist

- March produced some early rate cut driven signs of a rebound in economic activity but the overall data remains mixed, and growth continues to be subpar.
- This will keep the Reverse Bank of Australia (RBA) on its easing path over 2025 which should progressively assist the local economy. The key risk is an extended period of US policy uncertainty.
- Even with global uncertainties and the RBA easing, AUD yields are at historically higher levels but the impetus for added downward pressure over 2025 on rates is rising

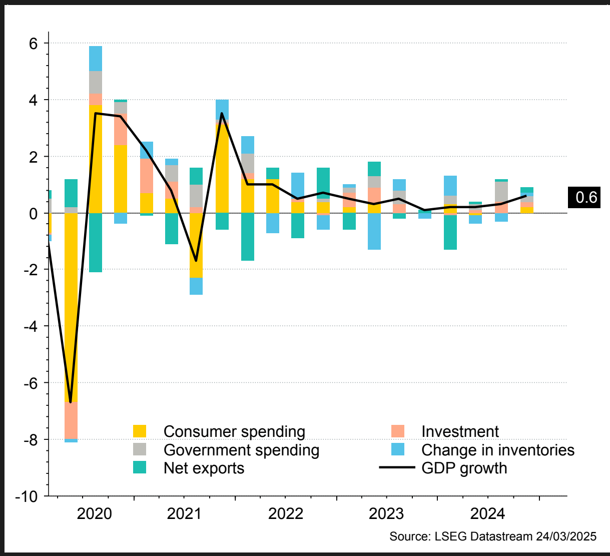
Coinciding with the RBA starting its easing cycle, there were early signs of a rebound in economic activity in March, namely the latest GDP, credit growth and S&P flash composite PMI data. The GDP expanded by 1.4% YoY in Q4 marking the strongest quarterly rise since 2022. While public spending was the main driver of growth, household consumption also rose modestly. Credit growth has also increased, led by business lending, which has a higher correlation to economic activity.

A marked upturn in private sector investment is unlikely to materialise based on one 0.25% rate cut from the RBA, with the global growth uncertainty from the US tariff policies and a likely tighter Federal election by 17 May, set to keep local companies hesitant on their growth and spending plans

Meanwhile, unexpectedly, the February labour data showed a 52.8k fall in employment. While the unemployment rate held steady at 4.1% given a large shift lower in the participation rate, the combination of falling employment and participation meant this was a soft jobs report, thereby giving some ammunition for the RBA to genuinely consider a second rate cut at their upcoming May meeting.

Australian GDP

GDP growth and cont



As expected, the focus from the Federal Budget, was on cost-of-living relief, with only select major surprises since most pre-election measures were already announced. Overall, the Budget is unlikely to prove to be a major factor in the RBA's deliberations in May.

Overall, the economy is expected to gain support progressively this year from RBA rate cuts (we expect circa 0.75% in total by end-2025), albeit growth will remain below trend. The chief risk to this scenario is an extended period of US policy uncertainty leading to weak global and US growth, noting that US business activity now stands at a 17-month low.

As to be outlined in the Fixed Income section, domestic market yields have also fallen recently but even with global uncertainties and the RBA now on an easing path, AUD rates are still at historically higher levels with 10-year bond yields within striking distance of the cyclical peak of circa 4.7% as of late March. This reflects a hawkish RBA and the recent surge higher in European bond yields driven by renewed defence-base fiscal stimulus. As noted below, overall, the impetus for further downward pressure over 2025 on US and Australian rates is growing.

Equities:

Volatilities rising

- Uncertainties from President Trump's tariff policies impact negatively on business confidence and market sentiment.
- The earnings season has been somewhat overshadowed by the rising concerns on global economic growth slowdown.
- Growth stocks with elevated valuations are the most vulnerable ones amid market volatilities.

After marching into new highs in mid-February, the S&P500 and Nasdaq 100 Indices both tumbled more than 10%. The S&P/ASX 200, our domestic equities index also declined nearly 10% from its record high by mid-March in less than a month, wiping out all the index price gain from the past year.

The sharp decline in the US and the domestic equities markets was primarily triggered by the rising uncertainty from the Trump administration's trade policies, which is estimated to be much more negative for global trade than during his first term in 2018, due to higher tariff rates and broader countries and products being targeted.

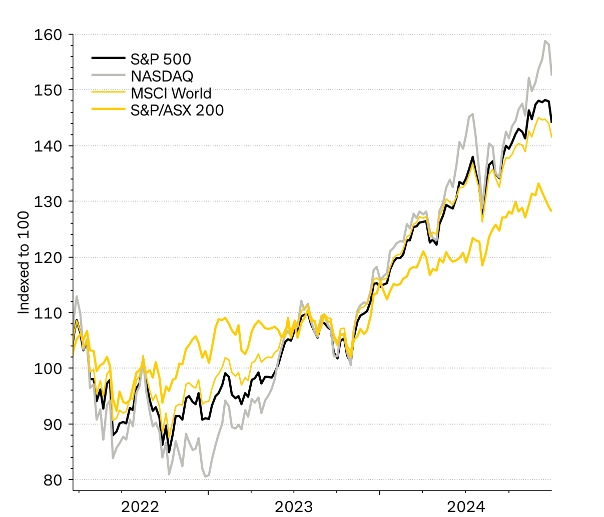
At the timing of writing, 2 April is when these tariffs will take effect. However, we note that Trump's new reciprocal tariffs are of developing nature, as they are open for negotiation and adjustment, and details of the plan are still being worked out.

While the world's largest economy is busy working on tariff policies, China, the second largest economy released its own cost-effective open-source Artificial Intelligence (AI) models on DeepSeek, causing anxieties around the future of AI-related infrastructure demand, such as GPUs and data centres.

In the domestic market, the February reporting season wrapped up with a usual level of earnings surprises, small earnings forecast upgrade, good cost performance, low but sequentially improving revenue growth, momentum trading losing steam, and above-average level of outsized share price movement.

Equities Indices falling from peak levels

With rising volatilities



Source: LSEG Datastream 24/03/2025

Direct US tariff impact is likely to have only minimal impact on Australian GDP, hence Australian corporate earnings should be relatively immune. Therefore, it's fair to say the sell-off in domestic equities over the last month wasn't really driven by deteriorating earnings outlook, instead, was mainly due to the risk-off sentiment led by the US market.

High-growth stocks with strong momentum, such as Tech, are the ones that have been hit the most amid market volatilities, partly because of their elevated valuation levels and concentrated positions by investors. On the other hand, the defensive sectors, such as Healthcare, Consumer Staples, and Utilities have outperformed in the recent market correction.

We view volatility as an opportunity to re-test convictions in portfolio holdings and adjust accordingly. Looking through the short-term chaos, what matters is the medium to long-term earnings outlook, which is the focus of our fundamental research.

Fixed Income:

US rates decline on growth concerns

- Driven by policy and growth uncertainty, US market yields have fallen recently. Rates are still historically elevated, but the impetus for further downward pressure over 2025 is rising
- Underpinned by solid fundamentals, global Investment Grade (IG) credit spreads have only moderately widened with the recent equity weakness
- Risk for credit weakness remains if the US policy and growth uncertainty is extended. Active fixed income managers are well placed to mitigate sudden change.

US market yields have fallen recently reflecting policy uncertainty and growth concerns. Thus far, soft survey data has notably weakened but has yet to bleed into hard data. The extent to which this occurs largely depends on the how long US policy and growth uncertainty continues.

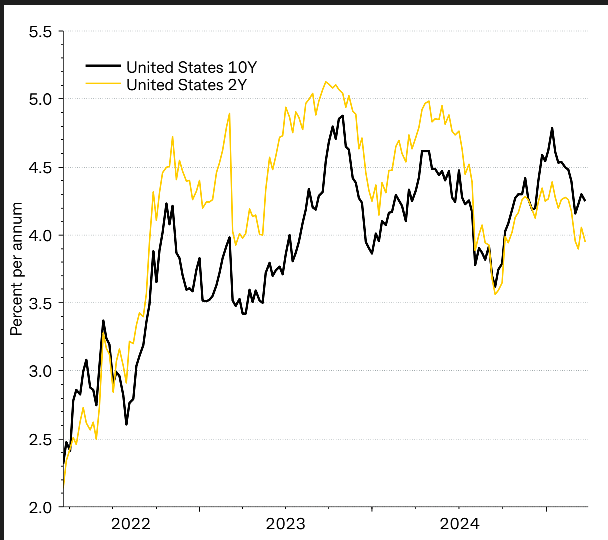
These themes were noted at the March FOMC meeting with the Federal Reserve (Fed) indicating that US growth will likely slow while also pointing to signs of an underlying strong economy. Chairman Powell also asserted that any tariff-based inflation impacts are likely to prove temporary. While the Fed kept rates steady, Powell confirmed the Fed stood ready to restart cutting interest rates if the US job market deteriorates from its current solid state. These statements indicate the Fed is more focused on US employment than inflation at this juncture.

Even with the recent falls, at +4%, US short and long-term bond yields are at historically higher levels. Overall, given the above, the impetus for further downward pressure over 2025 on US rates is rising.

Domestic rates have also fallen in sympathy but are still historically elevated given a more hawkish RBA and the recent surge in European bond yields led by defence-base fiscal stimulus.

US bonds yields remain historically higher

US 2-year and 10-year Government Bond Yields



Source: LSEG Datastream 24/03/2025

Supported by solid credit fundamentals, so far, global IG credit spreads have only modestly widened with the equity weakness. Thus, global credit spreads are still not pricing in much room for error, and the risk is for credit spread widening, especially in the US, if the policy and growth uncertainty is extended. Put another way, for credit spreads to re-tighten, higher US policy certainty is needed. As such, our preference for higher quality, high -grade issuers and portfolios is unshaken. Similarly, we favour diversified fixed income credit portfolios (such as the core fixed income managed account funds) where credit and rate positions are actively managed. These active managers have key tools to mitigate the impact of any future credit weakness on the portfolio, including adjusting duration, using credit hedges and operating mainly investment-grade rated portfolios. Also, with the large rise in base rates since 2021, elevated portfolio yields now provide a much greater buffer to total returns against any future credit weakness.

Real Assets:

Solid foundations

- Real Assets such as Property and Infrastructure can provide long-term investment stability.
- Real Assets can also provide a hedge against the inflationary-based erosion of asset value.
- With expectations for major central banks to either maintain or cut rates further over the remainder of 2025, the outlook is positive for Real Assets.

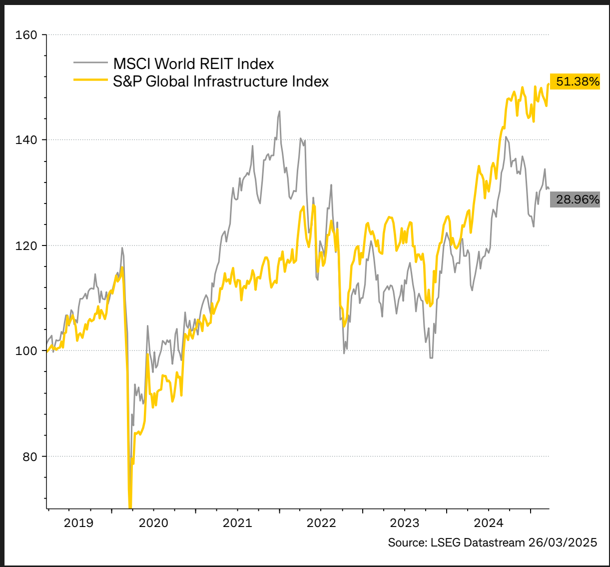
Returns from commercial property investments have been challenged over the past couple of years as rising interest rates subdued investor demand and impacted valuations. However, over the past six-months, the outlook for commercial property has improved, as investors became more confident that major central banks would maintain their easing bias, transaction activity increased, and valuations within wholesale commercial property portfolios stabilised.

The performance of global listed property securities (GREITs) has been similarly challenged since the commencement of the interest rate hiking cycle in late 2021, with investor sentiment in this sector not matching the level of enthusiasm for listed equities. This includes that GREIT indices didn't climb the same heights as listed equities in 2024, and that GREITS also sold off in March 2025 alongside equities.

While some of the concerns regarding sectoral headwinds are valid, including the potential impact of US import tariffs and reduced government spending on consumers and corporates, valuations remain sound and the sector has the potential to provide resilience and upside in the year ahead. We continue to monitor developments in this sector closely.

Real Asset investment returns

USD Total Return



Listed infrastructure securities have proven more resilient over the past two months, defying the selloff in broader equity markets. This is due to the fundamental nature of the asset class, being that it provides essential services which are more resilient to economic cycles that other asset classes, and that its underlying cash flows may be regulated, or otherwise subject to long-term contracts, with a measure of inflation indexation.

This asset class continues to evolve, bringing new opportunities to market in sectors such as energy transition, digital infrastructure, and waste recycling, which will provide a base for infrastructure investment and returns in the decade to come. Overall, we maintain our positive outlook for infrastructure investments in 2025.

Alternatives:

Many levers to pull

- Hedge Funds aim to provide absolute returns with low correlation to traditional asset classes.
- Alternative Credit offers enhanced yields.
- Private Equity offers access to value-added opportunities and participation in developing businesses and technologies.

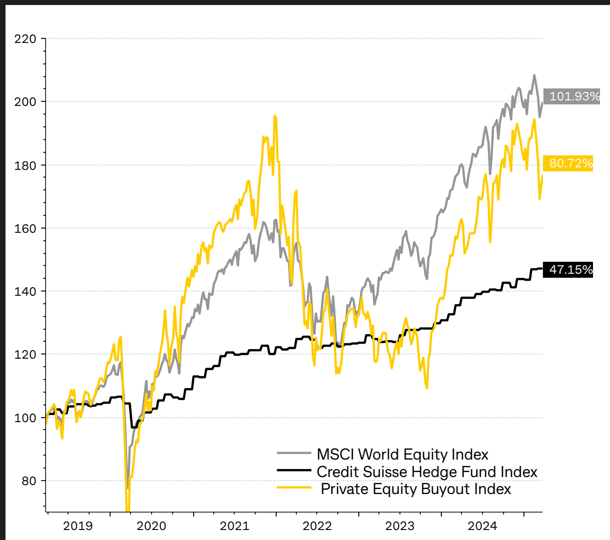
The re-emergence of market volatility in equity and investment grade credit discussed earlier in this report has also impacted US high yield corporate bond prices. At a headline level, the credit spread of the Bloomberg US Corporate US High Yield Index increased by circa 60 basis points from the late-January to 21 March 2025. However, to give this context, this increase can also be seen as a normalisation of spreads which reached historically low (post-GFC) levels in Q4 2024. Further, credit spreads of other high yield credit assets widened by a much lesser amount over the same period, for example, credit spreads on US liquid levered loans increased by 24 basis points (Source: Bloomberg).

Overall, while we continue to monitor credit market conditions, and are mindful of the risks of further volatility and the potential for softening of the US economic outlook, US corporates continue to be in reasonable shape, and we maintain a positive outlook for alternate credit assets with high yield exposures. We reiterate that judicious risk-aware credit selection will be paramount to navigating the year ahead successfully, rather than relying on passive long duration to deliver returns.

In Australian private credit, we have previously expressed our caution regarding private lending to real estate development projects in Australia, as builders and developers continue to digest elevated construction and interest costs, which presents elevated risks to lenders.

Alternative investment returns

USD Total Return



Source: LSEG Datastream 26/03/2025

Financial press throughout Australia have recently cited multiple examples of such risks being realised. More broadly, ASIC has continued its enquiries regarding Australian private credit funds, including private corporate loans and real estate debt. ASIC's focus in this regard is on understanding whether the risks involved and fund unit pricing are sufficiently transparent. While, on the whole, Australian private credit investors haven't suffered permanent losses of capital, some specific funds have reported reduced performance and reduced liquidity. Concerns regarding this investment segment are now being more widely reported, with one large dealer group withdrawing its investment recommendation of two Australian private credit managers, while an Australian research house has placed the entire private credit sector "On Watch".