VINCENTS

# Market Outlook

## FY25

*Louis Dooley & Kenneth Beanland*

# Vincents Private Wealth

**Our team has extensive experience operating in financial markets.**

Our investment philosophy is centred around helping our clients to maximise their wealth. We carefully assess each individual's tolerance to risk and personal objectives, allowing us to craft a tailored investment strategy and recommend a suitable portfolio.

**We offer a range of advisory services that include:**

- Investment & Management
- Retirement Planning
- Wealth Protection (insurance)
- Aged Care
- Strategic/Financial Planning

In addition to these services, we have access to additional specialist services within Vincents in areas such as taxation, lending and business advisory.

We believe this differentiates us from many other financial advisory groups, adding another level of commitment, focus and motivation to our role as your wealth management adviser.

We take pride in helping you achieve your financial goals and believe in the value of long-term relationships built on trust and results. The close relationship you can expect with our office provides access to all the support, information and advice you need to gain insight and take control of your wealth, helping you in making the best possible investment and strategic decisions.

Our advisory firm manages close to $1B of clients' investment capital and has been around for over 25 years.

**Our success is owing to the strength of our relationships and service.**

# Economic Outlook

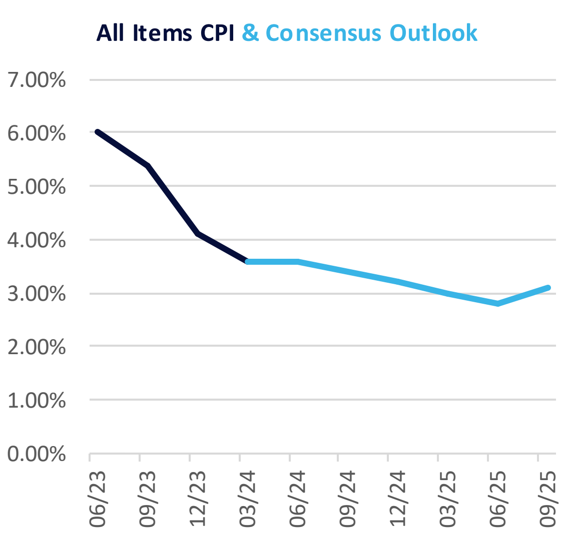
*Taking a closer look at the outlook for monetary policy and the Australian consumer - as expected by the market.*

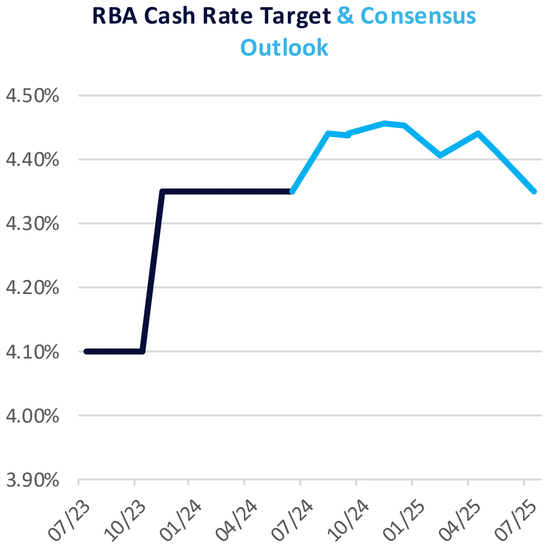
# Monetary Policy

Throughout FY24, we continued to observe declining headline inflation with now 5 consecutive prints of declining YoY CPI since the peak of 7.8% in the December 2022 quarter. Recent monthly prints have however, suggested a reacceleration to headline CPI necessitating a cautious approach by the Reserve Bank of Australia (RBA) and the central bank's interest rate target throughout FY25. As we have discussed in previous updates, Services inflation is proving to be far less susceptible to the blunt force of Monetary policy. While Goods inflation has capitulated more than 67% from its peak in the September 2022 Quarter, services inflation has only moderated 32% since its more recent peak in the June quarter of 2023. Sticky services inflation coupled with the prospective reignition to goods price inflation, may be the critical concoction needed to provoke well overdue action among our central bank.

We believe the June quarter release (due the end of July) will provide confirmation of the resurgence of headline cost pressures, with an increasing likelihood that the RBA's next move will be up. These recent reports have sparked a material adjustment to the forward rate curve which is now implying a rise in the September 2024 meeting (taking the cash rate target to 4.5%) - the first move in Monetary policy since November 2023.

Although we (and the market) are still not 100% convinced Governor Bullock and the Board will deploy a rise, our base case is now that current interest rates are likely to persist (with growing risk to the upside), **with the cash rate expected to stay above current levels until the EOFY.**



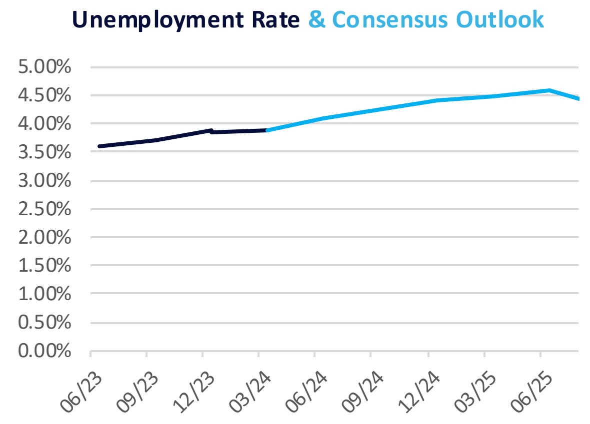



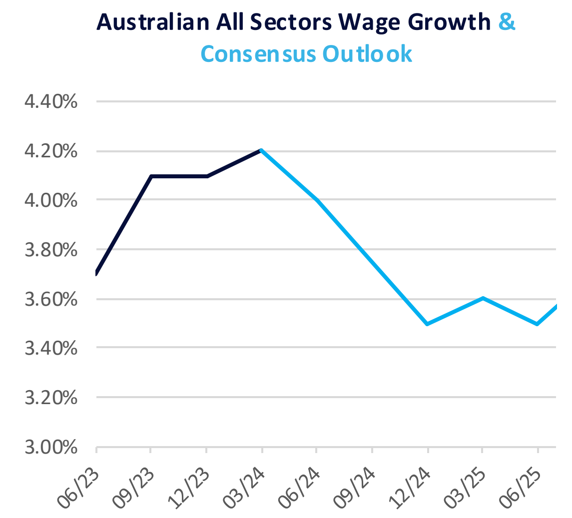
The outlook for a tighter monetary environment here domestically has instigated upward revisions for the AUD:USD conversion with consensus expecting a 69c AUD:USD by FY end.

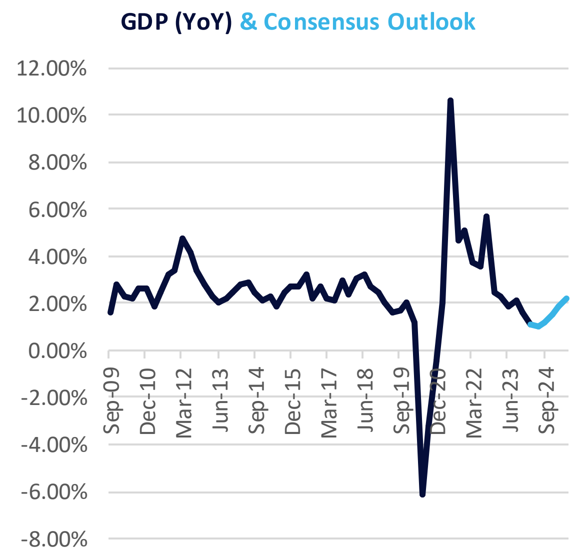
The immediate focus will be the labour market with the most recent data pointing towards continued tightness with unemployment decreasing to 4.0% in the most recent ABS release. **Our baseline expectation is that this will sequentially increase throughout FY25, with our view aligning with the RBA projecting 4.3%, Treasury expecting 4.5% and the consensus among 26 analysts expecting a 4.6% unemployment rate by the end of June 2025.** While achieving the top of the range (4.6%) would require a significant rate of change (+15%) from current levels, understandably provoking concern among market participants - it would still suggest a tighter labour market relative to the 5 (4.8%), 10 (5.26%) and 20 (5.16%) year average of Australian Unemployment. We flag the key risk within the labour market being engrained negative real wage growth - compounding the erosion to consumer purchasing power (further discussed below). March 2024's quarterly print demonstrated the first positive real wage growth since March 2021, coming in at 0.6% - this is still 21bps below the normalised average of 0.81% (from December 2019 back to 2004).

The consensus among 46 economists and market analysts are expecting Australian GDP to increase by 2.2% for the 2025 Calendar year - however, quarterly YoY prints are expected to be below 2% until the June 2025 print with a forecast of 2.2% for the period's release. **Ongoing below trend GDP growth and above target CPI confirms our concerns on the emergence of stagflation** - which we acknowledge as one of the key economic risks for the year ahead.

On a consensus basis, the market is pricing a recession probability of 23%. We concur with this assessment and **deem it unlikely Australia will enter a recession in the coming 12 months.**



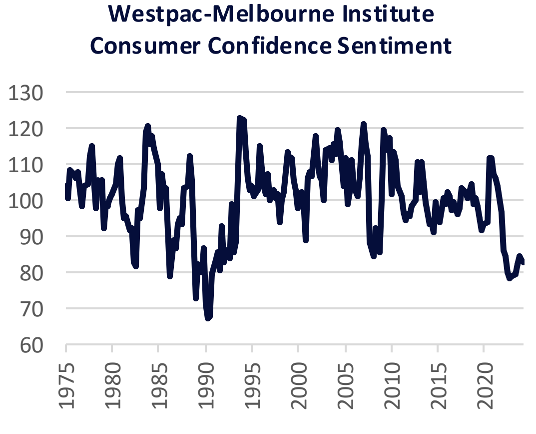
# Consumer

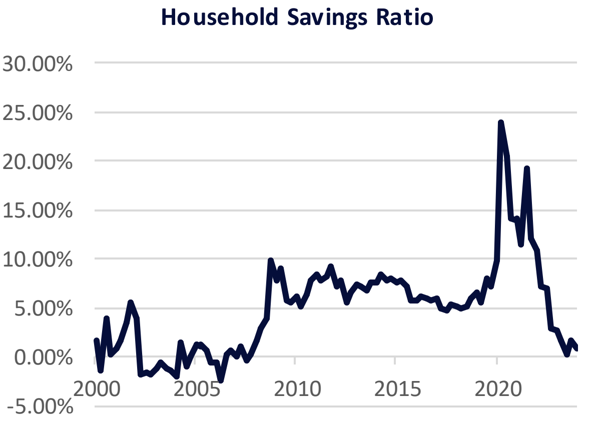
**Consumer spending is expected to face pressures in FY25** due to persistent inflation and elevated interest rates, which will continue to erode disposable income and lead to more cautious spending habits. **The Household Savings Ratio (currently at 0.9%) is at levels seldom seen in typical economic environments,** far below the 10 year average of 7.65%. The current savings ratio remains in significant deficit relative to a normalised 10 year average - between 2009 and 2019 of 6.68% (excluding the fiscally stimulated, covid savings boom).

Tighter household budgets are forcing consumers to prioritise essential expenses, with significant increases in spending on housing, insurance, and groceries (as detailed in recent ABS CPI releases). Conversely, discretionary spending is being cut, with below headline increases to areas such as clothing & footwear as well as Recreation & Culture. The ABS's most recent monthly household spending indicator corroborates this shift in spending behaviour with Health the largest increase among spending categories and more discretionary categories below trend growth or outright nominal declines.

Tight household budgets are likely contributing to sustained weakness in Westpac's Consumer confidence index that remains well below the neutral level of 100 with July's reading at 82.72  (meaning pessimists outnumber optimists by nearly 20 percentage points).

Although we acknowledge headline household spend to be illustrating sustained resilience, we caution taking these figures out of context. While spending has increased at the headline level - we note these figures to be artificially inflated on the back of strong migration figures inflating the perceived spending output. On a per-capita basis, we observe declining consumer spend, albeit at a slower rate than many market commentators had expected at this point in the cycle.



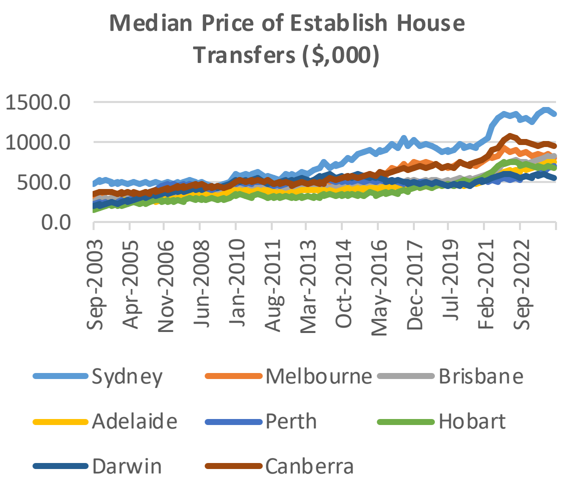



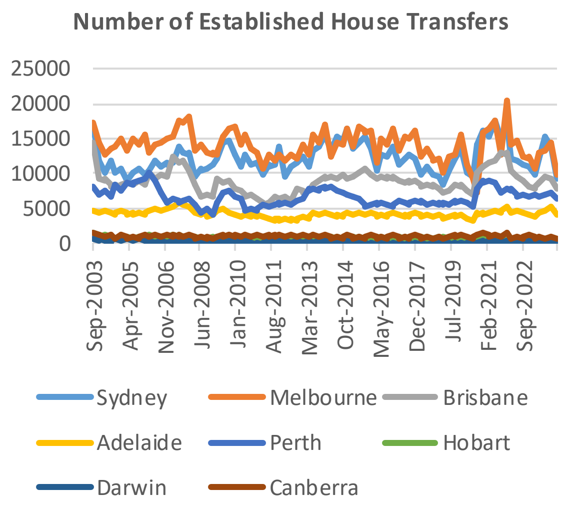
We believe sustained strength in Australian residential property prices are likely contributing to the *wealth effect* and supporting headline consumer spending in the economy.

Tight supply (notably low Dwelling Commencements & Completions) coupled with strong demand (strong net migration) are overshadowing higher borrowing and construction/maintenance costs.

Strong rental growth is helping property investors to alleviate the pressures of rising ownership costs - albeit within established housing markets, buying activity is still dominated by owner occupiers. New data is suggesting some reprieve is incoming for renters with Bloomberg's Mohsen Crofts noting private-sector residential vacancies could rise to 8.5% by December 2025 from a record low of 7% in June 2023.

The aforementioned conditions are driving sustained tightness in housing supply as detailed by the significant variance in establish house transfers relative to the average back to September 2003.




| Median Price of Established House Transfers | | | | | | | | |
|---|---|---|---|---|---|---|---|---|
| **City** | **Sydney** | **Melbourne** | **Brisbane** | **Adelaide** | **Perth** | **Hobart** | **Darwin** | **Canberra** |
| **Mar-20** | $ 947,500.00 | $730,000.00 | $540,000.00 | $472,000.00 | $477,500.00 | $529,000.00 | $470,000.00 | $720,500.00 |
| **Current (Mar 24)** | $1,350,000.00 | $810,000.00 | $842,000.00 | $765,000.00 | $700,000.00 | $691,000.00 | $550,000.00 | $951,800.00 |

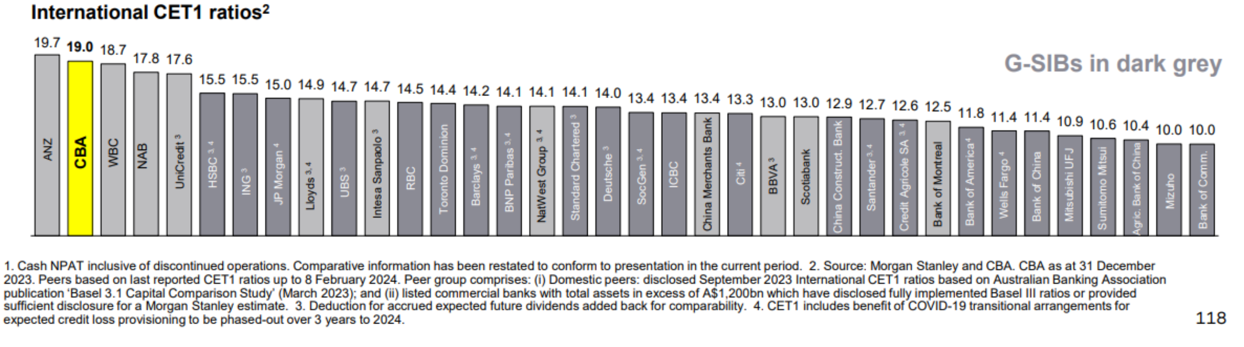
| Number of Established House Transfers | | | | | | | | |
|---|---|---|---|---|---|---|---|---|
| **City** | **Sydney** | **Melbourne** | **Brisbane** | **Adelaide** | **Perth** | **Hobart** | **Darwin** | **Canberra** |
| **Average** | 12242.28 | 14033.52 | 8919.75 | 4350.54 | 6705.30 | 900.23 | 377.02 | 1129.05 |
| **Current (Mar 24)** | 9254 | 9913 | 7815 | 4131 | 6377 | 398 | 271 | 580 |
| **Variance to Avg.** | -24% | -29% | -12% | -5% | -5% | -56% | -28% | -49% |

# Tactical Asset Allocation

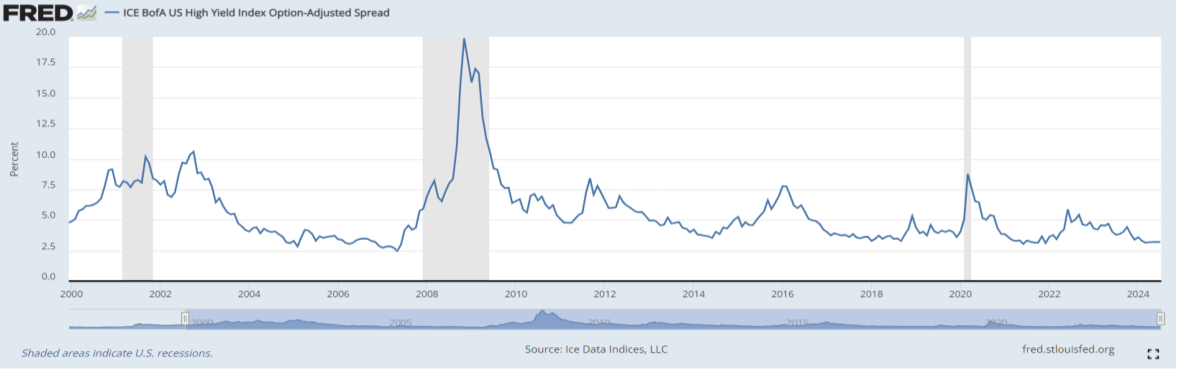
Looking ahead, we encourage investors to maintain a dynamic asset allocation framework to facilitate risk adjusted navigation of the turbulent economic environment expected to continue.

With our baseline expectation lending credence to a high-for-longer monetary policy environment,  we maintain a favourable outlook on defensive assets with a sustained overweight allocation to floating rate exposures. The rate of change in the interest rate market in recent years has presented selective opportunities within fixed rate exposure, and while we retain an underweight allocation to duration, view staging allocations to fixed rate bonds into portfolios as appropriate at current levels.

Domestically, our major financial institutions appear well capitalised relative to global peers  - refer to CBA's global capital position comparison in their most recent half yearly report below. It is our opinion that our domestic financials retain adequate liquidity buffers should economic conditions deteriorate. Our position on foreign exchange movements further supports our domestic fixed interest exposure preference. With this in mind - **we encourage overweight domestic fixed interest exposure, at the expense of international fixed interest allocations.**



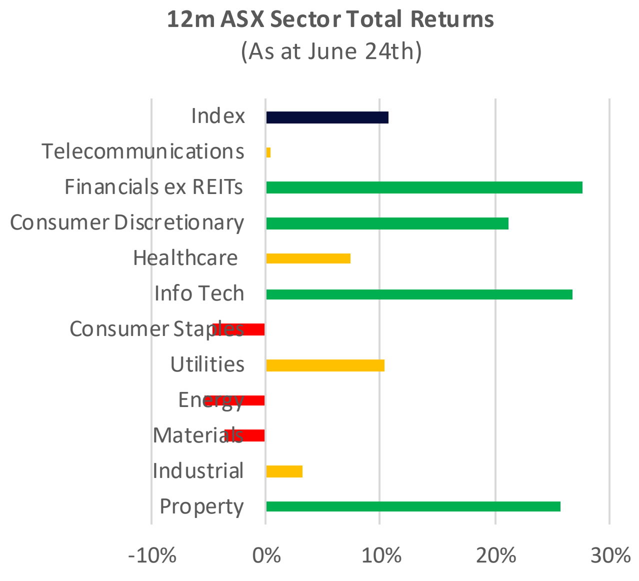

**We encourage investors to avoid high yield credit** (specifically US HYC) with credit spreads inadequately reflecting the risks to corporate defaults. We continue to view upside to the US credit spread which as you can see below – remains historically tight.

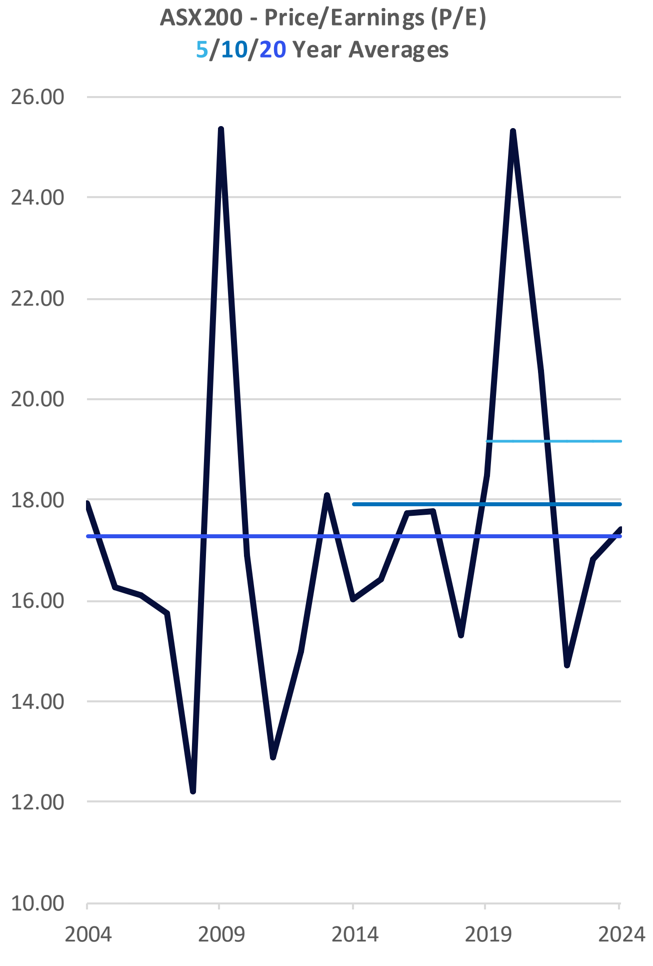


Australian listed Property had a strong FY24, generating a total return of 25.672% for the 12 months to the 24th June 2024. This return profile was only outperformed by ASX listed Information Technology and Financials over the same period. **While we acknowledge the sustained risk profile of the asset class with pockets of the sector still likely to experience material capital declines as NAVs are negatively revised, we view parts of the market as attractive investment opportunities at current levels.**

We continue to view turbulence in the fixed interest outlook as a headwind for the sector with interest expenses unlikely to moderate in the near term. This will drive ongoing risk to distribution profiles. We favour exposures with low levels of gearing (Goodman Group, Dexus Industrial & Australian Unity Office Fund) as well as select specialised providers that retain long duration, defensive tenant profiles (HealthCo Healthcare & Wellness REIT and Waypoint REIT). With ongoing volatility expected in the space throughout the oncoming FY25, we view diversified exposures as appropriate with a preference to Vanguard's Australian Property Securities Index ETF (VAP) and Resolutions Capital's Global Property Sector ETF (RCAP) for international listed property exposure.

We encourage an overweight allocation to Australian equities, however, encourage active management - with headline index performance expected to be muted for the year ahead. Per consensus expectations, the index should see EPS growth of less than 1% for the oncoming 12 months. With the current Market P/E of 17.4x being within range of long-term averages we expect to see little to no growth at an index level in the coming 12 months, and in turn deem active management as critical for the oncoming period. We detail our preferred Australian equity exposures below.

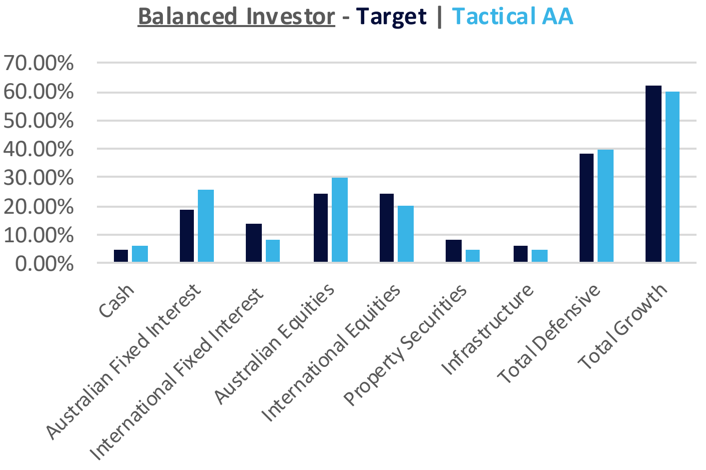


International equity exposure presents an interesting investment conundrum. While it is undeniable the major providers (namely the mega-cap US Technology players) will continue to play a pivotal role in global capital markets, especially as the rollout of Artificial Intelligence intensifies and expands globally - we believe valuations are towards the top end of acceptable ranges. **Earnings may very well continue to grow and justify these lofty current valuations - however we increasingly encourage caution with pricing suggesting these growth rates are all but in the price…we don't agree with this confidence.** While we acknowledge the risks associated with current valuations we believe pockets of international markets are presenting compelling value at current levels. In an environment of multiple compression and downside risk to earnings, **we view active management within this asset class as critical.**

We view the impending **US presidential election as a key point of focus for the year ahead**. While over the longer term, there is minimal difference between left- or right-wing governing parties (from a market performance perspective), we view the unique character that is Donald Trump as an entirely different circumstance. Should Trump secure victory (the expectation of the market)– from a high level, we should see softer regulation, lower taxes and strong EPS tailwinds for US corporations, per his prior term. He would also however likely stoke current geopolitical tension and accentuate 'deglobalization' trends.

We are **increasing exposure to small-mid cap global quality allocations** as we anticipate breadth to return to historically concentrated Indices. While acknowledging the risks within Emerging Markets should a softer global economy ensue, **we view a softening USD as constructive for EM.** We favour Asian exposure at current levels with China presenting as the most attractively priced major global index. Our blended Equity Risk Premium and Price/Earnings model indicates the headline **Hang Seng to be ~14% undervalued at current levels.**




| Investment Sector | Tactical Positioning |
|---|---|
| Cash | +1.00% |
| Australian Fixed Interest | +7.00% |
| International Fixed Interest | -6.00% |
| Total Defensive | +2.00% |
| Australian Equities | +6.00% |
| International Equities | -4.00% |
| Property Securities | -3.00% |
| Infrastructure | -1.00% |
| Total Growth | -2.00% |

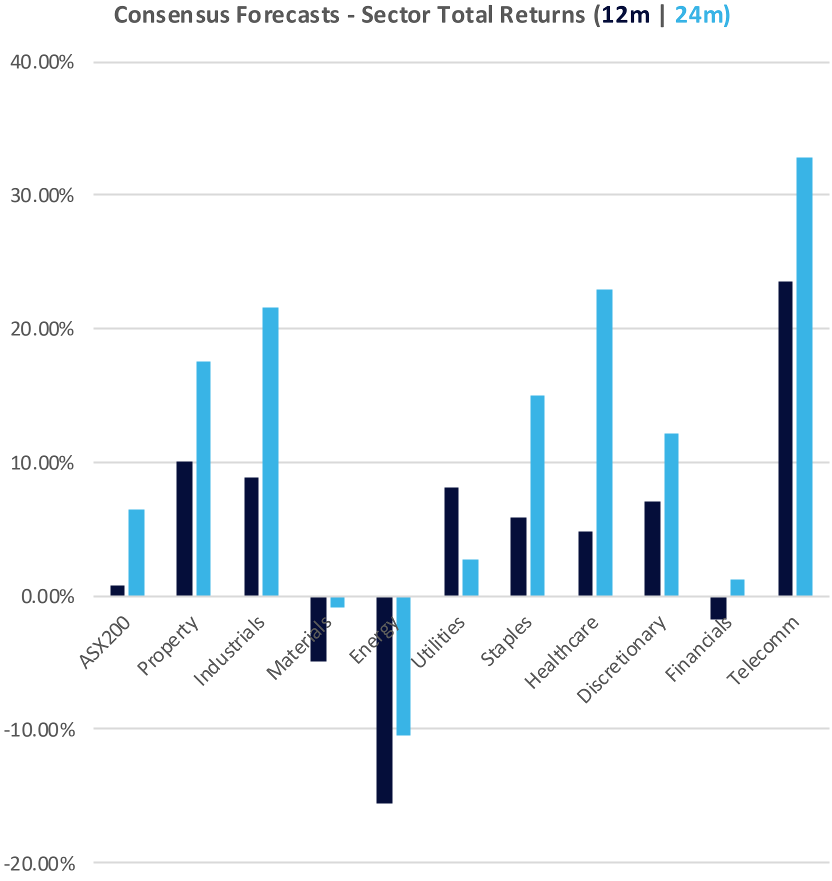

# ASX Outlook

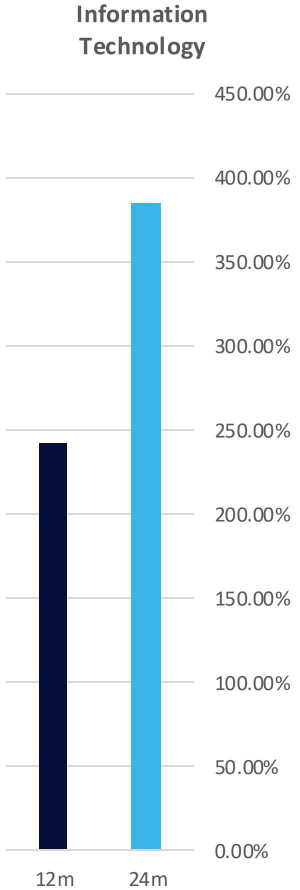
*Taking a look at the domestic market and detailing our preferred equity exposures for the year ahead.*

# Investment Strategy

At current levels, we see the ASX200 as fairly valued - trading within a 1% range of our blended Equity Risk Premium and Price/Earnings fair value of 7,854. Looking ahead, the market expects minimal earnings growth throughout FY25 with consensus expecting 0.8% EPS growth for the index over the period.

Taking a closer look at specific sectors, it is clear the market is anticipating declining EPS among Energy & Commodity producers and strong gains posted by IT, Utilities, Property and Discretionary Retailers. Financials are expected to be moderately down.



Our view reflects a far more favourable outlook for Energy and Commodity producers albeit acknowledging the reliance on external forces - namely the Chinese economic recovery and the energy supply environment dictated by OPEC as well as ongoing geo-political conflict. Our key sector picks include Woodside Energy (WDS), Newmont Mining (NEM) and BHP Group (BHP). We also view medium term value in Whitehaven Coal (WHC) following recent supply disruptions with the metallurgical coal sector.

Conversely, we are actively encouraging underweight positions to discretionary retailers with a preference towards staples among consumer exposed allocations. With this in mind, we are actively trimming exposure to Bunnings operator & local conglomerate - Wesfarmers (WES) and establishing a position in Australia's largest grocer Woolworths (WOW) and continue to recommend Coles (COL). While we continue to view WES as the market's premium retailer and a core position within portfolios, the recent rally in WES's share price and our expectation for a softening discretionary consumer environment provokes our aforementioned shift within consumer facing allocations.

We view mature, profitable, healthcare names as attractively valued with a favourable view of the defensive earnings profile within the sector. CSL Limited (CSL), ResMed (RMD) and Sonic Healthcare (SHL) make up our preferred exposures in the space.

Although we do not retain the same level of confidence in the broad industrials sector relative market expectations, we view pockets of the sector as attractive at current levels. Our preferred exposure within the sector is ALS Limited (ALQ) as we expect the company's geo-chemistry segment to drive outperformance in the coming period coupled with margin expansion in the companies life sciences division.

While we have previously acknowledged the preference to retain domestic, financial institution fixed interest exposure, we view equity exposure to the sector as less appealing. We anticipate greater than expected declines to EPS to trigger selling pressure within the sector, further compounded by a contraction to historically high earnings multiples among the major bank peer group. We maintain an underweight position and are actively taking profits in the world's most expensive major bank - Commonwealth Bank (CBA).

With upside risk to interest rates baked into our base case, we encourage limiting exposure to utilities. Pending the beginning of the cutting cycle, we favour APA group (APA) as our preferred infrastructure exposure.

We are less positive relative to the market in our domestic Information Technology, and Telecommunications sectors and in turn, recommend taking profits in data centre beneficiary NextDC (NXT), and despite recent selling, recommend avoiding any allocation to Australia's perpetual disappointment - Telstra (TLS).

| Energy & Materials | Healthcare | Consumer | Industrials |
| --- | --- | --- | --- |
| BHP | CSL | coles | ALS |
| Newmont | Sonic Healthcare | Woolworths | |
| Whitehaven Coal | ResMed | | |
| Woodside | | | |

# Investment View

**Defensive**

With our view suggesting a high-for-longer monetary environment, we view an overweight allocation to defensive assets as appropriate. Our preferred exposure is domestic fixed interest due to greater risk adjusted return profiles relative to global alternatives. We continue to favour floating rate exposure however believe cautiously adding duration into portfolios as appropriate at this point in the cycle. We are actively avoiding High yield credit with spreads inadequately compensating investors for the rising risk of defaults.

**Growth**

We believe now is the time for active management. With muted headline returns expected - minimal to no earnings growth and downside risk to multiples, we encourage investors to be dynamic in their capital allocation in the oncoming periods.

While we acknowledge value to be emerging in parts of the listed property market, we continue to observe downside risk to NAV's and medium term upside risk to interest expenses to weigh on distributions in the coming 12 months.

Defensive sectors within equity allocations are preferred in the current environment with a keen interest in select Staples and Healthcare names. Domestic energy and commodity producers in our view present attractive hedges against engrained inflation (& stagflation) with upside risk to spot pricing as the USD weakens throughout the FY.

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