December 2024

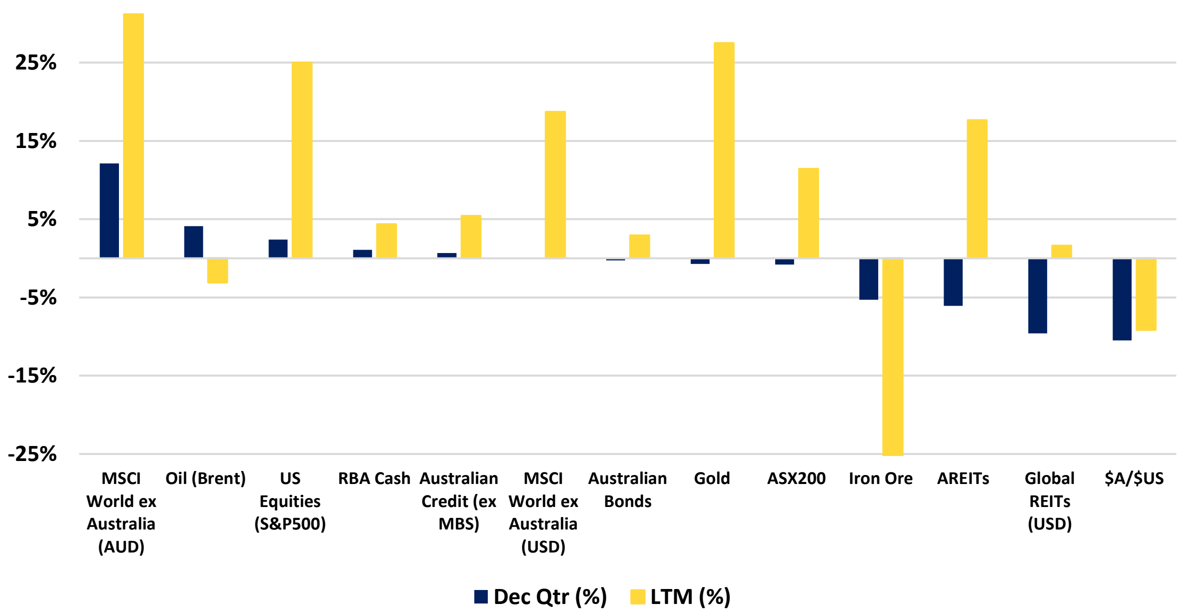
QUARTERLY SUMMARY

MARKET SUMMARY

KEY POINTS

- 2024 provided strong equity market gains, but the December quarter was more mixed – Overall equity market returns in 2024 were strong with the ASX200 rising 11.4% and MSCI World ex Aust index gaining 31.2% (in AUD terms). Returns in the December quarter were more mixed, however. Markets have moved to price in the new US President and policies which are likely inflationary in nature.
    - In local currency, the ASX200 (-0.8%) underperformed the Japanese Nikkei 225 (+5.2%), US S&P500 (+2.1%) and UK FTSE 100 (-0.8%) during the quarter but outperformed MSCI Europe (-3.6%), Emerging Markets (-4.2%) and Asia-Pacific ex Japan (-8%).
    - The MSCI World ex Australia was flat in USD terms but rose 12% in Australian dollar terms.
    - The property (AREIT) sector (-6%) was rocked by higher bond yields.
- Bonds fell as yields moved higher – The Bloomberg AusBond Composite 0+Y index dipped 0.3%. Australian 10-Year bond yields rose 39bps to 4.36%, while US 10-Year bond yields soared 79bps to 4.57% as strong US economic data, increased inflation expectations and a more hawkish Fed saw markets reprice expectations for less rate cuts in 2025. US government debt concerns added to the sell-off in US bonds as investors seek a higher premium to hold US treasuries. Australian credit markets rose 0.67%.
- Commodities – Commodity price moves were once again divergent.
    - Natural gas (+24%), alumina (+20%), Lithium (+9%) and oil (+4.1%) performed strongly.
    - Thermal Coal (-13.7%), Base metals (-8.7%), iron ore (-5.3%) and precious metals (-3.2%) lagged.

Asset class performance - December Qtr and Last 12 months (LTM)



Source: Equity Trustees

- **Global economic activity: Trump Trade has influenced markets** – The Trump victory has had a meaningful impact on markets. The Trump policies of tax cuts, tariffs, deregulation, and border protection have been seen as pro-US, equity market friendly but inflationary.
  - The USD strengthened throughout the quarter against all major currencies.
  - The US economy has remained resilient relative to expectations and US corporates have continued to announce robust results relative to expectations.
  - The US Federal Reserve cut rates in late September, November, and December (to 4.25-4.5%) – but at their last meeting implied there would be less rate cuts in 2025 than originally forecast.
  - The Chinese economy started to see some signs of stabilisation later in the year after continued stimulus announcements, however consumption and real estate investment remains weak. Many remain sceptical of a near term sustainable rebound and deflation remains a risk. US tariffs remain the key swing factor and are likely to influence future domestic policy announcements.
- **Australian Economy showing divergent trends between public and private sectors** – The RBA held cash rates at 4.35% throughout the quarter.
  - Inflation remains a little too strong for the RBA's liking and employment remains strong. The latest unemployment rate reading fell to 3.9%.
  - However, GDP is weak outside of the public sector. Investors have been pushing out the first rate cut toward May rather than February.
  - The Australian dollar (AUD/USD) sank 10.5% over the quarter to 61.88c impacted by a strong US dollar and weaker local and Chinese economy.

AFLPA PRA PORTFOLIO PERFORMANCE – AS AT 31 DECEMBER 2024

The investment objective of the AFLPA PRA is to maximise the net (after fees and taxes) earnings of the funds at the acceptable level of risk, having particular regard to protecting the long-term capital value of the investments. The assets of the AFLPA are managed as 4 individual sub funds with each of the sub funds having their own individual investment objectives and associated investment strategy.

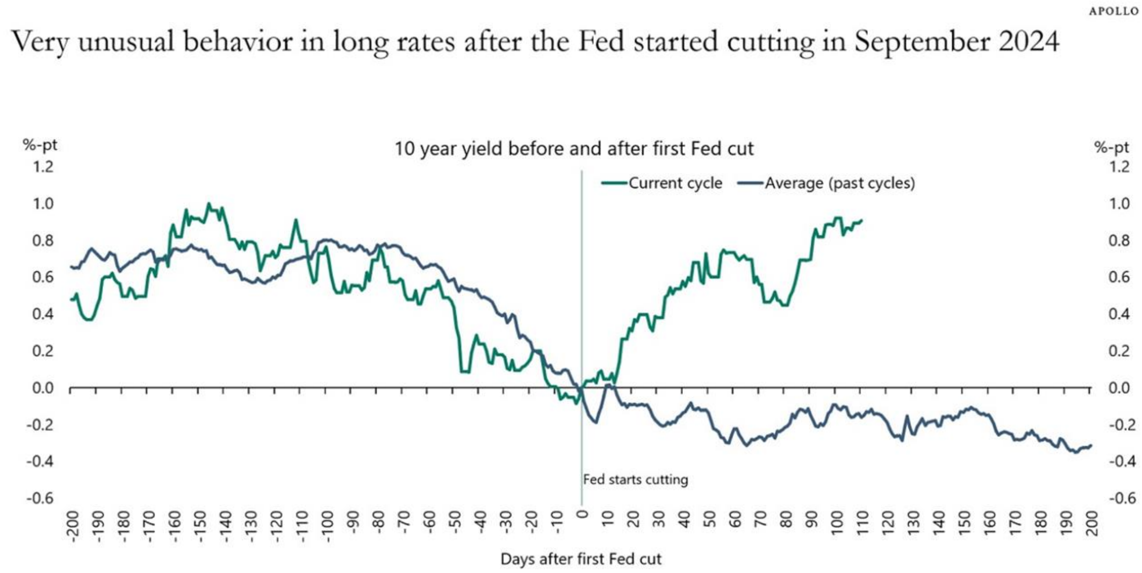
	3 Months	1 Year	3 Year (p.a.)	Since Inception (p.a.)	Inception Date
AFLPA Conservative Option[1,2]	0.4%	7.1%	3.2%	4.8%	31/08/2012
CPI + 1%[3,4]	0.5%	3.8%	6.1%	3.7%	
AFLPA Balanced Option[1,2]	0.9%	9.6%	3.3%	4.9%	31/08/2016
CPI + 2.5%[3,4]	0.8%	5.3%	7.6%	5.5%	
AFLPA Growth Option[1,2]	2.4%	12.1%	4.9%	8.4%	31/08/2012
CPI + 4%[3,4]	1.2%	6.8%	9.1%	6.7%	
AFLPA High Growth Option[1,2]	3.2%	15.5%	4.9%	8.5%	31/08/2013
CPI + 4.5%[3,4]	1.3%	7.3%	9.6%	7.2%	

[1]EQT AM commenced management of the AFLPA PRA from 1st May 2022
[2]For periods prior to 1st May 2022, the performance is based on data provided to EQT by previous investment managers
[3]CPI related benchmarks are based off the current AFLPA investment objectives for each strategy
[4]CPI is on a one period lag

OUTLOOK

Overall, investment returns for growth assets in 2024 were very strong, led by strength in the US economy and ongoing market leadership of the "Magnificent 7" technology stocks. Equity markets rallied as the odds of a soft-landing scenario increased with ongoing resilience in US consumer demand, solid productivity gains and moderating inflation being supported by interest rate cuts by the US Federal Reserve.

We expect US GDP growth to slow but remain resilient supported by Trump's pro-growth agenda and interest rate cuts. Markets in the December quarter moved to price in the new US President's stated policies and arguably protectionist agenda. While this saw equity markets initially rally, the US Dollar has also strengthened considerably, and bond yields have soared (despite the US Fed entering a rate cutting cycle) highlighting concerns that the new policies will be inflationary. The US Federal Reserve now only expects rates will be cut twice in 2025. Trump 2.0 policies are likely to be market friendly overall, it will also arguably be a period of greater policy volatility and uncertainty.



Higher bond yields led to equity markets retracing in the final weeks of December and will remain a cap to US equities in the face of unchanged or lower growth expectations. US equity market earnings growth should remain supported in the near term by ongoing strength in Mega-technology company earnings and a broadening of growth in the market as interest rate cuts feed through the economy.

While US growth has been resilient and may remain supported by lower taxes, increased deregulation and fiscal spending, growth in other major countries is less positive. European growth is subdued, while the Chinese have faced a two-speed economy with solid exports and manufacturing activity offset by depressed domestic demand and a subdued property market. Policy stimulus is yet to have a major impact on growth and the threat of increased US tariffs remains a key risk.

In Australia, outside of the public sector, domestic conditions remain weak. Additionally, a weakening Chinese economy remains a headwind. We expect GDP growth to remain at or below 2% in CY25 as the lagged impact of higher interest rates and weakening consumer spending continues to bite. We believe unemployment will edge higher towards 4.5% and inflation to moderate. We forecast the RBA to cut rates by between 25 to 50bp (ie 0.25-5%) but remain on slightly restrictive settings compared to "neutral rates" of 3.5%.

Earnings growth for the ASX200 in CY25 is forecast to rise ~4% on CY24 as interest rate cuts support economic growth, however earnings have consistently been downgraded over the last 12 months. The Australian market will remain heavily influenced by:

1) the banking sector which has re-rated to elevated valuation levels;

2) industrial companies which will need to offset cost increases in the face of a weak consumer (those with exposure to the US consumer, pricing power and USD earnings will be better placed); and

3) soft commodity prices impacting on resource company earnings should substantial extra Chinese stimulus not be deployed.

Our current tactical asset allocation views are to hold a modest underweight to growth assets offset by a modest overweight in defensive assets.

Equities – we remain modestly underweight equity markets as we believe the market is pricing in an already optimistic view of the path ahead. Elevated valuations leave little scope for adverse surprise or disappointment. The relative valuation appeal to bonds is also not as attractive as it has been in recent years.

- **Australian equities** - While portfolio holdings are all assessed on our fundamentally driven Quality at a Reasonable Price (QARP) process we carry a preferred exposure to select industrials over banks and resources. The Australian equity market is trading moderately expensive at 18x price-earnings (PE) ratio, well ahead of long-term averages particularly given relatively low near-term earnings growth. In our view this leaves little buffer to absorb adverse developments. The current income yield on Australian equities is ~3.5% (pre grossing up for franking credits) – again well below historic levels.

- **International equities** – While aggregate market valuations are above historic levels and leave little room for further re-rating, expectations are for solid earnings growth (~10%). The commencement of Central bank rate cuts has helped sentiment; however we believe the slower and shallower rate cutting cycle will prove a headwind to equities.

Fixed Income – We believe the outlook for Fixed Income returns looks reasonable as yields are at more sustainable levels and provide a degree of income support and diversification for clients wishing to moderate portfolio volatility. We see bonds as slightly cheap and offering improved income returns. At current bond yields we believe fixed income can deliver a 4.75% total return over the next 12 months with a range of returns between 2.5% to 7.5%.

Credit – The running yield on Australian listed credit is currently attractive. The asset class is supported by broadly supportive economic conditions and relatively conservative corporate gearing. Most new issues remain well received by credit investors. We forecast listed credit will likely return 6-7% across CY25.

Cash – Returns from Cash have been steady. Assuming the RBA target cash rate averages 4% next year, we can expect the EQT Cash Management Fund to deliver an average gross return of circa. 4.5%. Should the economy weaken considerably, then cash offers strong defensive characteristics.

We continue to note that while macro factors are important, in more challenging economic conditions it is beneficial to focus on basic micro factors as to what makes a good business and investment. We believe that active management in the right areas can contribute to strong overall returns.