MARKET COMMENTARY – December 2024

Quarter-End Commentary

Overview

- Numerous declines were evident across major equity Indexes over the quarter with pockets of positive returns across various sectors and countries.
- Bonds mostly following suit in negative territory after a quarter where bonds had their second-best quarterly return in over two decades.
- Australia's economy is seeing a tight labour market delaying monetary policy easing, yet cooling wage growth will provide the RBA some comfort noting 'sticky wages are not entrenched'.
- Inflation is moderating, but the RBA's preferred 'trimmed mean' measure is still above target at 3.5% year on year as of September 2024.

Asset class recap to end of December 2024

Australian shares

Australian shares had a slightly negative quarter, with the S&P/ASX200 accumulation index returning -0.80% for Q4 2024 however, the 12-month number returned a strong +11.44%. Financials proved to be the strongest sector for Q4, returning +5.86%. This was followed by Industrials (+3.19%) and Telecommunication Services (+2.96%). The largest negative returns over the quarter were seen in Materials, A-REITs and Energy with –11.75%, –6.09% and –5.33% respectively.

Global shares

The MSCI World Ex-Australia NR Index returned +1.98% over the quarter in local currency terms, with the 12-month return coming in at +21.22%. In Australian dollar terms, quarterly and annual returns were +12.12% and +31.18%, respectively, as the AUD declined against most major currencies during Q4.

In developed markets, Consumer Discretionary led the way with double digit returns +11.01% over the quarter. Communication Services closely followed with +7.85% and Financials with +7.08%. The remaining sectors all produced negative returns with Materials -10.56% and Health Care -9.43% leading the declines over the quarter. On the emerging markets front, it was a tough quarter for all sectors with Information Technology being the only sector producing positive returns with +5.98%. Double-digit negative returns included Materials (-14.29%), Consumer Discretionary (-12.77%), Energy (-10.82%) and Utilities (-10.25%). However, this should be considered against 12-month returns still in the black, with the exceptions being Materials (-13.69%) and a distant second Consumer Staples with a -4.36% decline for the period.

This document is issued by Morningstar Investment Management Australia Limited (ABN 54 071 808 501, AFS Licence No. 228986) ('Morningstar'). © Copyright of this document is owned by Morningstar and any related bodies corporate that are involved in the document's creation. As such the document, or any part of it, should not be copied, reproduced, scanned or embodied in any other document or distributed to another party without the prior written consent of Morningstar. The information provided is for general use only. In compiling this document, Morningstar has relied on information and data supplied by third parties including information providers (such as Standard and Poor's, MSCI, Barclays, FTSE). Whilst all reasonable care has been taken to ensure the accuracy of information provided, neither Morningstar nor its third parties accept responsibility for any inaccuracy or for investment decisions or any other actions taken by any person on the basis or context of the information included. Past performance is not a reliable indicator of future performance. Morningstar does not guarantee the performance of any investment or the return of capital. Morningstar warns that (a) Morningstar has not considered any individual person's objectives, financial situation or particular needs, and (b) individuals should seek advice and consider whether the advice is appropriate in light of their goals, objectives and current situation. Refer to our Financial Services Guide (FSG) for more information at morningstarinvestments.com.au/fsg. Before making any decision about whether to invest in a financial product, individuals should obtain and consider the disclosure document. For a copy of the relevant disclosure document, please contact our Adviser Solutions Team on 1800 951 999.

Bonds

With many central banks starting to ease monetary policy globally and yields increasing, fixed interest assets, in general, suffered. The Bloomberg AusBond Composite 0+Y TR AUD index was down -0.26% for the quarter. Similarly, the Bloomberg Global Aggregate TR Hdg AUD index saw a negative return of -1.22% for the quarter.

Global property & infrastructure

Domestic listed property saw negative returns for the quarter of -6.09%, alongside global property (-7.56%). Listed global infrastructure was relatively flat with a return of +0.95% for Q4, however the 12-month number remains strong at +17.57%.

This document is issued by Morningstar Investment Management Australia Limited (ABN 54 071 808 501, AFS Licence No. 228986) ('Morningstar'). © Copyright of this document is owned by Morningstar and any related bodies corporate that are involved in the document's creation. As such the document, or any part of it, should not be copied, reproduced, scanned or embodied in any other document or distributed to another party without the prior written consent of Morningstar. The information provided is for general use only. In compiling this document, Morningstar has relied on information and data supplied by third parties including information providers (such as Standard and Poor's, MSCI, Barclays, FTSE). Whilst all reasonable care has been taken to ensure the accuracy of information provided, neither Morningstar nor its third parties accept responsibility for any inaccuracy or for investment decisions or any other actions taken by any person on the basis or context of the information included. Past performance is not a reliable indicator of future performance. Morningstar does not guarantee the performance of any investment or the return of capital. Morningstar warns that (a) Morningstar has not considered any individual person's objectives, financial situation or particular needs, and (b) individuals should seek advice and consider whether the advice is appropriate in light of their goals, objectives and current situation. Refer to our Financial Services Guide (FSG) for more information at morningstarinvestments.com.au/fsg. Before making any decision about whether to invest in a financial product, individuals should obtain and consider the disclosure document. For a copy of the relevant disclosure document, please contact our Adviser Solutions Team on 1800 951 999.

MARKET COMMENTARY – December 2024

Market outlook

Although the S&P/ASX 200 TR AUD ended the last quarter for 2024 in slightly negative territory (-0.80%), directionally the market moved higher over the course of the year with its 1-year return of 11.44%. On an unweighted basis, Morningstar's coverage traded 8% above fair value on Dec. 6 when the S&P/ASX 200 index reached a record high of 8,495. While considering this "overvalued" territory, the premium not deemed to be extreme. We've seen valuations at such levels 40% of the time over the past 10 years.

Since the presidential election, our equity market has largely mirrored the US, with the S&P 500 and S&P/ASX 200 up roughly 4%. Trump has promised corporate tax cuts and deregulation, so the US rally is understandable. It's harder to see how our economy stands to benefit from Trump's America-first, anti-China agenda.

Granted, pockets of our market may emerge winners. Companies with US-based supply chains and operations, such as BlueScope, James Hardie, and Pro Medicus, look like the more obvious candidates. But the bigger question lies with the iron ore miners—BHP, Rio Tinto, and Fortescue—which account for roughly 15% of the S&P/ASX 200 index. Their fortunes are inextricably linked to China's prospects.

The Chinese economy, already struggling before the US election, could come under more pressure if another trade war breaks out. If China's growth slows, so too would steel production, driven largely by demand from the domestic construction sector. The market seems unfazed, with iron ore holding at roughly USD 105 per metric ton since the election, well above our midcycle assumption of USD 70.

Economic outlook

Looking forward, a new year always brings new predictions. If you own a cellphone or TV, it's impossible not to engage with market forecasts. Predictions, though ubiquitous, often miss the mark, as they are well-intentioned but usually amount to nothing more than just guess work.

For instance, the average year-end S&P 500 price target last year among 20 Wall Street strategists was 4,861, with the most optimistic forecast at 5,400.

Where did the S&P 500 close last year? At 5,881—21% above the average estimate and 10% higher than even the most bullish estimate. No one came close. This is only one example of why our investing belief system emphasizes process over predictions. Good investment outcomes require time—often much longer than a single calendar year. Our focus remains on decisions that will influence portfolios in the coming years, not just the next 12 months.

As we consider starting valuations—together with our belief that the price you pay for an asset plays a prominent role in long-term investment returns—our most reasonable view is that defensiveness should likely play a more prominent role in portfolios compared to recent years.

This document is issued by Morningstar Investment Management Australia Limited (ABN 54 071 808 501, AFS Licence No. 228986) ('Morningstar'). © Copyright of this document is owned by Morningstar and any related bodies corporate that are involved in the document's creation. As such the document, or any part of it, should not be copied, reproduced, scanned or embodied in any other document or distributed to another party without the prior written consent of Morningstar. The information provided is for general use only. In compiling this document, Morningstar has relied on information and data supplied by third parties including information providers (such as Standard and Poor's, MSCI, Barclays, FTSE). Whilst all reasonable care has been taken to ensure the accuracy of information provided, neither Morningstar nor its third parties accept responsibility for any inaccuracy or for investment decisions or any other actions taken by any person on the basis or context of the information included. Past performance is not a reliable indicator of future performance. Morningstar does not guarantee the performance of any investment or the return of capital. Morningstar warns that (a) Morningstar has not considered any individual person's objectives, financial situation or particular needs, and (b) individuals should seek advice and consider whether the advice is appropriate in light of their goals, objectives and current situation. Refer to our Financial Services Guide (FSG) for more information at morningstarinvestments.com.au/fsg. Before making any decision about whether to invest in a financial product, individuals should obtain and consider the disclosure document. For a copy of the relevant disclosure document, please contact our Adviser Solutions Team on 1800 951 999.

While valuations are not a timing tool, they offer insight into the expectations embedded in prices. In short, the bar is set exceptionally high for US large caps but less so for other asset classes. We believe this should inform investor thinking about how they position portfolios in the years ahead.

The road ahead will be fraught with risks. Among the most cited are:

- US equity valuations that provide little room for error.
- The potential impact of tariffs on businesses.
- Uncertainty surrounding a new administration in Washington.

These are some of the known risks that investors are already thinking about, yet there are always unanticipated developments as well. We believe a diversified, valuation-driven strategy remains the most effective approach to navigate any uncertainty, whether known or unexpected. By focusing on what can be controlled and maintaining discipline, investors can position themselves to face many shades of challenge the year ahead may bring.

Growth vs. Value

The big growth stocks returned to form in the fourth quarter, following a brief respite in the third quarter. The Morningstar US Growth Index notched a quarterly gain of 6.3%, compared with a 2.2% loss for the Morningstar US Value Index. Of the four US sectors that had positive returns, three were the traditional growth sectors (communication services, technology, and consumer discretionary). Although financials also had a positive quarter, all other sectors were in the red—and that included the normally defensive healthcare and consumer-staples sectors. For 2024, the growth index finished with a 23.4% return, versus a considerably smaller 13.8% gain for the value index.

Large vs. Small

Although US small-cap stocks had shown glimmers of strength in the third quarter, they lagged larger stocks in the fourth quarter, buoyed by gains in big-cap growth names. The Morningstar US Small Cap Index was roughly flat, with a 0.3% return, while the Morningstar US Large Cap Index recorded a 3.3% gain. For the year, the small-cap index delivered a 10.8% return, well behind the 27.9% return of the large-cap index.

This document is issued by Morningstar Investment Management Australia Limited (ABN 54 071 808 501, AFS Licence No. 228986) ('Morningstar'). © Copyright of this document is owned by Morningstar and any related bodies corporate that are involved in the document's creation. As such the document, or any part of it, should not be copied, reproduced, scanned or embodied in any other document or distributed to another party without the prior written consent of Morningstar. The information provided is for general use only. In compiling this document, Morningstar has relied on information and data supplied by third parties including information providers (such as Standard and Poor's, MSCI, Barclays, FTSE). Whilst all reasonable care has been taken to ensure the accuracy of information provided, neither Morningstar nor its third parties accept responsibility for any inaccuracy or for investment decisions or any other actions taken by any person on the basis or context of the information included. Past performance is not a reliable indicator of future performance. Morningstar does not guarantee the performance of any investment or the return of capital. Morningstar warns that (a) Morningstar has not considered any individual person's objectives, financial situation or particular needs, and (b) individuals should seek advice and consider whether the advice is appropriate in light of their goals, objectives and current situation. Refer to our Financial Services Guide (FSG) for more information at morningstarinvestments.com.au/fsg. Before making any decision about whether to invest in a financial product, individuals should obtain and consider the disclosure document. For a copy of the relevant disclosure document, please contact our Adviser Solutions Team on 1800 951 999.