StanfordBrown Private Wealth

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Investment Markets Report

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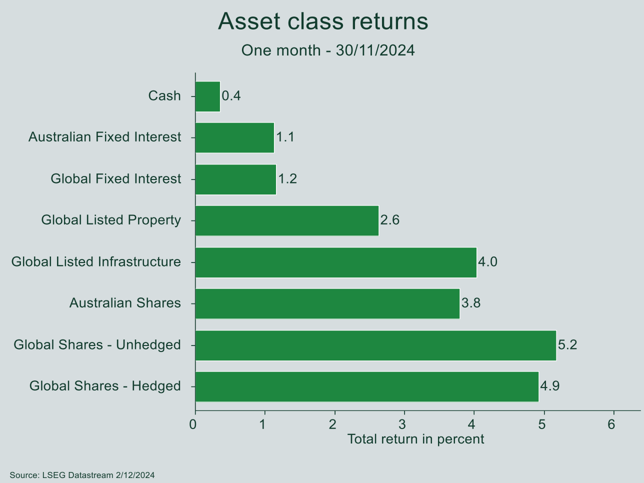
Our investment office unpacks what happened in the past month, current tactical positioning and what this means for our portfolio weightings to different asset classes.

What's changed in November?

November was a strong month for financial markets with US equities surging after the US election results prompted investors to upgrade their outlook for the US economy and corporate earnings. European and emerging market shares underperformed the US market, due to expectations that President-elect Trump would introduce tariffs that could hurt these economies. Expectations of higher US tariffs and greater monetary policy divergence between the US and its trading partners saw the US Dollar strengthen further.

EXECUTIVE SUMMARY

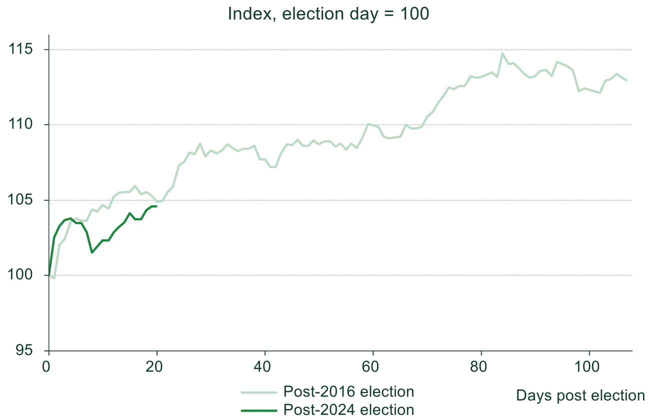
- In currency-hedged terms, developed market equities (MSCI World ex-Australia) returned 4.9% in November. The US equity market (S&P 500) was up 5.9% and Australian shares (S&P/ASX 200) gained 3.8%. European shares (STOXX 600) rose 1.2% and emerging market shares (MSCI Emerging Markets) fell 2.7%.
- 10-year government bond yields declined 9 basis points (bps) in the US, 15bps in Australia, 20bps in the UK, 30bps in Germany, while they rose 10bps in Japan.
- Investment-grade corporate bond spreads in the US narrowed by 3bps to 83bps over US treasuries while US high yield bond spreads fell by 14bps to 274bps.
- The Australian Dollar fell 0.4 US cents to US$0.6515.
- Oil prices fell 1.9% to US$68.26 per barrel (WTI). Gold rose 4.0% to US$2,734 per troy ounce. Iron ore prices fell 3.4% to US$103.78 per tonne.



Tactical Positioning

The election of Donald Trump as the 47th US President, along with the Republican sweep of Congress, drove further rises in US equities as investors have priced in a more favourable regulatory, tax and economic environment. The initial stock market moves have been similar to the equity market reaction that followed the 2016 election. If the new Trump administration focusses on boosting growth as well as cutting regulation and tax, there is a good chance that US economic exceptionalism can continue over the next few years. However, as we have seen previously, President Trump thrives on being unpredictable and recent threats to lift tariffs on Canada, Mexico, China and other countries serve as caution that the range of economic and market outcomes has widened.

US S&P 500 following Trump election



Source: LSEG Datastream 3/12/2024

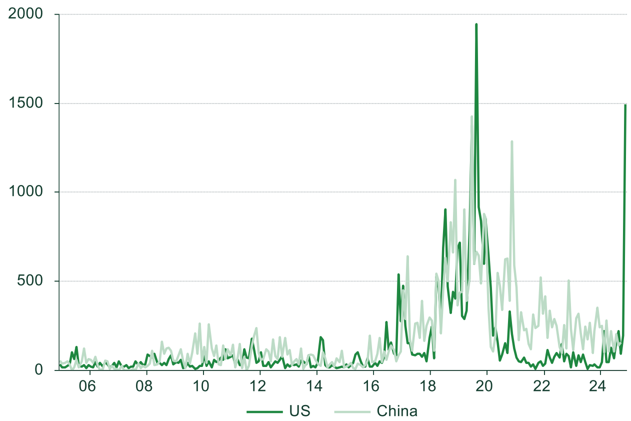
The early market reaction to the US election result suggests that investors are discounting chances of a major trade war, viewing tariff threats as part of Trump's negotiating tactics. Likewise, threats to deport millions of undocumented migrants is not being priced in by financial markets, given the massive cost and complexity of such an operation, as well as the impact on major industries such as agriculture, construction and food services which employ high numbers of migrants. If these threats are implemented, US inflation could rise, and growth slow, which would be at odds with promises of cost-of-living relief and a stronger economy that helped get Trump elected.

In our view even though the US election result widens the range of possible economic outcomes for the world's major economies it does not materially alter current economic trends over the near term. As we have discussed previously, in most major economies unemployment remains low, inflation is falling, interest rates are generally coming down and consumer purchasing power is improving after four years of decline. Unless there is a major trade war, we expect global growth continues to show a high degree of resilience, which is the consensus view in markets.

After two strong years for equity returns, share market valuation metrics are very high, particularly in the US and Australia, but less so in other regions. In our view, this does create a speed limit on returns for the year ahead and any gains are more likely to come from earnings growth than from increases in valuation multiples. As we discussed last month, the outlook is for corporate earnings to continue growing strongly in 2025, particularly in the US.

Following last month's portfolio changes, we continue to recommend a modest overweight to global shares funded by an underweight exposure in more defensive listed infrastructure. We are also maintaining a marginally higher exposure to US equities and global small companies. However, we remain mindful that the range of policy, economic and market outcomes is now wider than before the US election. In an environment with higher valuations as the starting point, and more trade policy uncertainty, we continue to like portfolio hedges in the form of longer-dated government bonds, non-correlated alternative investments and unhedged currency exposures that can buffer portfolios if we see greater downside equity volatility.

Trade policy uncertainty index



Source: LSEG Datastream 3/12/2024

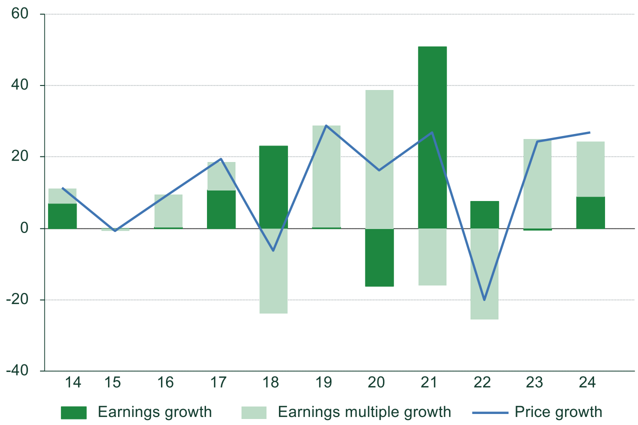
EQUITIES:

Equity markets continue to make new highs with the US S&P 500 index on track for two years in a row of 20%+ annual increases, something that has only happened four times in the past 100 years. The strong rise has been attributable to better-than-expected economic growth, strong earnings growth from the heavyweight tech stocks, falling inflation, declining interest rates and strong buying of equities and bonds from wealthier households sitting on excess cash accumulated during the pandemic.

Looking forward, we expect that equities can continue to push higher, helped by the same drivers as outlined above as well as fresh buyback activity from corporates due to falling interest rates and greater CEO confidence in the outlook. Lower US regulation should also help lift mergers and acquisitions activity, which has been subdued in recent years, and benefit sectors such as banks and energy companies.

Within equities we expect that the Magnificent Seven (Apple, Amazon, Microsoft, Tesla, Alphabet, Nvidia and Meta) will continue to grow earnings more strongly than the rest of the market. However, the degree of price outperformance will likely fade as the earnings growth of these companies slows while smaller company earnings accelerate. We also expect the US to continue to outperform other equity markets, particularly if trade policy uncertainty weighs on stocks in Europe, Japan and Asia ex-Japan.

S&P 500 source of returns



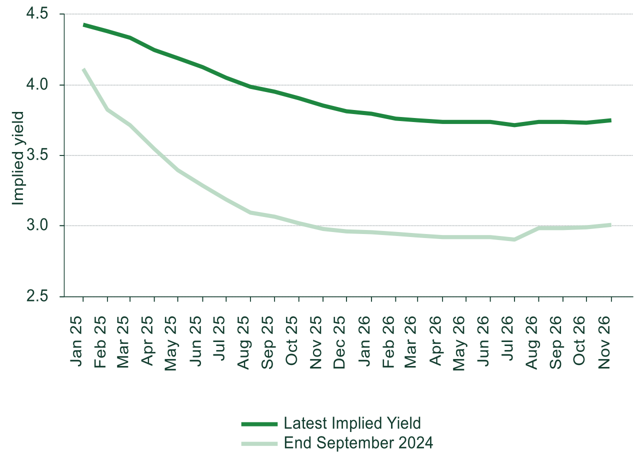
Source: LSEG Datastream 3/12/2024

The Australian equity market, with high valuations and lower earnings growth, remains less attractive than international share markets. It does, however, provide some optionality if global growth is stronger, if China stimulate its economy further in response to US tariffs or if the RBA unexpectedly cuts rates in early 2025. Local Australian companies with offshore earnings could also benefit from a weaker Australian Dollar that may accompany higher tariffs in the US.

FIXED INCOME:

Inflation has continued to decline globally, and the bond market expects that central banks will cut interest rates to less restrictive levels in 2025, assuming there is no sign that inflation is trending higher again. Although the easy wins in bringing inflation down are mostly behind us investors are more likely to focus on unemployment and global trade policy than inflation risks over the next few months.

US Fed Funds Rate Futures Curves

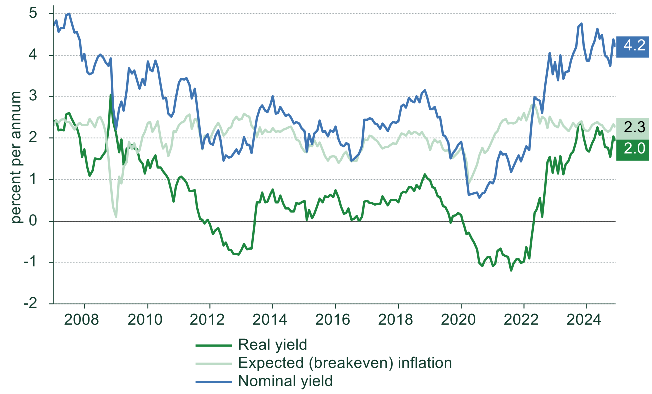


Source: LSEG Datastream 4/12/2024

The recent steepening of the yield curves, due to better economic data and forecasts of rising budget deficits, means that longer-dated bonds provide a more attractive real yield and 'term premium' relative to short term bonds and cash. We are happy to maintain a neutral weighting in Australian and Global Debt and around 5-6 years of interest rate duration.

US yields and inflation breakevens

10-year treasury bonds



Source: LSEG Datastream 4/12/2024

PROPERTY AND REAL ASSETS:

With declining inflation, a better growth outlook and prospects that longer-term bond yields remain close to current levels, then barring a growth shock, the need to hold real asset such as property and infrastructure is lower. We are therefore comfortable maintaining a moderate underweight to listed infrastructure.

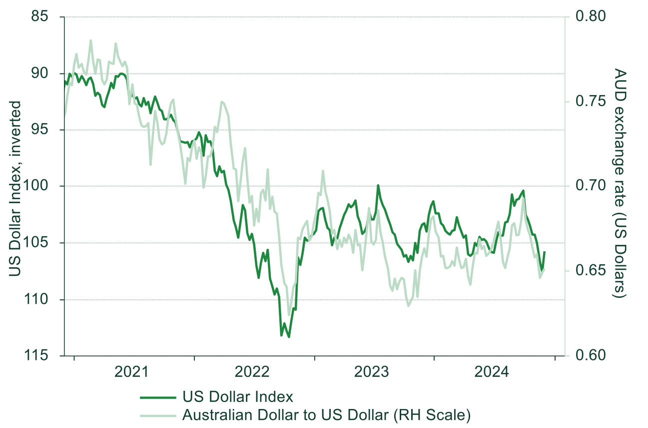
ALTERNATIVE ASSETS:

Liquid alternative assets gained 0.8% in November (HFRX Global Hedge Fund Index) with Macro/CTA funds and equity long short funds the best performers. Event driven funds posted small losses over the month. We remain neutral in alternative assets.

CURRENCY:

The Australian Dollar fell marginally in November following the US election result. The US Dollar has been appreciating as investors factored in possible US tariff and inflation increases and fewer rate cuts which strengthened the greenback. We are remaining currency unhedged in Global Shares.

US Dollar and Australian Dollar



Source: LSEG Datastream 4/12/2024

Current Balanced portfolio positioning summary

ASSET CLASS	POSITIONING	VIEW
Cash	Neutral	Cash rates are likely at their peak, but it's difficult to see rate cuts until at least February 2025 and there is a risk that rates stay higher for longer.
Australian Debt	Neutral	Retain a neutral weighting with interest rate duration close to benchmark of around five years. Longer term yields are more attractive, and risks are evenly balanced given cash rates are at their cyclical peak. Credit is generally expensive, but some local sub-sectors still offer relative value.
Global Debt	Neutral	Hold a neutral weighting with interest duration close to benchmark of around six to seven years. Bonds should provide a stronger offset to equities now that inflation has declined. Credit spreads are ultra low relative to history, as default rates stay contained. Credit is correlated with equities, which are similarly expensive by historical standards.
Alternative Defensive	Neutral	Alternative strategies generally benefit from higher base interest rates as cash is used as collateral to secure derivatives and short positions. These strategies have held up relatively well when more traditional defensive strategies, tied to interest rates and the credit outlook, have suffered.
Property & Real Assets	Underweight	Retain an underweight exposure to listed infrastructure given the strong recent performance due to investor enthusiasm for companies that can benefit from data centre energy demand, which we think will take a long time to play out. There are also headwinds from falling inflation and higher bond yields that favour more cyclical assets such as real estate where we continue to recommend a neutral weighting.
Alternative Growth	Neutral	Alternative growth strategies benefit from higher price volatility and dispersion with returns less correlated to broader risk sentiment. Trend-following strategies can often provide insurance-like characteristics by capturing downtrends and uptrends in prices of bonds, equities, commodities, and currencies and are lowly-correlated with risk assets.
Australian Shares	Neutral	The earnings outlook is relatively muted due to soft profit growth for banks. Equity valuations are above average relative to history, but the more cyclical nature of the market means that it could perform relatively well, particularly if Chinese fiscal stimulus can support the construction and infrastructure sectors as it has historically. Remain neutral for now.
Global Shares	Overweight	The improving global economic and corporate earnings backdrop and falling offshore interest rates should drive equities higher if earnings growth forecasts remain intact. Retain a modest overweight in Global Shares with a preference for US equities and more cyclically-sensitive small and mid-sized companies.
Currency hedging	Fully unhedged	The US Dollar has been strengthening due to stronger growth and fears about US tariff increases. Prefer to remain currency unhedged in Global Shares as a source of additional portfolio diversification as the Australian Dollar tends to move in line with global investor sentiment.

Strategic Asset Allocation (SAA) and Dynamic Asset Allocation (DAA) weights

PORTFOLIO	CONSERVATIVE		MODERATE		BALANCED		GROWTH		HIGH GROWTH	
ASSET CLASS	SAA	DAA	SAA	DAA	SAA	DAA	SAA	DAA	SAA	DAA
Defensive Assets	70.0	70.0	50.0	50.0	35.0	35.0	20.0	20.0	5.0	5.0
Cash	15.0	15.0	10.0	10.0	5.0	5.0	2.5	2.5	2.5	2.5
Australian Debt	20.0	20.0	10.0	10.0	5.0	5.0	0	0	0	0
Global Debt	30.0	30.0	25.0	25.0	20.0	20.0	15.0	15.0	0	0
Alternative Defensive	5.0	5.0	5.0	5.0	5.0	5.0	2.5	2.5	2.5	2.5
Growth Assets	30.0	30.0	50.0	50.0	65.0	65.0	80.0	80.0	95.0	95.0
Property & Real Assets	5.0	2.5	7.5	5.0	10.0	7.5	10.0	7.5	10.0	7.5
Alternative Growth	5.0	5.0	7.5	7.5	10.0	10.0	7.5	7.5	7.5	7.5
Australian Shares	5.0	5.0	15.0	15.0	20.0	20.0	25.0	25.0	25.0	25.0
Global Shares	15.0	17.5	20.0	22.5	25.0	27.5	37.5	40.0	52.5	55.0
Total	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0

Major Financial Markets

To 30 November 2024	Latest	1 month	3 month	Year-to-date	1 year	3 year	5 year
Equities	Local currency returns including dividends in percentage, not annualised						
Australia - S&P/ ASX 200	8436	3.8	5.5	15.1	23.4	31.5	51.8
Japan - Nikkei 225	38208	-2.2	-0.5	16.1	16.2	57.1	43.3
US - S&P 500	6032	5.9	7.2	28.1	33.9	35.8	107.9
US - NASDAQ Composite	19218	6.3	8.7	28.9	36.1	24.7	130.7
UK - FTSE 100	8287	2.6	-0.4	11.1	15.4	30.6	35.2
Europe - STOXX 600	510	1.2	-2.4	10.0	14.2	20.3	45.4
Developed Markets - MSCI World	2998	4.9	5.6	23.9	29.1	32.4	88.3
Emerging Markets - MSCI EM	67334	-2.7	-0.1	12.3	15.9	6.0	33.0
Government bond yields	Change in annual yield in percentage points						
Australia - 2 year	3.98	-0.08	0.36	0.27	-0.13	3.63	3.28
Australia -10 year	4.36	-0.15	0.39	0.40	-0.03	2.63	3.33
US - 2 year	4.18	0.01	0.25	-0.07	-0.53	3.65	2.57
US - 10 year	4.19	-0.09	0.28	0.33	-0.15	2.75	2.42
UK - 10 year	4.25	-0.20	0.23	0.71	0.07	3.44	3.55
Germany -10 year	2.09	-0.30	-0.20	0.06	-0.36	2.43	2.44
Currencies and Commodities	Change in price						
Australian Dollar (US$)	0.6515	-0.004	-0.027	-0.031	-0.012	-0.058	-0.025
US Dollar Index	105.74	1.76	4.04	4.40	2.24	9.75	7.47
Gold (US$/ounce)	2640.85	-93.30	127.50	572.19	605.40	836.45	1180.70
Iron Ore (US$/tonne)	105.31	1.53	4.76	-34.61	-25.82	2.78	19.30
Crude oil (WTI, US$/barrel)	69.03	-0.55	-5.49	-2.86	-6.58	2.85	13.86

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