StanfordBrown Private Wealth

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Investment Markets Report

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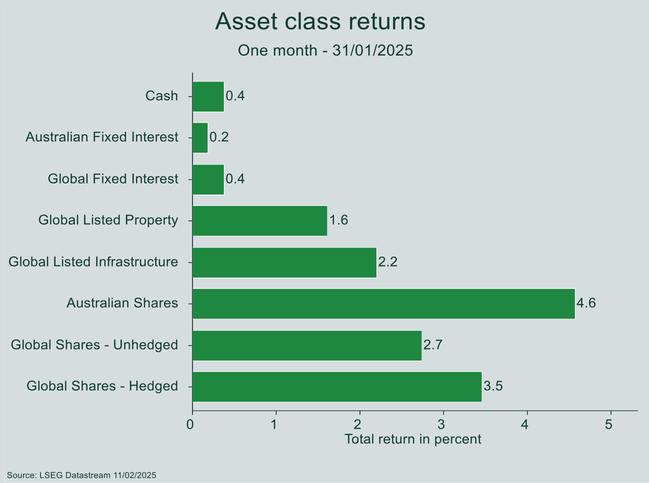
Our investment office unpacks what happened in the past month, current tactical positioning and what this means for our portfolio weightings to different asset classes.

What's changed in January?

January was a reasonable month for equity markets as investors initially gained comfort when President Trump did not follow through on his promise to impose tariffs on his first day in office (20th January). This helped boost European shares which outperformed the US given the greater impact of tariffs on European companies. Bond yields and currencies were little changed over the month as economic data and central bank decisions contained few surprises.

EXECUTIVE SUMMARY

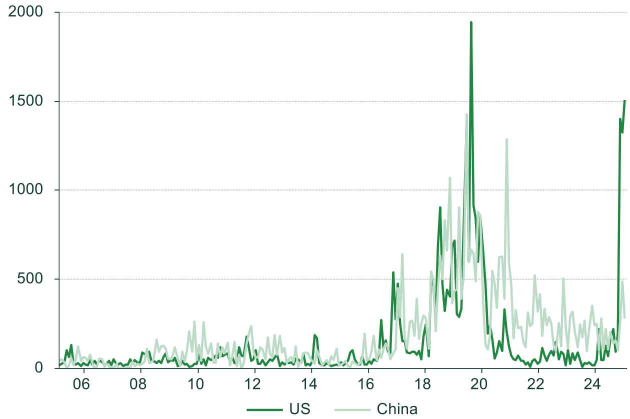
- In currency-hedged terms, developed market equities (MSCI World ex-Australia) returned 3.5% in January. The US equity market (S&P 500) was up 2.8% and Australian shares (S&P/ASX 200) gained 4.6%. European shares (STOXX 600) rose 6.4% and emerging market shares (MSCI Emerging Markets) rose 1.6%.
- 10-year government bond yields declined 3 basis points (bps) in the US, 4bps in Australia, 3bps in the UK while they rose 10bps in Germany and 16bps in Japan.
- Investment-grade corporate bond spreads in the US were steady at 82bps over US treasuries, while US high yield bond spreads fell by 24bps to 268bps.
- The Australian Dollar rose 0.5 US cents to US$0.6238.
- Oil prices fell 0.6% to US$72.84 per barrel (WTI). Gold rose 7.6% to US$2,812 per troy ounce. Iron ore prices rose 4.6% to US$105.78 per tonne.



Tactical Positioning

January provided a taste of some of the risks and themes we wrote about in the 2025 Investment Outlook, specifically *Trump 2.0* and *Artificial Intelligence* (AI). Investors initially took comfort that Trump did not follow through with his threat to impose tariffs on his first day in office and that Scott Bessent, his new US Treasury Secretary, would be market friendly focussed on boosting GDP growth, ramping US oil production and lowering the budget deficit. However, in early February we were reminded that Trump thrives on creating uncertainty with a range of tariff and other policy announcements that in some cases were paused or reversed within days.

Trade policy uncertainty index



Source: LSEG Datastream 11/02/2025

January also saw the emergence of another disruptor, Chinese AI model DeepSeek, costing just a fraction of models from US tech heavyweights with investors again questioning whether the hundreds of billions in AI spending is wasted. Despite the headlines about Trump and DeepSeek, markets have largely ignored the noise and focussed on longer term fundamentals which continue to point to healthy economic and corporate earnings growth, particularly in the US.

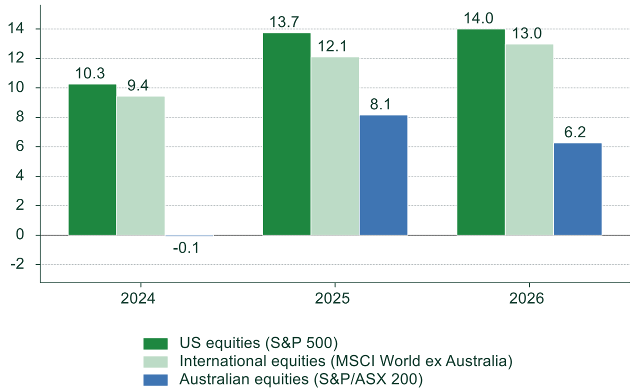
Economic data continues to support our view that US economic exceptionalism is likely to continue for now. Consumer spending and employment remain strong and although inflation has declined to 2.8% (core PCE inflation), it is likely to take some time before it returns to the 2% level targeted by the Federal Reserve, particularly if new widespread tariffs are passed onto consumers. All this has seen the bond market price only another one to two US rate cuts this year with the first cut not fully priced until September.

We continue to take the view that low double-digit earnings growth for global equities should be sufficient to generate positive equity returns in 2025, barring some unforeseen event that alters the growth outlook or dents investor sentiment. That said, with elevated valuation multiples, lower growth rates from the largest technology companies, fewer interest rate cuts and greater policy uncertainty, another year of 20%+ returns from global equities is less likely in our view.

We continue to retain neutral allocations in growth and defensive assets with a modest overweight to global shares offset by an underweight in infrastructure. To protect portfolios from equity volatility, we continue to like portfolio diversifiers in the form of longer-dated government bonds, where the real yield and term premium above cash is more attractive than previously. We also like uncorrelated alternative investments and unhedged currency exposures that can buffer portfolios if we see greater equity volatility.

Earnings per share growth estimates

per cent year-on-year change



Source: LSEG Datastream 11/02/2025

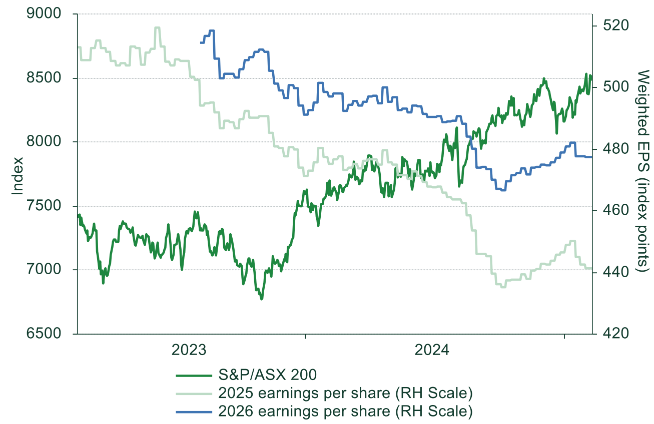
EQUITIES:

US earnings reporting season has so far produced reasonably good results with 12% year-on-year growth which is the strongest annual growth rate since the post-pandemic earnings recovery in late 2021/early 2022. While some of the strong growth is attributable to the Magnificent Seven, the median S&P 500 company grew earnings by a healthy 7%. The outperformance of the largest seven companies over the 493 other companies in the index, in terms of earnings growth and share price returns, continues to narrow and is forecast to fall further over the next couple of years.

Despite the slowing growth of the Magnificent Seven and question marks around their large weighting in US equity market indices, as technology companies (outside Apple and Tesla) they are somewhat immune from tariffs and trade wars and their structural growth makes them relatively defensive. Their 'safe' structural growth characteristics is one of the factors that may be supporting elevated valuation ratios.

In 2025, the Magnificent Seven are planning to spend a record US$330 billion on new investments, largely in datacentres and computing equipment. Although the release of DeepSeek has many questioning whether these investments will translate into future incremental profits, in their recent quarterly reports many of these companies have suggested that they are currently being constrained by a lack of computing resources to meet demand for cloud computing and AI.

S&P/ASX 200 and earnings forecasts



Source: LSEG Datastream 11/02/2025

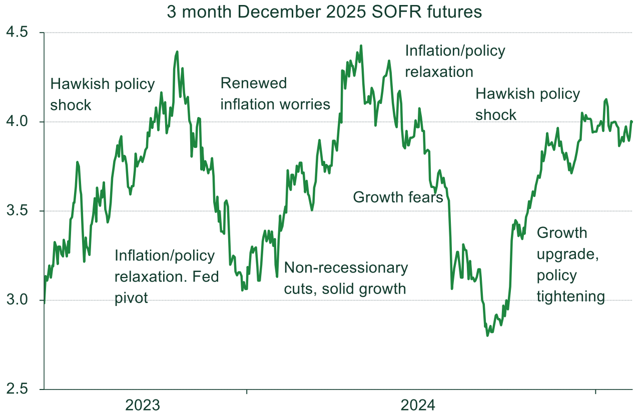
The Australian equity market, with high valuations and lower earnings growth, remains less attractive than international share markets. However, as we head into the February reporting season, fewer Australian companies have pre-announced earnings downgrades this year. The 10% fall in the Australian Dollar has likely helped, given around 50% of S&P/ASX 200 earnings come from offshore. We expect management teams will be somewhat cautious with any guidance for 2025 full-year earnings given elevated uncertainty over tariffs and the upcoming Federal election notwithstanding likely rate cuts over coming months.

FIXED INCOME:

Inflation continues to moderate slowly, but sticky services and housing inflation is preventing it from fully returning to major central bank targets of around 2%. Low unemployment, housing shortages and improving consumer spending power is likely to mean that inflation remains a little higher than target over the short to medium term. Tariff uncertainty is also complicating the interest rate outlook with some central banks citing this as a reason to keep rates on hold or not provide forward guidance pending greater clarity on the growth and inflation outlook.

Fed pricing - growth and inflation/policy worries

3 month December 2025 SOFR futures



Source: LSEG Datastream 11/02/2025

Fewer rate cuts and rising budget deficits means that longer-dated bonds now provide more attractive real yields and 'term premium' relative to cash. While the new US Department of Government Efficiency is trying to reduce government spending, the reality is that most spending is on health, defence and social security as well as (rapid increasing) interest expenses which can't be easily slashed and higher term premia are likely to remain embedded in longer dated yields. We maintain a neutral weighting in Australian and Global Debt.

US 10-year Treasury bond

ACM term premium

Source: LSEG Datastream 11/02/2025

PROPERTY AND REAL ASSETS:

With lower inflation, a better growth outlook and prospects that longer-term bond yields remain close to current levels, the need to hold more defensive real assets such as property and infrastructure is lower. We maintain a moderate underweight to infrastructure.

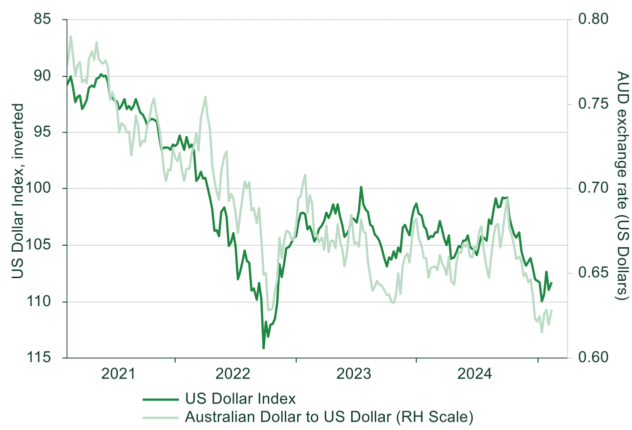
ALTERNATIVE ASSETS:

Liquid alternative assets gained 1.0% in January (HFRX Global Hedge Fund Index) with equity long short funds the best performing sector. Macro and trend-following funds posted small losses over the month. We remain neutral in alternative assets.

CURRENCY:

The Australian Dollar recovered marginally in January, after hitting its lowest level since the March 2020 pandemic selloff. The US Dollar has been supported by strong economic growth, higher rate outlook and safe-haven status that kicks in when there is uncertainty. We are remaining currency unhedged in Global Shares.

US Dollar and Australian Dollar



Source: LSEG Datastream 11/02/2025

Current Balanced portfolio positioning summary

ASSET CLASS	POSITIONING	VIEW
Cash	Neutral	Cash rates are likely to be cut in coming months, however, we expect the rate-cutting cycle to be relatively shallow given the RBA's estimate of neutral interest rates is around 3.5%.
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 likely to decline this year. 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 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. We continue to recommend a neutral weighting in real estate.
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 and there is a high degree of uncertainty due to the upcoming Federal election and potential for a trade war which could impact Chinese demand for commodities. Continue to hold a neutral allocation.
Global Shares	Overweight	The improving global economic and corporate earnings backdrop 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 31 January 2025	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	8532	4.6	5.1	4.6	15.2	38.4	51.5
Japan - Nikkei 225	39572	-0.8	1.4	-0.8	11.0	57.1	43.3
US - S&P 500	6041	2.8	6.2	2.8	26.4	40.8	102.6
US - NASDAQ Composite	19627	1.7	8.7	1.7	30.4	42.7	123.1
UK - FTSE 100	8674	6.2	7.6	6.2	18.0	28.7	42.7
Europe - STOXX 600	540	6.4	7.1	6.4	14.8	28.5	52.6
Developed Markets - MSCI World	3038	3.5	6.5	3.5	23.6	38.3	87.3
Emerging Markets - MSCI EM	69034	1.6	0.1	1.6	19.7	10.8	33.8
Government bond yields	Change in annual yield in percentage points						
Australia - 2 year	3.82	-0.10	-0.23	-0.10	0.09	2.91	3.16
Australia -10 year	4.43	-0.04	-0.08	-0.04	0.38	2.53	3.46
US - 2 year	4.20	-0.04	0.03	-0.04	-0.03	3.03	2.87
US - 10 year	4.55	-0.03	0.26	-0.03	0.60	2.77	3.03
UK - 10 year	4.54	-0.03	0.09	-0.03	0.74	3.23	4.01
Germany -10 year	2.46	0.10	0.07	0.10	0.30	2.45	2.90
Currencies and Commodities	Change in price						
Australian Dollar (US$)	0.6238	0.005	-0.031	0.005	-0.037	-0.081	-0.046
US Dollar Index	108.37	-0.12	4.39	-0.12	5.10	11.83	10.98
Gold (US$/ounce)	2812.05	198.25	77.90	198.25	758.80	1016.80	1227.85
Iron Ore (US$/tonne)	105.78	4.67	2.00	4.67	-24.79	-32.26	24.43
Crude oil (WTI, US$/barrel)	72.84	0.40	3.26	0.40	-3.44	-15.31	21.28

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