A challenging outlook for Australia

Lower growth and higher inflation than our peers?

Core Offerings

Our latest view of markets and insights into our latest strategic and tactical asset allocation positions

October 2024

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A challenging outlook for Australia

Lower growth and higher inflation than our peers?

AN UPDATE FROM LGT CRESTONE'S CHIEF INVESTMENT OFFICE

Scott Haslem
Chief Investment Officer

"It was the best of times, it was the worst of times". Sure, comparing Australia's outlook to the period of the French Revolution is both a stretch and an overstatement. Still, at its most simplistic level, the duality of human experience that Charles Dickens was speaking to (and which may persist in Australia over the next few years) has some similarities. As an economy, our weak productivity tells a tale of a lack of reform and rising inefficiency. The conflict between monetary and fiscal policy may well deliver a mix of sub-trend growth and higher inflation than our peers. And the disruption to our past sources of growth (housing and China) may rend economic strain. Slower-than-expected rate cuts may also have the potential to extend the current contrast in lived experience between borrowers and savers.

In this month's *Core Offerings*, we look at the likely path for Australia's growth, inflation, and interest rates over the coming year or so. While recession will likely be avoided and inflation should moderate further, the mix of growth and inflation may disappoint. There is also the risk that interest rates may be slower to fall. For markets, return drivers may have more to do with income than 'animal spirits', and higher yielding defensive assets may outperform the prior growth engines of the equity market. In contrast, we note improved dynamism (both on the policy and economic front) overseas, as the US Federal Reserve (Fed) joins the global rate-cutting cycle, as it attempts to stick a soft landing. This month we increase our tactical equities overweight to reflect this supportive outlook.

"It was the best of times, it was the worst of times, it was the age of wisdom, it was the age of foolishness, it was the epoch of belief, it was the epoch of incredulity, it was the season of Light, it was the season of Darkness, it was the spring of hope, it was the winter of despair...".

Charles Dickens

Where is our growth coming from?

Recent data suggest Australia's economy is approaching 'stall speed'. Annualised growth in H1 2024 was a mere 0.8% against an historic trend pace nearer 2.5% (and resilient US H1 growth annualising near 3.0%). Excluding the pandemic, the year to mid-2024 was the weakest financial year for growth since the recession of 1991/92. With growth in the population estimated to be running at 2.3%, we are also clearly in a per capita recession (now for a year and a half), with growth and spending 'per person' in decline.

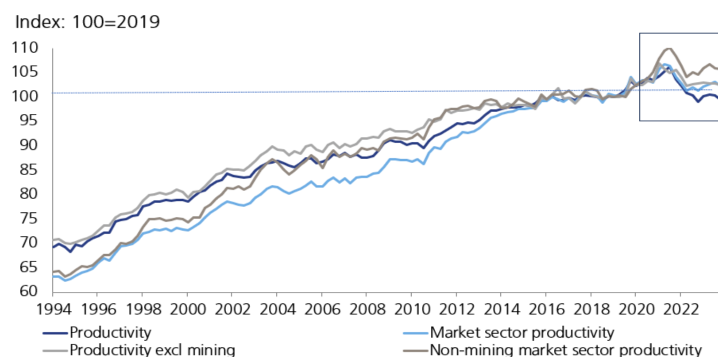
Moreover, most of that growth is coming from government consumption (up 1.4% over the past year), led by spending on benefit programs for health services. According to Tim Hext from Pendal, "this remains a major source of strength for employment and inflation, and is central to the current animated debate between Treasurer Chalmers and the Reserve Bank of Australia (RBA)" on who's to blame for Australia's sticky inflation (with core at 3.4% in August, compared to the mid-2% for most of our peers who are already trimming policy rates). Elsewhere, consumer demand fell in Q2, and is up a tepid 0.5% over the past year, dwelling activity is 3.0% below a year ago, while business investment has slowed from 10.1% a year ago to just 2.5%. Growth in our exports has also slowed from almost 8% a year ago to 'flat' in mid-2024 on weaker resources and rural export volumes.

"Productivity [is] the key determinant of living standards and the economy's overall competitiveness. At the moment, it is a centrepiece of the debate about interest rates as the economy stalls but inflation remains persistent."

Barrenjoey Research
September 2024

Ironically, the US economy is delivering faster growth and lower inflation than Australia. One of the key differentiators is its stronger productivity growth at around 3%, compared with ours at closer to zero. As Barrenjoey Research notes, "productivity sets the pace of sustainable trend growth", together with population and participation. Further, Barrenjoey notes that in the current cycle "the public sector drag on productivity growth is sizeable" due to zero or negative productivity within the sector, that is also growing in size. Declining productivity is also generating higher unit labour costs (real costs of labour to businesses), underpinning higher service sector inflation, impacting equity return on investment.

Is Australia's productivity stalling?



Source: Australian Bureau of Statistics, Macrobond, Barrenjoey Research.

The 'worst of times' is likely behind the consumer…lagged rate cuts are a headwind

As noted, real consumer spending is up just 0.5% over the past year. In light of 2.3% population growth, demand per person is now falling. Moreover, the mix of that spending has swung sharply to items that inevitably fit into the 'un-fun' basket, notably essentials like housing costs, utilities, and health, where spending has risen 1.3%, versus discretionary items (including clothing, cars, and recreation), which are down 0.5%.

Arguably, the 'worst of times' may be behind the consumer, given interest rates have likely peaked…

And like elsewhere globally, there have crudely been two types of consumers. Savers (who have benefited from higher interest income) and borrowers, who have faced challenges with greater cost of living pressures. Ongoing (or greater) spending by savers has likely supported demand (and corporate pricing power), delaying the path to lower interest rates.

…but fiscal easing may also keep the RBA on the sidelines for longer, pressuring those with the greatest ability to accelerate the economy's growth.

But arguably, the 'worst of times' may be behind the consumer, given interest rates have peaked and the RBA has at least indicated sympathy to current market pricing for modest rate reductions from early 2025. Recent reporting season feedback from retailers also suggests trading conditions in early Q3 have improved, most likely on the back of the significant (cumulative) 1 July fiscal easing via the prior government's stage-three tax cuts and the current government's 'cost-of-living' relief (and solid minimum wage increases).

This boost to household income, according to UBS and CBA, should help (real) consumer spending pick up from around 1% on average in 2024 to a little under 2% in 2025. This largely 'fiscal' boost (notwithstanding some likely modest rate cuts through 2025) is likely to go a long way to mitigating the risk of recession for Australia in the period ahead.

But it may also keep the RBA on the sidelines for longer, relegating Australia to a more sluggish growth outlook by shifting the balance of consumer 'support' more toward fiscal stimulus (and higher average rates) and away from the arguably more powerful impact of greater rate cuts that would benefit those facing the greatest cost-of-living pressures (and the greatest likelihood to accelerate consumption). This may explain why forecasts for 2025 consumption are well below the 3% trend pace of the past 20 years to 2022.

Housing: A failure of planning and a constrained growth outlook

Australia's housing construction outlook faces a multitude of headwinds, alongside a seemingly endless (but largely unfruitful) commentary on where the problems lie and whose fault it is. Relative to the government's target of 1.2 million homes over five years (at 240,000 per year), activity has been annualising at 170,000 over the past two months, well below the 200,000 plus average over the past decade.

Australia's housing construction outlook faces a multitude of headwinds, alongside a seemingly endless (but largely unfruitful) commentary on where the problems lie and whose fault it is.

There is no shortage of demand, given strong immigration and population growth, nor the pent-up demand from those who can afford to transition away from the rising cost of renting. Yet, affordability is challenged by higher rates and the cost of construction (led by higher commodity costs). Those in the industry highlight government planning and approval (and worker) inefficiencies as adding to cost and delaying new supply. Sadly, higher rates are also being flagged as a headwind to developers lifting supply. The 'best of times', arguably, involves more affordable housing and less constrained growth.

These challenges are leading analysts to predict modest growth over the coming year. CBA expects a contraction in housing investment in 2024 of 2.2%, before recovering modestly to 1.4% in 2025. UBS is more pessimistic, expecting further contraction in 2025. Approvals for construction are expected to trend higher into 2025 (UBS 180,000, CBA 174,000), but remain well short of that required to ease the imbalance (or spur growth).

China's balance sheet recession may be a headwind if stimulus efforts fail (again)

China remains the world's second largest economy. While global businesses (motivated by geo-political instability) are seeking to shift their supply chains away from China, China is unlikely to be de-throned as the world's manufacturing hub any time soon. And if an economy this size can grow near the 5% pace that the authorities are targeting, it will continue to make a significant contribution to world growth in the years ahead.

For Australia, the shifting mix of China's growth (as authorities seek to boost consumer spending rather than drive commodity-intensive leveraged housing and infrastructure investment) could be a headwind for resources companies and Australia's fiscal firepower.

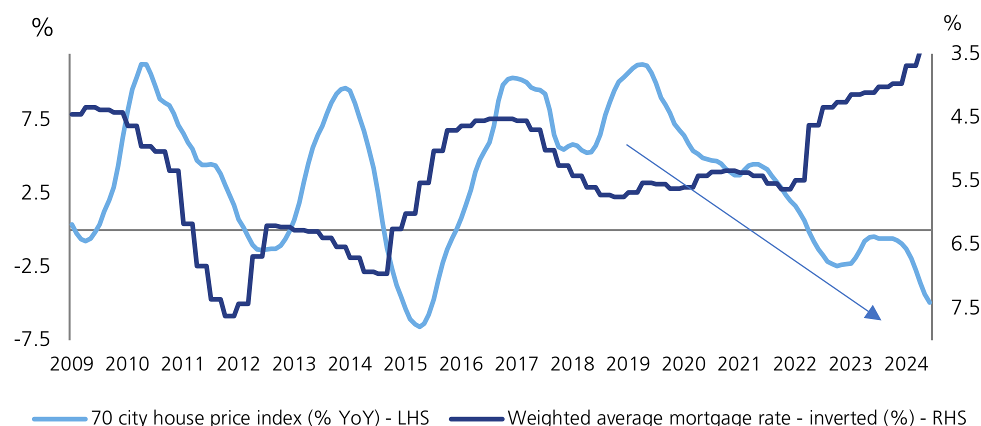
All that said, the world has become somewhat used to a more dynamic pace of growth, and the risks of a substantially weaker result remain elevated (despite the recently announced fiscal and monetary stimulus). As Longview Economics notes, "China's balance sheet recession dynamics have intensified. After the bursting of China's real estate bubble (in 2021), falling land and property prices have increasingly put downward pressure on private sector balance sheets. This year, the decline in asset prices has accelerated. The liabilities associated with those assets, though, have remained broadly unchanged. As such, and in the absence of any meaningful policy stimulus, China's private sector remains under growing pressure to retrench (i.e., save and deleverage)."

Efforts to support China's growth through over-production are, for now, aiding commodity prices and leading to some renewed exporting of deflation to the world. Positively (at least in the short term), this may foster global disinflation and lower global interest rates. Recently announced stimulus measures may be enough to underpin markets, but unless authorities follow through, China's transition from commodity-driven investment to consumer spending could be a headwind for commodities and Australia's fiscal firepower.

"China must act on deflation, former central bank governor warns. Yi Gang calls for looser monetary policy in rare admission of pressing economic concern."

Financial Times, September 2024

China's monetary easing measures have struggled to support housing markets thus far



Source: Longview Economics, Macrobond.

Will a lagged RBA see a rising Australian dollar drive some disinflation?

Prior to the recent Fed cut, markets were pricing nine 0.25% Fed rate cuts by the end of 2025 (to 2.78%) about twice the number of rate cuts expected for the RBA (to 3.16%). Notwithstanding the RBA never went as high as the Fed, this still reverses the current US rate premium. While the exact outcome is uncertain, the likely greater magnitude of Fed cuts relative to the RBA may impart upward pressure on the Australian dollar (even with the headwinds of China's more subdued commodity demand). Indeed, Société Générale (SG) expects the first RBA cut in May 2025, by which time the Fed may have cut 1.5%.

Markets are currently pricing a further nine 0.25% Fed rate cuts by end-2025 (to 2.78%), about twice the number of cuts expected for the RBA (to 3.16%), which could put upward pressure on the Australian dollar.

Trailing other central banks may well be one of the tools in the arsenal of the RBA to contain inflation, as a higher currency will put some downward pressure on import prices (albeit the impact is modest and over time). Consensus expects the Australian dollar to appreciate almost 5% to USD 0.70 (UBS and CBA forecast USD 0.72, a rise of almost 7%).

A slow grind on growth and disinflation, with moderate rate cuts in the mix

It's hard to craft a recession view for Australia over the coming year, given fiscal stimulus, a backlog of infrastructure work, and the need for more housing. Still, holding rates higher for longer (were weak productivity to slow inflation's return to target) runs the risk of unexpectedly shunting the economy onto a sharply weaker path. This is not our central case. Still, the RBA, hawkishly, continues to believe that economy-wide demand is outpacing supply, limiting its ability to ease rates. While supply could lift, this seems less likely near term, amid our productivity woes, leaving the RBA focused on reducing demand.

Indeed, unless China's stimulus measures succeed in re-igniting growth, a dysfunctional housing sector and our relatively lagged interest rate cuts present a more challenging outlook for Australia. The usual uncertainty facing businesses and consumers as we approach a federal election in H1 2025 may also add to headwinds.

Consensus expects growth to recover in 2025 to 2.1% from this year's likely 1.2%...not a recession, but still noticeably below trend. A likely later rate-cutting path suggests any recovery in Australia's growth rate may be relatively modest over the coming years. Recent fiscal stimulus should see consumers lift their spending moderately ahead, housing activity should edge higher on the back of peaking rates, while government expenditure, including capex and infrastructure, should remain strong.

To some extent, Australia's outlook reflects a mix of opportunities and disappointments. Structurally poor productivity impacts our ability to deliver improved standards of living via sustainable real wages and real wealth gains. And our fiscal position is vulnerable, given emerging deficits, despite elevated commodity prices. Yet positively, underlying growth dynamics (even if below trend) combined with sticky inflation should deliver reasonable nominal growth, while also sustaining the attractiveness of higher yielding defensive assets.

The opportunities for investors

Fixed income: Still attractive returns to be harvested

Notwithstanding a more challenged disinflationary outlook, the likely ongoing patchy sub-trend growth outlook is unlikely to lead to any further rate hikes from here. Rate cuts are still the likely outlook. As such, fixed income will potentially remain an attractive asset class in Australia, though the mix of returns may have less significant capital gains and more persistent income than offshore (or prior cycles).

With the RBA likely to be one of the last G10 central banks to start easing, we expect bond yields to remain elevated relative to Europe, the UK, and the US, keeping the opportunity to add domestic duration alive for longer. Investment grade credit spreads should also benefit if a (US) soft landing is achieved, default rates remain low, and equity markets react well to rate cuts. We suggest investing in fixed rate investment grade bonds between four and seven years to maturity to lock in current yields while also taking advantage of the higher three-month Bank Bill Swap Rate, with floating rate products. We also like private debt managed by our preferred managers, targeting returns between 3-4% above cash.

Structurally poor productivity impacts our ability to deliver improved standards of living via sustainable real wages and real wealth gains. And our fiscal position is vulnerable, given emerging deficits, despite elevated commodity prices.

Equities: Key sectors face headwinds, but value within the index

Australia's market is dominated by two large sectors, which are not without headwinds, namely resources and banks. Recent earnings growth has been sluggish, suggesting some over-achievement, given the market's price/earnings (P/E) ratio has risen from around 15x to 17x. Resources are unloved and cheap, but potentially challenged by weaker global commodity demand. In contrast, banks are expensive and lack the catalyst of an aggressive cutting cycle (while housing activity is constrained). Still, the market's valuation is relatively 'fair', growth exists, and parts of the consumer complex are well supported by fiscal easing.

To this end, on balance, we expect more opportunities to present themselves within the index, than at the index level itself (absent a China recovery that lifts commodity prices and large-cap resource stocks), and therefore continue to prefer actively managed portfolios. At a factor level, investors should continue to seek exposure to mid-cap equities (where the growth dynamic is more structural and resilient) and small-cap equities (as rate cuts come more clearly into view).

Yet, positively underlying growth dynamics (even if below trend) combined with sticky inflation should deliver reasonable nominal growth, while also sustaining the attractiveness of fixed income returns.

Alternatives: Australia remains attractive within private markets

While generally advocating for greater allocations to global private debt, given a much broader opportunity set, a slower easing cycle locally naturally supports higher unlevered yields for domestic private debt in the near term. Given the previously noted proliferation of global product, this can also support patience in finding the right global portfolio mix. Simply put; continue to allocate to domestic private debt, where we maintain a preference for corporate and consumer-based strategies.

Within private equity, Preqin data continues to point towards Australia-focussed funds, showing outperformance (vintage years 2013 to 2020) over global peers with a median net internal rate of return of 14.5%, ahead of North America (14.0%), Asia (14.0%), Europe (13.8%), and the rest of the world (8.8%). When combined with normalising deal activity, a healthy secondary market, and likely greater interest in Australia from overseas investors (given outflows from China), the domestic market warrants its bias.

This month, we lean further into growth assets as we see a more constructive path

While Australia's outlook seems lethargic, we are growing more constructive on the near-term pathway for the global economy, particularly the US. Growth in the US is moderating but, importantly, not falling off a cliff, with still limited signs of corporate or leverage excesses that might presage a left-field shock. Meanwhile, as inflation continues to trend towards target, the Fed has more leeway to focus on the other side of its dual mandate, supporting growth and inflation. This has allowed it to join the global rate cutting cycle, with a sharp 50 basis points (bps) easing.

We have also responded to the various stimulus packages announced by China in late September. While it is uncertain whether they are sufficient to spark a re-acceleration in growth, they may be enough to put a floor under already-depressed markets. We think this overall macro and policy backdrop increases the likelihood of the fabled 'soft landing', and we have implemented a modest overweight to US equities and closed our emerging market equity underweight to reflect this more constructive outlook. This takes our overall equities overweight to +3 from +1. This is a meaningfully constructive position, but one that still leaves us with the flexibility to respond to evolving risks and opportunities as they emerge.

What's driving our views

Leaning into growth assets as the Federal Reserve cuts, China loosens fiscal shackles

We maintain a broadly constructive macro view and, while we expect further moderation in global growth and inflation, the risks of a deeper slowdown appear modest and policymakers may be able to stick the 'soft landing'. We have further increased our tactical overweight to equities to reflect this more supportive outlook. We maintain a nimble stance with our tactical positioning, given evolving macro and political risks.

Can policymakers stick the landing? After a fast and steep hiking cycle, central bankers now need to calibrate policy to lower inflation without triggering a recession. There are political and geo-political risks, and the secular inflation outlook is volatile.

Politics takes centre stage in 2024: After the geo-political shocks of the past two years, politics will be a key market driver this year. More than 64 'national' elections are taking place in 2024. The headlining US election is approaching in November.

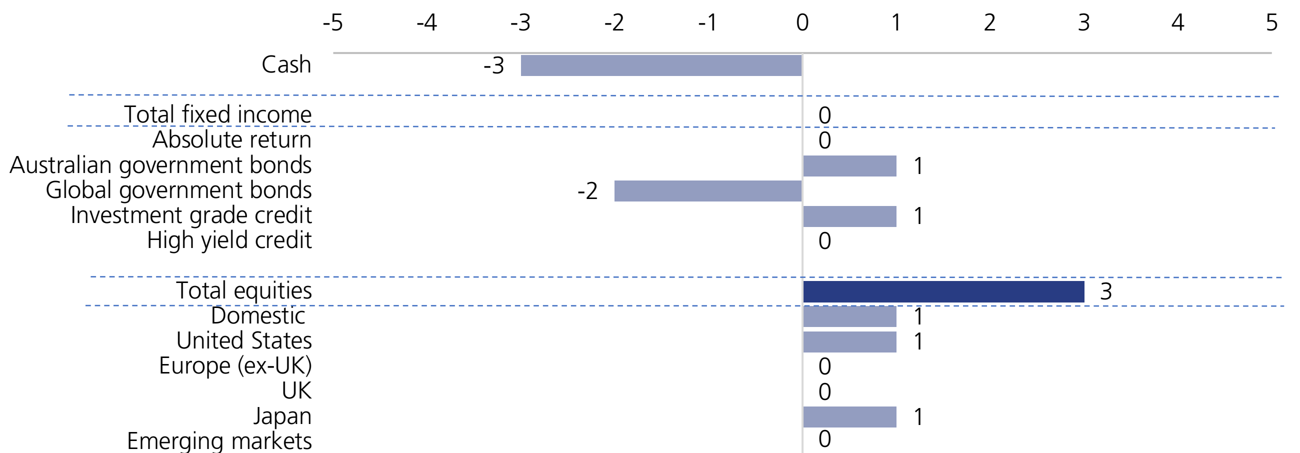
Diverging cycles: The US economy is resilient, but momentum has peaked, while Europe is struggling to emerge from recession. China faces key cyclical and structural challenges. How these macro dynamics play out will be a key driver for markets this year.

Fortune favours the flexible: With ongoing volatility and uncertainty, we believe it pays to be diversified, nimble, and flexible over the year ahead. Investors will benefit from prudently managing liquidity and investing with high quality active managers.

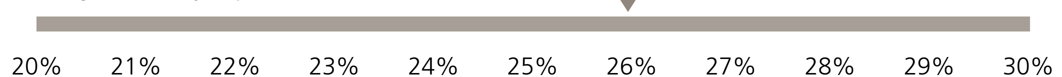
Structural thematics

Transitioning towards **multi-polarity** will likely create more volatility, presenting growth and opportunities for investors.	The trade-off between net-zero commitments, cost and energy security creates a **challenging energy transition**.	**Artificial intelligence** presents challenges and opportunities. Advances in pharmaceuticals are a constructive force for the long term.	**Higher rates** increase forward-looking returns across all asset classes, giving investors more options.

Tactical asset allocations (% weights)



Foreign currency exposure (Balanced SAA)



	What we like	What we don't like
Equities	▪ Japanese equities with bottom-up corporate reform tailwinds. ▪ Actively managed small and mid-cap equities. ▪ Broader (non-mega cap) S&P 500 exposure.	▪ Passive or benchmark-aware strategies in concentrated markets. ▪ Expensive defensives in Australia (e.g., CBA and WES).
Fixed income	▪ Actively managed funds investing in higher quality credit. ▪ Fixed/floating rate 4 to 7-year senior and tier 2 bank credit. ▪ Investment grade fixed-rate corporates and Kangaroo issuers.	▪ Longer-maturity bonds, which are vulnerable to rising inflation and term premia risk. ▪ Lower quality credit vulnerable to higher cost of funds.
Alternatives	▪ Multi-strategy hedge funds and other diversifying strategies. ▪ Global venture capital secondaries. ▪ Senior private debt, incl corporate, asset-based finance. ▪ Global infrastructure across the risk spectrum, particularly playing to long-term structural themes.	▪ Long-bias equity hedge fund strategies. ▪ Construction and/or junior lending within real estate. ▪ Carbon-intensive assets/ industries with no transition plan.

Source: LGT Crestone Wealth Management. Units refer to the percentage point deviation from strategic asset allocations. Investment grade credit includes Australian listed hybrid securities. Foreign currency exposure is representative of the balanced strategic asset allocation.

Economic and asset class outlook

Economic outlook

Global economy

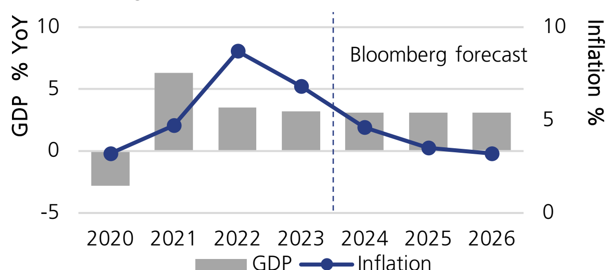
Following significant volatility through July and August, on the back of shifting views around the outlook for the US, Japan and China, developments in September were more settled. The narrative has, once again, returned to be one that is focused on a moderately slowing US economy that supports a start to a rate-cutting cycle, patchy recoveries in Europe and the UK post 2023's mild recessions, optimism regarding Japan, pessimism regarding China, and sticky inflation that continues to weigh on Australia's ability to join the rate-cutting cycle any time soon.

Indeed, from a rate-cutting perspective, the highlight of the past month was the larger-than-expected 0.5% start to the cutting cycle by the Fed. In cutting rates, it joined central banks in Europe, the UK, Canada, and Asia, which have all trimmed rates over the past couple of months. A further gradual moderation in global growth and inflation over the rest of 2024 is expected to foster an ongoing moderate easing cycle, ahead of a patchy growth recovery through 2025. Indeed, as noted by Société Générale (SG), "the Fed matters more than the US election for pricing markets in a falling commodity price environment", and together with the recent falls in oil prices, such developments continue to provide support for fixed income returns. This is the case even if much of the outperformance has passed relative to equities, where lower rates and moderate growth are tailwinds.

As always, uncertainties have the potential to shape the macro outlook away from the central thesis. Sticky services inflation globally holds the potential to slow or disappoint rate cut expectations through 2025. And prospects of unrest in the Middle East remain (with oil prices spiking in late August on supply disruptions, but now falling on weaker demand), while the US presidential election still lies ahead in November. More positively, secular themes around AI and the energy transition could more strongly underpin future growth and earnings.

Consensus expects global growth to slow in 2024 to a pace modestly below long-term averages of around 3.5%, with a similar pace unfolding through 2025. Consistent with that, UBS expects growth to average a little over 3% in both 2024 and 2025, with advanced economies expanding by around 1.6%, and emerging markets expanding by around 4.5%.

Global GDP growth and inflation



Source: Bloomberg as of 30 September 2024.

Australia

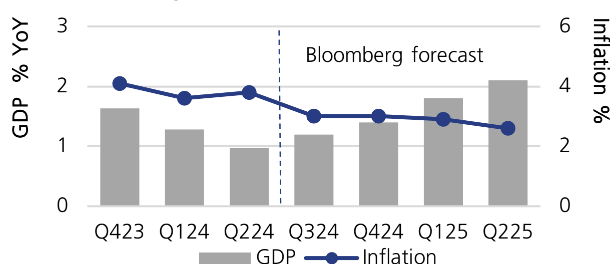
Real economic activity has slowed significantly in H1 2024, led by a soft consumer, weaker housing activity, and softer external conditions, including in China. However, the outlook is combined with other indicators that suggest some aspects of the economy are robust, including the jobs market, house price growth, and the demand for services. With only limited further progress on reducing Australia's relatively high inflation during Q2, together with a much more stimulatory fiscal position than expected from mid-year, hoped-for year-end interest rate cuts are now expected to be delayed into 2025.

Growth in Q2 stayed weak, rising just 0.2%, the same as in Q1. Annual growth slowed to 1.0% from 1.3%, which apart from the pandemic, marks the weakest financial year since the recession of 1991/92. With growth in the population estimated to be running at 2.5%, Australia's growth and spending 'per person' is clearly in decline. Much of that growth is coming from government consumption (up 1.4% over the year), led by programs for health services. Elsewhere, consumer demand fell in Q2, to be up a tepid 0.5% over the past year, housing activity is 3.0% below a year ago, while business capex has slowed from 10.1% a year ago to just 2.5%. Growth in our exports has also slowed from almost 8% a year ago to 'flat' in mid-2024 on weaker resources and rural export volumes.

Government subsidies have engendered a marked deceleration in headline inflation outcomes, with the latest figures for August showing inflation easing to a 2.7% (from 3.5%), placing it within the RBA's 2-3% target for the first time since 2021. Core inflation, however, remains high, at 3.4% in August (down from 38%). Reflecting this, comments from RBA officials remain hawkish, with Governor Bullock flagging the need for demand to slow to bring it back in line with the economy's current rate of supply. UBS and Barrenjoey expect the first cut from the RBA to occur in February 2025, although SG still expects it to be delayed until May 2025.

After growth of 2.0% in 2023, UBS expects Australia to avoid a recession, with growth of 1.2% in 2024, ahead of a recovery to 2.0% in 2025. CBA sees slightly slower growth of 1.1% for 2024, ahead of a similar rebound (2.1%) in 2025.

Australian GDP growth and inflation



Source: Bloomberg as of 30 September 2024.

Economic outlook

United States

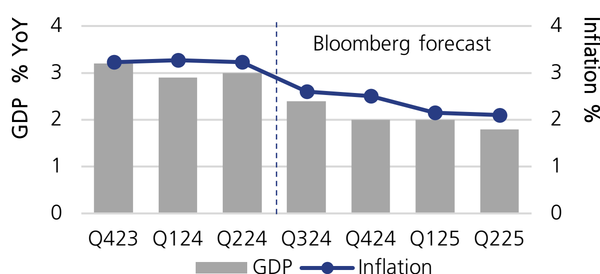
Recent months have revealed more convincing evidence that US growth is on a slowing path and the bulk of inflationary pressures have passed. Reflecting this, the Fed started its easing cycle in September, with further cuts expected in late 2024 and through 2025. While some analysts continue to raise the spectre of a recession in 2025, recent data does not suggest an imminent collapse in growth. Instead, activity is expanding at an above-trend pace, despite a softening jobs market. This has led some to question whether the significant rate-cutting cycle priced into markets can be delivered. With only one month to go until the US presidential election, Vice President Harris's successful debate has contributed to a close Whitehouse race.

Growth rose by a robust 0.7% (3.0% annualised) in Q2. But when combined with Q1, H1 growth expanded by 2.2%, a cooling from the 3.1% growth in 2023. Q3 data has ebbed and flowed, but recently robust retail data (with core up by 0.3%), has contributed to nowcast estimates reaccelerating to 3%. However, key to the Fed's decision to start cutting rates, non-farm jobs growth has slowed to just 114,000 (with sharp downward revisions to prior months), while unemployment surprised higher to 4.3% from 4.1%. September's composite Purchasing Managers' Index (PMI) fell to 54.4 from 54.6.

Inflation continues to trend lower, with Longview Economics noting "underlying inflationary pressures in the US have (significantly) decelerated in recent months". In August, core inflation was unchanged at 3.2%, while headline inflation fell from 2.9% to 2.5%. At its September meeting, the Fed voted to lower the target range for the federal funds rate by 0.5% to 4.75-5.00%, the first change since a hike in July of last year. According to MST Marquee, "the decision to start with a 0.5% cut, instead of 0.25%, highlights the Fed's desire to not be behind the curve on preserving maximum employment". Chair Powell noted that this should not be assumed to be the pace of rate cuts going forward, with the Fed 'dots' signalling two more 0.25% cuts by year-end.

After 2.5% in 2023, UBS now sees growth maintaining an above-trend 2.5% pace in 2024 (was 2.3%), before slowing to 1.5% in 2025. SG expects an even less significant slowing ahead, with growth unchanged in 2024 at 2.6% before easing moderately to 2.0% (was 2.2%) in 2025.

US GDP growth and inflation



Source: Bloomberg as of 30 September 2024.

Europe

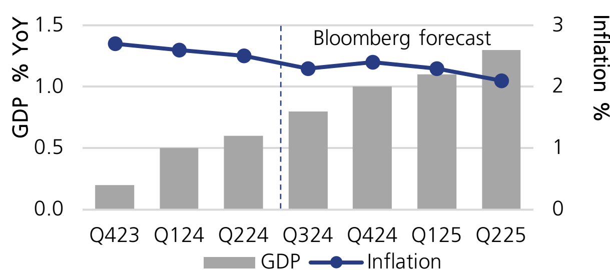
Growth data for Q2 revealed Europe's economy emerged from its mild recession in H2 2023. However, recent data suggest the economy's recovery has lost momentum in early Q3, with headwinds from still tight monetary policy, a soft external environment (including China), and fiscal tightening in Germany. In France, President Macron officially named Michel Barnier as the new prime minister. At 73 years old, Barnier is a member of the centre-right party Les Républicains. According to SG, he has had a long and distinguished career.

Growth in Q2 rose 0.3% (0.6% annually), repeating Q1's result and beating expectations. Among the larger economies, France and Spain surprised to the upside, while Germany disappointed. Recent attention has been focused on this north-south divide. As Longview Economics notes, "Germany (and some others in the North) remain under pressure, with economic leadership increasingly switching to southern economies (e.g., Italy and Spain). These are, on the whole, in a much better structural position." Near-term weakness in Germany and Northern Europe will add to the case for cuts over coming months. Germany's export business is under pressure from weak global manufacturing, real rates are too high for its real estate sectors, while fiscal policy is restrictive.

Inflation continues to trend lower, albeit the core measure remained unchanged at 2.9% in July (and headline inflation edged higher on energy). Wages growth also slowed from 4.7% to 3.6% in Q2. The European Central Bank (ECB) members voted unanimously to cut their key policy rate from 3.75% to 3.50% in September, the second cut this year. President Lagarde reiterated that the ECB was committed to keeping policy "sufficiently restrictive for as long as necessary to achieve" its inflation target, sticking to the notion of data dependence. While BCA Research expects the next ECB cut to be in December, UBS sees a cut in September and December.

After relatively weak growth of 0.5% in 2023, UBS expects an increasingly modest recovery in H2 2024, with growth up 0.6% in 2024 (with CBA and SG forecasting a similar 0.7% gain for 2024). Forecasts for 2025 focus on a further acceleration of growth, ranging from of 1.0% to 1.2%.

European GDP growth and inflation



Source: Bloomberg as of 30 September 2024.

Economic outlook

United Kingdom

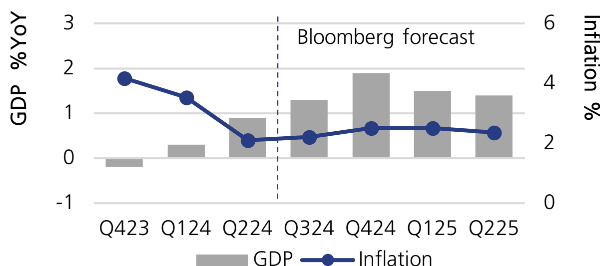
After rebounding strongly from H2 2023's recession, the UK economy appears to have lost some momentum as H2 2024 gets underway. Nonetheless, while financial conditions remain relatively tight, underlying inflation continues to trend lower and wages growth is moderating, opening the way for additional monetary easing over coming months. As SG notes, together with rising real incomes and consumer confidence, this should provide a positive support for growth ahead.

Growth surprised positively in Q2, rising 0.6% (after 0.7%), a strong rebound from contractions of 0.3% and 0.1% in H2 2023. Annual growth lifted from 0.3% to 0.9%. Data in early Q3 has been more mixed. After falling in June by almost 1%, retail sales rose 0.5% in July, while unemployment reversed several months of gains, easing to 4.1% from 4.4%, signalling tight conditions. Overall monthly output was unchanged in July, the same pace as in June. UBS estimates that this is consistent with growth of 0.1% in Q3. "This marks a significant step down compared to surprisingly strong growth in H1 24, and stands in contrast to the July and August PMIs, which pointed to a further pick-up in activity".

Inflation was a touch higher than expected in August, with the headline measure unchanged at 2.2%, while core rose from 3.3% to 3.6%. While the reacceleration in inflation was consistent with the Bank of England's (BoE) forecasts, it kept its policy rate unchanged at 5.00% in September. This too was widely expected, following the cut from 5.25% in July, its first reduction since early 2020. The BoE's guidance suggests a cautious approach, indicating further reductions will depend on renewed progress on inflation moving lower toward the target. CBA expects two more rate cuts before year-end (November and December), in line with market pricing. UBS expects only one cut in November before the end of the year.

After growth of just 0.1% for 2023, UBS has again revised higher its recovery in 2024 to 1.1% from 0.7% (and 0.2% earlier), with stronger 1.5% growth expected in 2025. SG has also revised higher to 1.2% (was 1.0%) for 2024. CBA has lifted its growth outlook for 2024 from 0.2% to 0.6%, and a more moderate 1.0% pace in 2025.

UK GDP growth and inflation



Source: Bloomberg as of 30 September 2024.

Japan

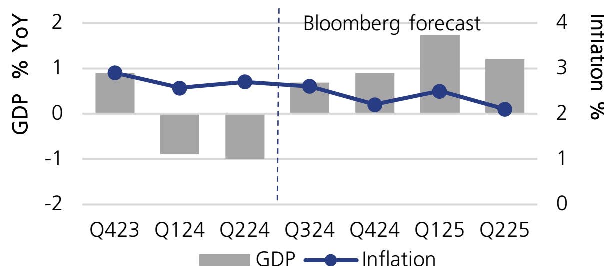
A strong rebound in Q2 growth has renewed optimism that Japan is on a path to successfully transition from secular stagnation to nominal recovery. According to KKR, "an economic reawakening supported by real income growth and improved productivity is accelerating off a low base". Focus remains on the domestic consumer, and the potential for wages growth to support stronger spending. Improving global trade and tourist arrivals are also considered positive growth drivers ahead. Over the past month, the Bank of Japan (BoJ) has hinted at more tightening before year-end. Japan's ruling party elected a new leader, Shigeru Ishiba, in late September.

Japan's growth rebounded by a stronger-than-expected 0.7% (2.9% annualised) in Q2, following -0.6% (-2.3%) in Q1. The annual pace was still negative (at -0.8%). However, positively, consumption rose over 1% in the quarter after four quarters of negative growth. Early Q3 data has been mixed, but consistent with ongoing growth. Wages growth accelerated, with gains in both July and August, the first consecutive rise in more than a year. Despite this, August consumer confidence remained unchanged, albeit on an improving trend. Industrial production in July rebounded 2.8% after a dip the previous month at -4.2%, though firms' production outlook weakened. The August composite PMI rose further to 52.9 from 52.5.

Inflation remained unchanged at 2.8% in July, consistent with improving underlying demand and robust pricing signals in the Tankan survey. Following its somewhat unexpected policy hike to 0.25% from 0.15% in July, BoJ commentary has been relatively hawkish. Governor Ueda recently stated that, "if the data shows conditions are on track, and if such data accumulates, we would of course take the next step (this year)." This has led SG to bring forward its forecast for the next BoJ hike from March 2025 to December 2024. UBS expects two hikes this year, while Morgan Stanley views BoJ commentary as overly hawkish and has retained its view for the next hike to be in January 2025.

After strong growth of 1.8% in 2023, UBS expects flat growth in 2024 (on Q1 weakness), before steadying at around 1.1% in 2025. SG forecasts a similar pace of -0.1% for 2024, but a strong rebound to 1.3% for 2025. It expects growth uplifts to be underpinned by a stronger consumer and more capex.

Japanese GDP growth and inflation



Source: Bloomberg as of 30 September 2024.

Economic outlook

China

Data over recent months continue to deteriorate, pointing to weaker activity than expected, and below the pace authorities are targeting. Analysts have typically made additional downgrades to China's growth outlook over the past month, led by ongoing property weakness. China also faces future growth headwinds into 2025, given the risk of new tariffs if former President Trump wins the US election. The European Union has recently announced plans to impose an additional tariff on electric vehicle imports.

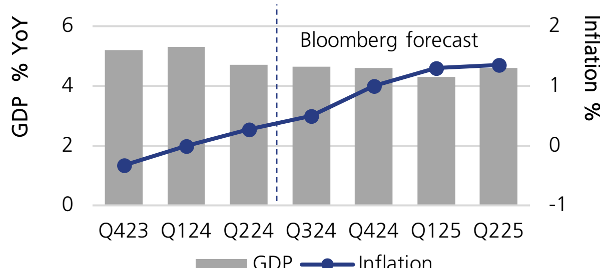
In the first seven months of 2024, overall property sales have declined 19% annually, new property starts have fallen 23%, and real estate investment has dropped 10%. Home prices have also fallen further. This has occurred despite policy measures that use government-backed funding to buy unsold new homes to help inventory destocking. As UBS notes, "the implementation of the destocking plan has been slow so far", and there is little evidence co-ordinated debt restructuring in the property sector is proving effective.

The anaemic economy has seen authorities recently announce a fresh set of more substantive measures, including a raft of monetary support and, importantly, a significant shift in fiscal tone. While details are scant and there are questions around whether this is enough to re-ignite economic growth, the latest moves may be enough to underpin markets in a similar manner to the ECB's 'whatever-it-takes' moment in 2012.

China's output slowed to 4.7% in Q2 (from 5.3% in Q1). According to UBS, activity in the quarter slowed more sharply from around 6% to below 3%. Data for August and early September was subdued. In August, retail sales growth eased (2.7% to 2.1%), as did manufacturing (8.3% to 8.0%) and infrastructure (10.8% to 6.4%). Property activity was weak, with new starts falling (-16.7% after -19.7%) and property sales down (-12.6% after -15.4%). Meanwhile, export growth lifted (8.7% after 7.0%), though imports collapsed. Inflation steadied, rising from 0.5% to 0.6% in August, though producer prices signalled deeper deflation (-0.7% after -0.2%).

After 5.2% in 2023, UBS has cut its China growth outlook to 4.6% in 2024 (was 4.9%), ahead of further slowing to 4.0% in 2025 (was 4.6%). SG has trimmed growth for 2024 from 5.0% to 4.8%, and expects a slowing to 4.5% in 2025.

Chinese GDP growth and inflation



Source: Bloomberg as of 30 September 2024.

Emerging markets

Momentum in emerging market growth has slowed into mid-2024. UBS estimates that annualised Q2 growth slipped below 4%, including and excluding China, led particularly by weakness in emerging Europe, and to a lesser extent Asia. While the annual pace of growth may drift lower into early 2025, the quarterly pace of activity is expected to moderately rebound in H2 2024, led by stronger Asian activity across selected countries in North and South Asia, including Korea, Thailand, Philippines, Singapore, and India.

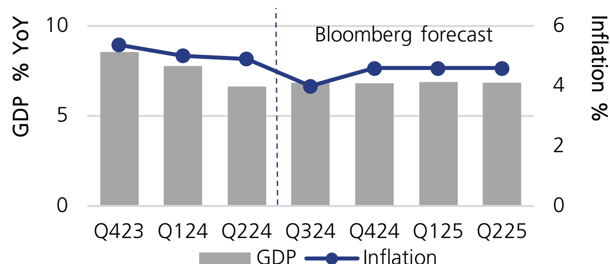
The outcome of the upcoming US presidential election is likely to impact views on the outlook for emerging markets. As noted by UBS, key areas where policy change could matter include 1) US corporate tax rates, given emerging market and Asian companies compete directly with US firms; 2) likely tariff hikes, given emerging market companies have 13-15% US revenue exposure; 3) differing climate policies, as 6-10% of firms benefit from current policies; 4) US isolationism, with India, Japan, and Korea positively exposed to higher global defence spending; and 5) the potential for a weaker US dollar.

Reflecting this, UBS expects "Taiwan, Korea and, to an extent Japan, to fare better under a Democrat scenario: stocks have significant US revenue exposure with the risk of higher tariffs under Trump". Large parts of the market should benefit from Biden's climate policies and direct US competition (benefitting from higher US corporate tax rates under Harris). China could be better off under Harris, primarily due to less harsh tariff outcomes. South Asian markets are likely better positioned under Trump. This is because they have less exposure to Republican policies, given lower US revenue exposure, favourable sensitivity to US dollar weakness, little direct US competition, and relatively low exposure to climate policies.

In India, growth normalised in Q2, slowing from 7.8% to 6.7%, helped by lower government spending and 'heat wave' conditions. Despite inflation being below 4% across July and August, policy makers are not in a rush to trim, given the strength of the domestic economy. SG expects a 0.25% cut from the Reserve Bank of India to 6.25% in December.

For all emerging markets, after 4.7% in 2023, UBS expects similar growth of 4.3% in 2024 (was 4.4%) before a modest slowing to 4.0% (was 4.1%) in 2025.

India GDP growth and inflation



Source: Bloomberg as of 30 September 2024.

Asset class outlook

Absolute return and government bonds

Position: Neutral absolute return; underweight global government bonds; overweight Australian government bonds

Key points

- We recommend maintaining a diversified portfolio of fixed and floating rate bonds.
- High grade bond yield curves have steepened, with the front end outperforming.
- The domestic bond market has underperformed the US-led rally, and we look for outperformance ahead.

US Treasury yields declined in September, confident that the Fed would deliver a 50bps cut. This happened following data which signalled weak employment, lower inflation, and slowing growth. The 10-year US Treasury yield moved to below 3.65% prior to the Federal Open Market Committee meeting, the lowest level since June 2023. Post the Fed delivering a 50bps cut, Treasury yields ended being slightly higher as the underlying message from Powell was less dovish than the market was positioned for. Overall, the message was about preserving labour market gains where possible, as the US economy is back in balance in terms of growth versus inflation. Powell said the 50bps move was "a commitment to make sure we don't fall behind". However, the initial rally in rates was unwound as Powell pushed back against the notion that this would be the Fed's new pace of easing. What is clear for markets going forward is that the labour market will be the decisive factor for the Fed in terms of how much and how quickly it cuts rates.

With the expectation that global monetary policy will continue to lower interest rates, the Treasury curve has steepened. While still relatively flat (the spread between two years and 10 years is 8bps), the front end of the curve is outperforming, and this is expected to continue. We do not see many further gains at the longer end of the curve, as the Fed's 'dot plot' indicates two further 25bps reductions this year and 100bbps of cuts in 2025. This puts the Fed funds rate at 3.40%, suggesting the long end of the curve is fully priced at 3.70%.

Commonwealth Government bond yields and price action are influenced by US rates, particularly at the longer end of the curve. However, as the RBA was less aggressive in raising rates and is likely to remain on hold for longer, the Australian yield curve has been underperforming the recent US Treasury rally. At 3.90%, the 10-year yield is now 20bps above the US Treasury 10-year yield, a level not seen this year. Consensus is that the RBA is unlikely to cut while service inflation remains sticky and the labour market strong. We do not expect the RBA to move until Q1 2025, keeping rates higher for longer.

With a level of political uncertainty and US borrowing requirements going forward, we recommend investing at the front end of the US curve. In Australia, to benefit from more restricted level of rates, we recommend investing in the four- to eight-year part of the curve.

Investment grade credit and high yield credit

Position: Overweight investment grade credit; neutral high yield credit

Key points

- We prefer investment grade bonds as inflation cools and downside risks to global growth moderate.
- High yield credit spreads are vulnerable to widening but the quality has improved and demand for outright yields has risen, which is driving spreads lower.

Investment grade credit: Investment grade credit spreads have been tightening in September, reversing the widening in August. Falling interest rates and optimism of a soft landing supported the rally, generating returns in the mid to high single digits. We remain overweight investment grade bonds as we continue to see support from historically elevated yields and low spread volatility. Within European investment grade credit, the average yield is around 3%. For US investment grade credit, yields for all maturity and intermediate profiles are just below 5%. Credit fundamentals for US investment grade corporates remain solid, and we expect limited credit quality deterioration. Any widening of spreads due to growth concerns should be more than offset by falling interest rates. Staying in high-quality bonds should also protect portfolios if there is a significant growth slowdown.

Domestically, the focus has been on the announcement from the Australian Prudential Regulation Authority (APRA) on additional tier 1 (AT1) bank hybrids. APRA plans to phase out bank AT1 instruments, which are often complex and difficult to activate in times of crisis. They will be replaced with a mix of more straightforward and reliable capital, such as tier 2 bonds and common equity tier 1. The transition is scheduled to begin in January 2027, with existing AT1 instruments expected to be fully replaced by 2032. APRA's proposal aims to simplify the resolution process during bank distress, ensuring more reliable capital absorption mechanisms while maintaining financial system stability.

High yield credit: High yield credit spreads remain sensitive to economic conditions and are more susceptible to volatility from both high interest rates and concerns about a potential economic slowdown. While there has been some recovery in spreads since August, as investor demand returned and refinancing activity increased, the market is at historically tight levels. However, the high-yield sector still offers attractive yields, averaging around 7.75% in the US and 6.5% in Europe. This has attracted capital, despite risks of a recession. Recent data indicates that while many high-yield issuers have improved their financial health by reducing leverage and extending maturities, certain sectors like communications remain vulnerable due to high leverage and low interest coverage. Investors are encouraged to focus on higher-quality bonds and diversified portfolios as central banks move towards easing monetary policy in late 2024 and beyond.

Asset class outlook

Domestic equities

Position: Overweight

Key points

- The S&P/ASX 200 index was 3.1% in September, rising to a record high. The index is now up 12.5% year-to-date. Although it has lagged global indices, since its 18 January lows, it has been one of the better performing global indices in Australian dollar terms.
- At a sector level, there was no discernible trends. Defensive sectors, such as healthcare and consumer staples lagged, as did energy.
- In September, the market witnessed one of the largest single-day rotations from banks to resources over the past 20 years.

The Australian economy has been more resilient than many expected, with lower unemployment and data generally coming in within reasonable expectations. This has led to a delayed rate cycle compared to offshore. For banks, which are the most cyclical segment of the market, impairment charges are benign and net interest margins have started stabilising (and exiting positively). This has resulted in overall EPS upgrades of 2-3%. Combined with extreme pessimism around China and any prospect of an economic recovery, this has seen a crowding effect of regional flows out of China and into Australian banks.

The extreme pessimism towards China has hit sentiment towards the commodity sector (combined with a US slowdown), with energy and iron ore stocks trading weakly until later in the month. Lithium (spodumene) had fallen 92% from the peak of USD 8000 per tonne (p/t) to trade at USD 740 p/t, and iron ore had weakened below USD 80 p/t. However, two major events occurred during the month. Firstly, China's Contemporary Amperex Technology (which represents around 5% of global supply) cut / suspended production from its Jiangxi lithium mine. In doing so, it signalled that prices had fallen too far. Secondly, Chinese authorities announced a slew of policy measures on 24 September, designed to stimulate depressed consumer demand/sentiment. On 24 September, resources outperformed banks by more than 5%. Although daily moves are generally not important, a move of this magnitude can be and has been seen on only 22 occasions in the past 20 years. Importantly, it is often a precursor to a regime change. On a one-year forward basis, the index's resources sector has outperformed banks 73% of the time after similar moves, with a median value of 8%.

While there were bright spots during the recently concluded reporting season, the overall rate of downgrades through the season climbed above average and has left earnings per share (EPS) growth at a tepid 2% for financial year 2025. Consensus EPS downgrades of -2.9% marked the second weakest month for results in the past decade.

International equities

Position: Overweight Japan and the US, neutral Europe the UK and emerging markets

Key points

- The MSCI World ex-Australia Index was largely flat in September.
- The Fed lowered official interest by 50bps, with the market anticipating a further 75bps of cuts through to the end of 2024, and a further 125bps till the end of 2025.
- Asian and tech names performed strongly in September, but were offset by weakness across Japan, Europe and the UK. Chinese stimulus measures were taken very positively by Asian markets, sparking a rally across Chinese-exposed stocks.

Chinese authorities unveiled a raft of policy measures over the past month. These included cutting the seven-day reverse repo rate by 20bps to 1.5%. The loan prime rate was also cut 20-25bps, to 3.35%, and the minimum down payment on a second mortgage was lowered from 25% to 15%. The current -1 standard deviation de-rating versus long-term averages for the MSCI China Index is a situation that has only been seen 19% of the time over the past 15 years. A reversion to the 15-year average multiple of 11x would necessitate a larger 20% rally from current levels.

For US equities, the lowering of official interest rates by 50bps was taken positively by investors. Equity market price action continues to favour the likelihood of a soft landing for the US economy, while other markets, such as commodities and rates, have reacted more to incremental growth fears.

With the Fed now equally (if not more) focused on the other side of its dual mandate (employment) the market is now braced for an additional seven to eight cuts by the end of 2025 (3%). Without wanting to oversimplify the task ahead, much of the debate will centre upon whether the world's largest economy succumbs to a recession over the next six months. Again, simplistically, out of the last 12 easing episodes, eight were accompanied by a recession and four by a soft landing. Historically, the initial equity market reaction to the start of rate cuts has tended to be rather muted, but subsequent performance has diverged significantly, depending on which growth outcome prevailed. Longer term, equity performance following the start of a Fed easing cycle has been largely contingent on the growth outcome. A soft or no-landing scenario has seen equities deliver very strong returns, while recessions have usually seen equities show absolute weakness for a number of months after the cuts began.

European equities briefly shook off the August volatility and reclaimed their all-time highs at the end of August. However, this leaves little upside on most strategists' price targets. Unfortunately, in Europe, growth has been sluggish and is expected to remain so. Europe's manufacturing sector remains weak and earnings forecasts are rolling over.

Asset class outlook

Currencies

Key points

- In September, the US dollar remained around its lowest level since December 2023 as the Fed kick-started its cutting cycle with a bumper 50bps easing.
- The Australian dollar moved to back to around USD 0.69 after some early-month volatility as traders responded to a weaker US dollar and Chinese stimulus.

Currency markets ended the month in broadly risk-on mode, with the US dollar weakening as the Fed joined the global easing cycle, and cyclical currencies were boosted by recently announced Chinese stimulus.

The US dollar ground steadily lower over the month—historically, traders have been uncertain about the timing of the Fed's first rate cut of the cycle. Markets fluctuated between pricing for a 25bps cut and a 50bps cut, eventually coalescing around a two-third chance of a 50bps cut, which the Fed eventually delivered. With more confidence in disinflationary trends as economic activity moderates, political risks around the US election and the ongoing evolution of the US economic cycle are likely to be key drivers for the US dollar over the year ahead. Structural factors, including a deteriorating US budget deficit and increasing geo-political multipolarity, point to downside pressures longer term.

After initial weakness on the back of soft Chinese economic data, the Australian dollar touched a one-year high amid Fed cuts and optimism around China's latest stimulus package. Current levels have moved towards longer-term fair value estimates, though we expect the US elections to spur increased volatility across currency markets in coming months. Our external partners continue to forecast the Australian dollar to end the year in the range of USD 0.68 to USD 0.70.

In September, the euro traded stronger against the US dollar, as markets priced in US rate cuts. We continue to expect the Eurozone to face macro risks on a structural basis, though a soft US landing is likely to support the currency in the near term, as the US embarks on its cutting cycle.

The Japanese yen continued to strengthen over the month, as the US joined the global rate-cutting cycle. This added further contrast to the BoJ expected tightening cycle. Japan's internal inflation and macro dynamics remain tilted towards policy normalisation, with a 'nominal renaissance' in growth expected to continue over the next 12-18 months.

Commodities

Key points

- Global commodity prices bounced back in September, supported by hopes of a US 'soft landing' and Chinese stimulus. Gold breached new all-time highs of USD 2,650 per ounce.
- Iron ore prices were boosted late in the month by China's stimulus announcement, but are still below USD 100 p/t.

Pessimism around the Chinese economy appeared to peak earlier in September as authorities announced a fresh set of substantive stimulus measures, including significant interest rate cuts and an injection of liquidity to support China's equity market. This fresh shot of stimulus, coupled with the Fed's first cut of the cycle (and renewed hopes for a soft landing), led to a rebound in commodity prices. Bloomberg's broad commodity price index was up approximately 4% over the month.

Brent crude oil prices remained rangebound, with softening demand offsetting ongoing tensions in the Middle East. Oil traded at USD 75 per barrel (p/b) at the end of September after closing around USD 77 p/b at the end of August.

Fed rate cuts and geo-political concerns have helped propel gold to fresh record highs of a little over USD 2,650 per ounce. Industrial metal prices have rebounded in line with Chinese stimulus, with copper and aluminium prices rising 6% and 4% in September respectively. Iron ore also responded positively, though it still trades below the USD 100 p/t mark.

The evolution of China's economy will continue to play a key role in the near-term outlook for commodities. Although authorities are targeting 5% growth in 2024, UBS notes there is downside risk to this outlook. The latest stimulus package has been well received by markets in the near term, though it remains to be seen whether further monetary easing and liquidity measures can support fundamental activity, given still moribund consumer confidence.

The key upside risk for commodities is that economic stresses threaten social stability and force authorities to pursue more aggressive fiscal stimulus, which could support a cyclical rebound in commodity prices in the absence of a broader global slowdown. This backdrop will likely lead to ongoing elevated volatility in commodity prices.

Longer-term themes, including climate change and geo-politics, are likely to support the commodity complex on a secular basis. It is difficult to determine how these competing cyclical and secular forces might evolve over the year ahead. We are particularly cognisant of the risk that a cyclical downturn could outweigh secular tailwinds in the near term.

Asset allocation views

Strategic asset allocation views

Why do we believe in strategic asset allocation?

We believe that the central component of successful long-term performance is a well-constructed strategic asset allocation (SAA). Empirical evidence suggests that a disciplined SAA is responsible for around 80% of overall investment performance over the long term[1]. Diversification plays a critical role within SAA. By diversifying your portfolio among assets that have dissimilar risk and return behaviour, lower overall portfolio risk can be achieved, and your portfolio can be better insulated during major market downswings.

Why do we advocate SAAs to our clients?

We believe that SAAs encourage a disciplined approach to investment decision-making and help to remove emotion from these decisions. A thoughtfully designed SAA provides a long-term policy anchor for clients. Over the long term, we believe clients are best served by identifying the risk they can bear, then adjusting their return expectations accordingly. Return expectations may be anchored unrealistically. However, risk tolerance tends to remain more consistent through different cycles.

Why strategic asset allocation?

Strategic asset allocation is an important part of portfolio construction as it structures your portfolio at the asset class level to match your specific objectives and risk tolerance.

Furthermore, history has shown that a disciplined strategic asset allocation is responsible for around 80% of overall investment performance over the long term.

Strategic asset allocations in models

	Yield (%)	Balanced (%)	Growth (%)	Endowment (%)
Cash	**4**	**4**	**4**	**4**
Fixed income	**52**	**34**	**16**	**13**
Absolute return	11	6	2	2
Government bonds	27	14	7	5
Investment grade credit	11	12	5	4
High yield credit	3	2	2	2
Equities	**23**	**41**	**59**	**38**
Domestic	10	17	25	11
United States	8	14	20	16
Europe (ex-UK)	2	3	5	4
Japan	1	2	3	2
United Kingdom	1	2	2	2
Emerging markets	1	3	4	3
Alternatives	**21**	**21**	**21**	**45**
Private markets	8	10	11	20
Real assets	7.5	7	6.5	14
Hedge funds and diversifiers	5.5	4	3.5	11
Target foreign currency exposure	15	25	35	30
Indicative range for foreign currency	10–20	20–30	30–40	25–35

Source: LGT Crestone Wealth Management. Investment grade credit includes Australian listed hybrid securities.

[1] Ibbotson, Roger G., and Paul D. Kaplan. 2000. '*Does Asset Allocation Policy Explain 40, 90, or 100 Percent of Performance?*' Financial Analysts Journal, vol. 56, no. 1 (January/February).

Active portfolio weights and tactical asset allocation views

Our current tactical asset allocation views

We expect growth and inflation to continue to slow in most developed economies through the end of this year as a global rate-cutting cycle takes effect.

We do not see a deep global recession on the horizon, with still-resilient consumers, positive secular investment pressures, and central banks that are pivoting from fighting inflation to supporting employment. Australia continues to be challenged by stubborn inflation and stagnant growth. We believe this backdrop supports a more constructive outlook and have increased our preference for equities, which stand to benefit most if policymakers achieve the fabled 'soft landing'. We continue to maintain a nimble stance in the face of evolving macro and geo-political risks.

Why tactical asset allocation?

Tactical asset allocations have a six- to 12-month investment horizon and are reviewed monthly. They can be considered an interim strategy where the aim is to provide a smoother investment journey without altering the end goal.

Cash

Our cash position is -3, reflecting our view that a global easing cycle favours fixed income and equities over cash.

Fixed income

We are now neutral fixed income overall to fund an increased equities overweight. Within this, we favour investment grade credit to take advantage of attractive yields and supportive economic conditions. We remain overweight Australian government bonds, as we believe markets are under-pricing the potential for RBA cuts over the coming year, even if it chooses to hold rates steady near term. The extent of global government bond yield declines in recent months likely limits further capital upside, so we have shifted further underweight.

Alternatives

We favour infrastructure, private debt, hedge funds and diversifying strategies. We are becoming more constructive on real estate globally and anticipate that the next three to six months should present an attractive long-term entry point for those looking past short-term volatility.

Equities

We have increased our overweight to equities, reflecting our central case for a soft-ish landing and supportive central banks. We are overweight domestic equities and have introduced an overweight to US equities to reflect our soft-landing thesis. We are overweight Japan and have increased our emerging market underweight to neutral.

Active portfolio weights and active tactical asset allocation tilts

	Active tilt	Yield (%)	Balanced (%)	Growth (%)	Endowment (%)
Cash	-3	1	1	1	1
Fixed income	∨ 0	52	34	16	13
Absolute return	0	11	6	2	2
Australian government bonds	1	14.5	8	4.5	3.5
Global government bonds	∨ -2	11.5	5	1.5	0.5
Investment grade credit	1	12	13	6	5
High yield credit	0	3	2	2	2
Equities	∧ 3	26	44	62	41
Domestic	1	11	18	26	12
United States	∧ 1	9	15	21	17
Europe (ex-UK)	0	2	3	5	4
Japan	1	2	3	4	3
United Kingdom	0	1	2	2	2
Emerging markets	∧ 0	1	3	4	3
Alternatives	–	21	21	21	45
FX exposure	1	16	26	36	31

∨ Decreased weight this month   ∧ Increased weight this month

Source: LGT Crestone Wealth Management. Investment grade credit includes Australian listed hybrid securities.

Our view on fixed income

Australian government bonds

We are overweight Australian government bonds. Domestic bond yields have been underperforming the US as sticky inflation and labour data delay the RBA from easing. We view any weakness in domestic government bonds as a buying opportunity, as it is likely that the RBA will need to ease at some stage in the period ahead, in line with global rates.

Global government bonds

We are underweight global government bonds. Bond yields are largely priced for further cuts from the ECB, BoE and Bank of Canada. However, we do still see value at the front end of the US curve as it steadily steepens, reflecting the initial rate cuts from the Fed. The longer end of the curve has priced in future rate cuts. We, therefore, see limited upside for capital growth.

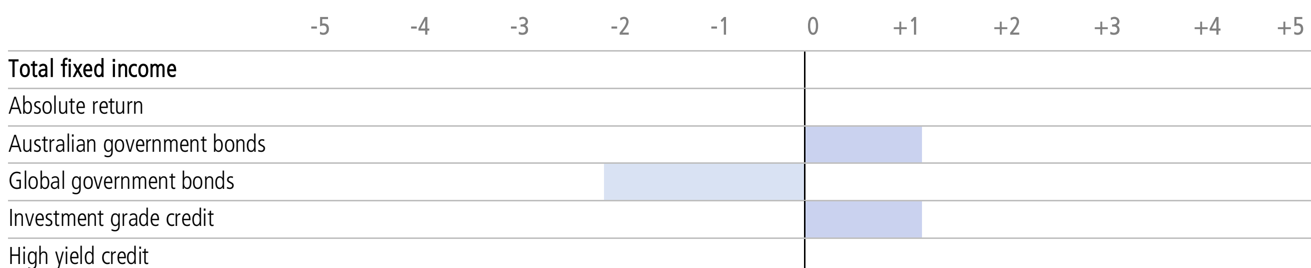
Investment grade credit

We are overweight investment grade credit. While all-in yields are at historically elevated levels, we believe investors should continue to deploy into investment grade credit, both in fixed and floating rate formats. Credit fundamentals remain solid, and we expect limited credit quality deterioration.

High yield credit

We are neutral high yield credit. Spreads are near historically low levels, brought down by demand from yield-hungry investors and the improvement in the average credit rating, which is currently BB. However, the sector is susceptible to adverse economic outcomes and there is a potential for a rise in default rates from its current low base.

Active fixed income weights (%)—We have trimmed our overweight position in fixed income



Fixed income market summary

Fixed income indices	Current	One month ago
Australian iTraxx	63.32	64.3
Australian 3-year yield	3.54%	3.55%
Australian 10-year yield	3.97%	3.97%
Australian 3/10-year spread	42.5 bp	40.5 bp
Australian/US 10-year spread	0.2 bp	0.1 bp
US 10-year Bond	3.78%	3.90%
German 10-year Bund	2.12%	2.30%
UK 10-year Gilt	4.00%	4.02%
Markit CDX North America Investment-Grade Index	52.7 bp	49.3 bp
Markit iTraxx Europe Main Index	58.82	52.55
Markit iTraxx Europe Crossover Index	310.85	288.48
SPX Volatility Index (VIX)	16.73	15.00

Source: LGT Crestone Wealth Management, Bloomberg as of 30 September 2024. Active fixed income weights sourced from LGT Crestone Wealth Management. Units refer to the percentage point deviation from strategic asset allocation.

Our view on equities

Domestic

We are overweight domestic equities, which rose to an all-time high in September. Recently announced Chinese stimulus, which has a strong emphasis on the housing market, should provide support for commodity prices towards the end of the year (which also typically exhibits seasonal strength). Consumer sentiment is improving as rate cut expectations firm for early 2025.

US

We are overweight US equities, given the higher likelihood of a 'soft landing'. The Fed began its easing cycle with a 0.5% cut, and markets are pricing an aggressive easing stance. While we are conscious of historically expensive valuations, we favour the US on a relative basis as the highest quality economy in the world with a supportive policy backdrop.

Europe (ex-UK)

We are neutral European (ex-UK) equities, where undemanding valuations (12.8x forward P/E) are offset by weaker earnings backdrop. PMIs are below levels that are historically consistent with positive EPS revisions. However, recent Chinese stimulus should bolster those sectors which are leveraged to China.

United Kingdom

We are neutral UK equities. Valuations are attractive and forward earnings expectations are more modest than **in** the US. The UK is less reliant on China compared to Europe, and as a low-beta market**,** it **should** perform well on a relative basis if volatility picks up, or **if** markets sell off.

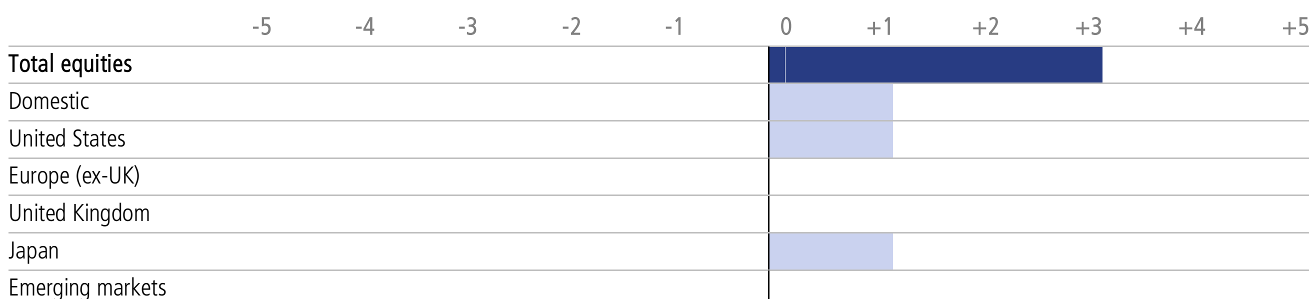
Japan

We are overweight Japan equities, as the bottom-up structural reform thesis continues to play out. The recovery in real wages over the past two months has supported domestic consumption, and corporate governance reform is evidenced by the acceleration in cuts to strategic shareholdings and growth in share buybacks. If the aggressive expectations surrounding Fed cuts do not materialise, then a weaker Yen should support corporate profits.

Emerging market equities

We are neutral emerging market equities. China's response to deteriorating growth seems set to come from both the fiscal and monetary side. When combined with a lack of positioning and cheap valuations, this creates a supportive backdrop for emerging market assets short term, especially given Fed rate cuts and forecasts for a weaker US dollar.

Active equity weights (%)—We have increased our overweight to equities



Equity market summary

Region	Index	Latest price	Consensus 1 yr Target	Consensus 1 yr Upside	Next year P/E[1]	Next year D/Y[2]
Australia	S&P ASX 200	8,269.8	8,136.0	-1.6%	20.1	3.5%
New Zealand	S&P NZ 50	12,423.8	13,364.7	7.6%	31.3	3.0%
United States	S&P 500	5,762.5	6,241.1	8.3%	20.9	1.3%
Europe	Euro Stoxx	516.3	584.0	13.1%	12.9	3.4%
United Kingdom	FTSE 100	8,237.0	9,413.6	14.3%	11.8	3.8%
China	CSI 300	3,336.5	3,421.1	2.5%	12.1	3.0%
Japan	Nikkei 225	37,919.6	44,212.1	16.6%	18.6	1.8%
India	Sensex	84,299.8	89,114.2	5.7%	23.9	1.3%

Source: Bloomberg. Data as of 30 September 2024; 1 P/E = Price to earnings ratio; 2 D/Y = Dividend yield. Active equity weights sourced from LGT Crestone Wealth Management. Units refer to the percentage point deviation from strategic asset allocation.

Our view on alternatives

Hedge funds and diversifiers

Higher rates and greater asset price dispersion are supporting the case for hedge funds. Macro and structural market forces should further increase the divide between winners and losers in coming years, creating a more expansive set of long and short opportunities for unconstrained investment vehicles, like hedge funds. Against this backdrop, hedge funds are well positioned to capitalise on a greater magnitude of market dispersion, given their natural role as both liquidity providers and opportunistic investors. Low-beta, multi-strategy exposures are preferred within core hedge funds, while we have also introduced alternative diversifying strategies into portfolios through royalties, insurance and litigation, due to higher equity/bond correlations.

Private markets

Private equity remains core, with venture secondaries particularly attractive. Deal and exit activity remains muted, albeit green shoots are emerging. This should support valuations, given underlying company fundamentals appear strong. In light of this, we recommend maintaining exposures to private equity and venture capital and building positions where underweight. We prefer new primary and secondary fund commitment structures, with venture secondaries presenting attractive opportunities, given ongoing persistent dislocations and heightened discounts relative to buy-out equivalents. However, investors should maintain discipline and partner with fund managers that have sufficient data and qualitative insights to source and assess high quality opportunities.

Private debt is preferred, albeit competition is increasing. Higher base rates and increased spreads on private debt offshore mean that risk-adjusted returns continue to be attractive relative to other asset classes. However, public markets have re-opened, which has increased competition, and spreads are beginning to tighten, whilst the anticipated trajectory of interest rates will reduce absolute returns longer term. Direct, sponsor-backed transactions versus broadly syndicated strategies are preferred, as loan terms can be negotiated directly, but we are also looking at private, asset-backed finance. As well as being a good diversifier, this has the potential to be a much larger, yet less competed market. We are cautious on construction and land-focussed real estate lending.

Real assets

We are becoming more constructive on global real estate. Valuer sentiment in Australia has shifted, which has resulted in meaningful downgrades in valuations. This is more in line with what has been experienced globally across sectors. While there may still be further to move, particularly in lower quality assets, we anticipate that the next three to six months should present an attractive long-term entry point for those looking past the noise, particularly when you consider replacement costs have risen materially, which limits future supply. While we do expect interest rates to moderate globally from here, which will support valuations, investors should focus on buying well into high quality assets without making heroic assumptions on the path of prospective interest rate moves or value-add initiatives. Trying to pick the bottom of any market remains challenging. But taking a long-term view, core-plus property equity is looking more attractive. We prefer global relative to local markets at this juncture.

Infrastructure is the most preferred sub-asset class within alternatives. Infrastructure continues to perform strongly, given its more defensively positioned assets with often long-term, inflation-linked contracts. Infrastructure also plays to long-term, multi-decade structural growth themes, most notably decarbonisation and digitisation, where we are happy to take on a little more risk through value-add exposures. Private clients remain underinvested in unlisted infrastructure relative to Australia's institutional community, and growing exposures should aid long-term portfolio outcomes on both return-enhancing and risk-reduction measures.

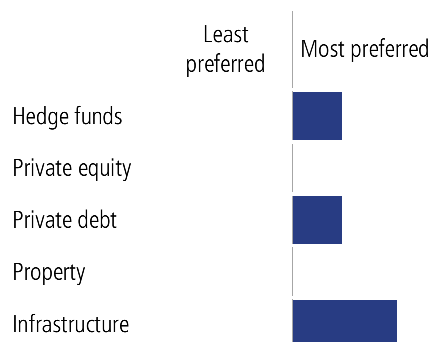
We favour infrastructure, private debt, hedge fund and diversifying strategies, and are maintaining private equity exposures. We are becoming more constructive on real estate globally.

What we like

- Multi-strategy hedge funds and other diversifying strategies.
- Global venture capital secondaries.
- Senior private debt, including corporate, asset-based finance.
- Global infrastructure across the risk spectrum, particularly playing to long-term structural themes.

What we don't like

- Long-bias equity hedge fund strategies.
- Construction and/or junior lending within real estate.
- Carbon-intensive assets and industries with no transition plan.



Direct equity

Recommendations:
Domestic equities—Best sector ideas

Objective of this list

The objective is to identify the best business models or best in breed by GIC's Industry Group for longer-term investors. While we also overlay valuation, companies are included based on anticipated three to five-year performance. When analysing companies to add to the list, some metrics we consider are:

- **Profitability measures**—Return on net operating assets, return on invested capital, free cashflow and return on equity.
- **Liquidity and leverage**—Net debt to equity, Altman Z-score, net debt to earnings before interest, tax, depreciation, and amortisation (EBITDA).
- **Efficiency**—Capital expenditure to sales.
- **Valuation**—Price/earnings ratio, price/book ratio, enterprise value to sales and EBITDA, private equity screens.

Code	Company	Sector	Market price	Consensus price target	P/E 1yr fwd (x)	Dividend yield	ROIC	ROE	1yr EPS growth	MSCI ESG rating
REA	REA Group Ltd	Com. Services	$201.00	$196.83	48.2	1.2%	42%	32%	18.6%	AA
ALL	Aristocrat Leisure Ltd	Cons. Disc.	$58.60	$55.69	24.4	1.3%	25%	23%	8.8%	AA
TLC	Lottery Corp Ltd/The	Cons. Disc.	$5.12	$5.37	29.4	3.3%	23%	113%	7.5%	AA
MTS	Metcash Ltd	Cons. Staples	$3.58	$4.14	13.0	5.4%	19%	19%	5.8%	AAA
ALD	Ampol Ltd	Energy	$30.53	$34.35	15.8	4.5%	13%	14%	19.7%	AA
BPT	Beach Energy Ltd	Energy	$1.22	$1.52	7.3	4.9%	14%	11%	39.2%	AAA
MQG	Macquarie Group Ltd	Financials	$232.37	$211.66	21.7	3.0%	na	12%	12.7%	AA
SUN	Suncorp Group Ltd	Financials	$18.09	$18.22	18.2	4.4%	6%	11%	12.2%	AAA
RMD	ResMed Inc	Health Care	$34.97	$37.65	26.4	0.6%	29%	25%	9.6%	A
CSL	CSL Ltd	Health Care	$286.28	$324.80	29.5	1.0%	14%	18%	16.6%	AA
MND	Monadelphous Group	Industrials	$12.91	$14.02	18.0	5.0%	18%	15%	7.6%	AAA
BXB	Brambles Ltd	Industrials	$19.03	$18.84	21.3	2.0%	22%	28%	11.3%	AAA
XRO	Xero Ltd	Info. Tech.	$149.44	$160.32	90.3	0.0%	13%	17%	40.9%	AA
IGO	IGO Ltd	Materials	$5.86	$6.54	27.5	1.8%	2%	4%	41.8%	AAA
JHX	James Hardie Industries	Materials	$57.43	$53.54	26.5	0.0%	40%	30%	18.8%	AA
GMG	Goodman Group	Real Estate	$36.99	$35.83	30.7	0.8%	12%	12%	13.5%	AA
APA	APA Group	Utilities	$7.76	$8.49	47.3	7.3%	6%	8%	31.7%	AAA

Source: Bloomberg Analyst consensus and MSCI Research. This list does not constitute research and is the output of material prepared by our research providers. To obtain a copy of the underlying research, please contact your investment adviser. Data as of 30 September 2024. ESG is environmental, social, and corporate governance.

Trade opportunities

Please note the following opportunities may not fully satisfy metrics for the above table.

REA Group (REA AU) – Buy. The stock has fallen 10% since REA lodged a GBP 6 billion bid for Rightmove, the dominant real estate advertiser in the UK. With the bid knocked back by Rightmove, we see this as an opportunity to add to REA. Revenue is forecast to grow in the double digits, and the opportunity in India is large, while the magnitude of losses there are decreasing.

Brambles Ltd (BXB AU) – Buy. BXB is compensating investors with a 4.5% free cash flow yield and providing guidance for double-digit EPS growth. Return on invested capital for financial year 2025 is forecast to stay above 20%, and inventory optimisation and reduced loss are pointing to sustainably higher free cash flow generation.

IGO Ltd (IGO AU) – Buy. With news that Chinese producer CATL is reducing supply, and mines shutting at the marginal end of the cost curve, there is evidence that lithium could soon find support. As the world's lowest cost producer of lithium with a large net cash position, IGO is well positioned to weather the current weakness. It intends to develop a copper division, which is a stable complement to the extreme volatility of the lithium sector.

Recommendations: Domestic equities—Sustainable income

Objective of this list

This objective is to generate 'sustainable income' over time. Historically, companies that grow their dividends consistently can offer superior long-term performance. While we also overlay valuation, companies are included based on anticipated three to five-year performance. When analysing companies to add to this list, some metrics we consider are:

- **Profitability measures—**Return on assets, cashflow, return on invested capital and return on equity.
- **Liquidity and leverage**—Net debt to equity.
- **Efficiency**—Change in revenue, EBITDA, and margins.
- **Management signalling**—Dividend growth and pay-out ratios.

Code	Company	Sector	Market price	Consensus price target	P/E 1yr fwd (x)	P/B 1yr fwd (x)	Franking	Div. yield	1yr DPS growth	MSCI ESG rating
SUN	Suncorp Group Ltd	Financials	$18.09	$18.22	16.2	1.66	100%	4.4%	0.7%	AAA
MQG	Macquarie Group Ltd	Financials	$232.37	$211.66	19.2	2.53	40%	3.0%	9.3%	AA
WBC	Westpac Banking Corp	Financials	$31.72	$26.56	16.2	1.53	100%	5.4%	-8.0%	A
QBE	QBE Insurance Group Ltd	Financials	$16.54	$18.63	10.0	1.69	20%	4.2%	11.8%	AAA
COL	Coles Group Ltd	Cons. Staples	$18.06	$18.87	18.7	6.66	100%	3.9%	14.3%	AA
MTS	Metcash Ltd	Cons. Staples	$3.58	$4.14	12.3	2.58	100%	5.4%	4.6%	AAA
TLC	Lottery Corp Ltd/The	Cons. Disc	$5.12	$5.37	27.4	31.38	100%	3.3%	8.3%	AA
TAH	Tabcorp Holdings Ltd	Cons. Disc	$0.51	$0.58	18.0	0.92	0%	2.8%	21.4%	AA
TLS	Telstra Group Ltd	Com. Services	$3.88	$4.27	18.1	3.00	100%	4.8%	5.9%	AA
NEC	Nine Entertainment Co.	Com. Services	$1.26	$1.77	10.4	1.25	0%	5.9%	16.2%	AA
RMD	ResMed Inc	Health Care	$34.97	$37.65	24.1	7.37	100%	0.6%	9.3%	A
PME	Pro Medicus Ltd	Health Care	$178.25	$136.42	135.6	99.15	100%	0.3%	29.4%	BBB
REP	RAM Essential Services	Real Estate	$0.71	$0.75	13.6	1.64	0%	7.2%	2.0%	-
MGR	Mirvac Group	Real Estate	$2.15	$2.20	17.2	0.91	0%	4.2%	11.1%	AA
IRE	IRESS Ltd	IT	$9.92	$10.47	24.9	6.23	0%	1.1%	136.3%	AA
DBI	Dalrymple Bay Infra	Industrials	$3.23	$3.18	17.2	1.45	67%	6.8%	-16.4%	-
ALX	Atlas Arteria Ltd	Industrials	$4.89	$5.51	13.2	1.16	0%	8.2%	2.7%	AA
APA	APA Group	Utilities	$7.76	$8.49	35.9	3.07	0%	7.3%	1.8%	AAA
ALD	Ampol Ltd	Energy	$30.53	$34.35	13.2	2.16	100%	4.5%	28.8%	AA
BPT	Beach Energy Ltd	Energy	$1.22	$1.52	5.3	0.84	100%	4.9%	81.4%	AAA
BHP	BHP Group Ltd	Materials	$45.96	$44.83	13.3	3.59	100%	2.9%	-2.9%	A
AMC	Amcor PLC	Materials	$16.34	$16.08	14.5	4.21	0%	3.1%	1.2%	A

Source: Bloomberg Analyst consensus and MSCI Research. This list does not constitute research and is the output of material prepared by our research providers. To obtain a copy of the underlying research, please contact your investment adviser. Data as of 30 September 2024. ESG is environmental, social, and corporate governance.

Trade opportunities

Please note the following opportunities may not fully satisfy metrics for the above table.

Mirvac Group (MGR)—Buy. The stock is trading at 0.8x book value with catalysts on the horizon: office valuations finding a bottom, successful divestments reducing earnings uncertainty, capital partnerships unlocking a development pipeline, and a tailwind from interest rate cuts. It pays a 5.1% fully franked dividend with its price protected by buffer to net tangible assets.

Iress (IRE)—Buy. IRE is refocusing on its core wealth and trading business, with the sale of the platforms business plus the sale of UK mortgages due to complete on 1 August 2024. This will enable IRE to restate its dividend, alongside improving momentum at the top line (contract resets) and bottom line (cost efficiencies).

Atlas Arteria (ALX)—Buy. The company is forecast to distribute 7.6% in dividends in the coming 12 months. A new concession tax, which is being imposed on traffic networks, is fully priced, yet there is a chance it will be overruled by the French constitutional court. Even if the tax is upheld, Atlas may seek compensation, which is all upside to its current price.

Recommendations:
International equities—Best sector ideas

Objective of this list

The objective is to provide a list of large-cap international companies across sectors with sustainable business models that generate compounding returns on investment and capital over the longer term. While we also overlay valuation, companies are included based on anticipated three to five-year performance. When analysing companies to add to the list, some metrics we consider are:

- **Profitability measures**—Return on net operating assets, return on invested capital, free cashflow and return on equity.
- **Liquidity and leverage**—Net debt to equity, Altman Z-score, net debt to EBITDA.
- **Efficiency**—Capital expenditure to sales.
- **Valuation**—Price/earnings ratio, price/book ratio, enterprise value to sales and EBITDA, private equity screens.

Code	Company	Sector	Base CCY	Market price	Consensus price target	P/E 1yr fwd (x)	Yield (%)	Market cap (USD bn)	MSCI ESG rating
GOOGL US	Alphabet Inc	Com. Services	USD	165.83	204.65	18.7	0.4	2,049,552	BBB
UMG NA	Universal Music Group	Com. Services	EUR	23.50	27.18	22.7	2.5	47,871	AA
DIS US	Walt Disney Co/The	Com. Services	USD	96.19	109.93	18.6	1.1	174,449	A
9988 HK	Alibaba Group Holding	Consumer Disc.	HKD	110.00	106.07	11.0	0.7	271,670	BBB
NKE US	NIKE Inc	Consumer Disc.	USD	88.40	91.10	25.0	1.9	132,543	BB
SBUX US	Starbucks Corp	Consumer Disc.	USD	97.49	99.13	25.0	2.5	110,476	A
ABNB US	Airbnb Inc	Consumer Disc.	USD	126.81	125.01	25.5	0.0	81,364	BB
RMS FP	Hermes International	Consumer Disc.	EUR	2206.00	2196.00	45.5	0.9	259,342	BB
EL US	Estee Lauder Cos Inc/The	Consumer Staples	USD	99.69	109.53	25.3	3.0	35,786	A
COST US	Costco Wholesale Corp	Consumer Staples	USD	886.52	938.72	45.1	0.6	393,025	A
288 HK	WH Group Ltd	Consumer Staples	HKD	6.16	7.45	7.4	0.8	10,167	–
SHEL LN	Shell PLC	Energy	GBP	2425.00	3126.90	7.1	0.1	201,906	AA
LSEG LN	London Stock Exchange	Financials	GBP	10220.00	11039.19	25.9	1.4	72,621	AA
LLOY LN	Lloyds Banking Group	Financials	GBP	58.80	62.36	8.1	5.6	48,383	AA
WFC US	Wells Fargo & Co	Financials	USD	56.49	64.17	10.3	3.0	192,279	BB
2318 HK	Ping An Insurance Group	Financials	HKD	50.15	53.00	6.2	5.2	135,591	A
939 HK	China Construction Bank	Financials	HKD	5.88	6.81	4.0	6.9	192,693	AA
MA US	Mastercard Inc	Financials	USD	493.80	523.50	29.7	0.6	456,211	AA
JNJ US	Johnson & Johnson	Health Care	USD	162.06	171.17	15.1	3.1	390,118	A
NOVOB DC	Novo Nordisk A/S	Health Care	DKK	786.80	968.53	27.1	1.9	524,831	AAA
ISRG US	Intuitive Surgical Inc	Health Care	USD	491.27	486.00	64.5	0.0	174,575	A
EXPN LN	Experian PLC	Industrials	GBP	3931.00	4166.31	29.8	0.0	48,335	A
DSV DC	DSV A/S	Industrials	DKK	1382.50	1582.35	22.4	0.5	44,199	AA
2330 TT	Taiwan Semiconductor	Information Tech.	TWD	957.00	1227.71	17.9	1.7	783,781	AAA
ASML NA	ASML Holding NV	Information Tech.	EUR	745.60	1017.35	25.5	1.1	331,775	AAA
MSFT US	Microsoft Corp	Information Tech.	USD	430.12	499.04	28.1	0.8	3,197,098	AA
ACN US	Accenture PLC	Information Tech.	USD	353.48	380.27	25.1	1.7	221,662	AA
SHW US	Sherwin-Williams Co/The	Materials	USD	381.67	372.46	29.7	0.8	96,279	A
EQIX US	Equinix Inc	Real Estate	USD	887.63	919.18	64.7	2.1	84,276	AA
ORSTED DC	Orsted AS	Utilities	DKK	445.20	460.37	15.9	na	27,960	AAA
		Average Yield:					1.7%		

Source: Bloomberg Analyst consensus and MSCI Research. This list does not constitute research and is the output of material prepared by our research providers. To obtain a copy of the underlying research, please contact your investment adviser. Data as of 30 September 2024. ESG is environmental, social, and corporate governance.

Recommendations: Thematic investing—The intersection of AI and decarbonisation

Objective of this list

Thematic investing is an approach which focuses on predicting long-term trends rather than specific companies or sectors. As it is also often associated with secular forces, this means it can provide investors with exposure to themes that are expected to grow at rates above economic growth over the longer term. Thematic investing is best suited to longer-term investors and those looking for opportunities beyond the comparatively smaller investment universe that exists in Australia. Some key themes that investors are exploring include:

- Climate change.
- Cryptocurrency and blockchain.
- Demographics.
- Electric vehicles.
- Healthcare and genomics.
- Energy transition.
- Artificial Intelligence.
- Security and safety.
- Supply chain disruption.
- Sustainable investing.

The intersection of AI and decarbonisation—Select exposures

Energy demand is being underpinned by two major crosscurrents simultaneously—the world's transition commitment, and the nascent, yet burgeoning, demand for AI and its significant energy requirements. There exist opportunities across multiple industries, capital structures, and asset classes, making it a rich environment for alpha generation.

Code	Company	Sector	Base CCY	Market price	Consensus price target	P/E 1yr fwd (x)	Yield (%)	Market cap (USD bn)	MSCI ESG rating
GOOGL US	Alphabet Inc	Comm. Services	USD	165.83	204.65	18.7	0.4	2,049,552	BBB
AMZN US	Amazon.com Inc	Cons. Disc.	USD	186.33	219.94	27.9	0.0	1,955,639	BBB
TSLA US	Tesla Inc	Cons. Disc.	USD	261.63	216.62	83.5	0.0	835,814	BBB
NXE US	NexGen Energy Ltd	Energy	USD	6.53	9.35	na	na	3,687	A
CCJ US	Cameco Corp	Energy	USD	47.76	56.44	36.0	0.2	20,784	AA
SHEL LN	Shell PLC	Energy	GBP	2425.00	3126.90	7.1	0.1	201,906	AA
BPT AU	Beach Energy Ltd	Energy	AUD	1.22	1.52	5.3	8.8	1,917	AA
STO AU	Santos Ltd	Energy	AUD	7.02	8.37	11.5	3.1	15,768	AA
SU FP	Schneider Electric SE	Industrials	EUR	236.20	237.74	25.2	1.7	151,409	AAA
VWS DC	Vestas Wind Systems	Industrials	DKK	147.85	206.83	17.2	0.2	22,306	AAA
GEV US	GE Vernova Inc	Industrials	USD	254.98	233.59	37.8	0.0	70,069	A
NVDA US	NVIDIA Corp	IT	USD	121.43	147.59	30.0	0.0	2,978,791	AAA
MSFT US	Microsoft Corp	IT	USD	430.12	499.04	28.1	0.8	3,197,098	AA
2330 TT	Taiwan Semiconductors	IT	TWD	957.00	1227.71	17.9	1.7	783,781	AAA
ASML NA	ASML Holding NV	IT	EUR	745.60	1017.35	25.5	1.1	331,775	AAA
NXT AU	NEXTDC Ltd	IT	AUD	17.50	19.92	na	0.0	7,667	AA
IFX GY	Infineon Technologies	IT	EUR	31.46	42.03	15.2	1.2	45,751	AAA
ON US	ON Semiconductor Corp	IT	USD	72.61	87.08	15.1	0.0	31,103	A
FCX US	Freeport-McMoRan Inc	Materials	USD	49.92	55.04	22.7	1.5	71,728	BBB
GMG AU	Goodman Group	Real Estate	AUD	36.99	35.83	27.1	0.8	48,903	AA
NEE US	NextEra Energy Inc	Utilities	USD	84.53	88.20	23.5	2.7	173,709	AA
CEG US	Constellation Energy	Utilities	USD	259.95	267.56	29.1	0.6	81,915	BBB
ORSTED DC	Orsted AS	Utilities	DKK	445.20	460.37	15.9	3.8	27,959	AAA

Source: Bloomberg Analyst consensus and MSCI Research. Data as of 30 September 2024. ESG is environmental, social, and corporate governance.

Important information

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