2024 YEAR IN REVIEW & MARKET OUTLOOK

2024 YEAR IN REVIEW

The year 2024 saw global financial markets navigate a landscape shaped by inflationary trends, central bank interest rate policy, and significant geopolitical events. Share markets began the year positively, supported by signs of easing inflation, particularly in Australia and the US. Investor optimism grew as expectations of future rate cuts emerged, despite inflation remaining above target levels.

Throughout the first half of the year, the US market surged, led by a wave of enthusiasm for artificial intelligence (AI) and strong corporate earnings. The rally was concentrated as the AI theme led the 'Magnificent 7', particularly Nvidia, to be the leading driver of rising markets. Australian shares experienced more modest gains. Throughout the rally, valuations remained elevated, and concerns about growth and inflation led to periodic volatility.

Fixed interest markets reflected these uncertainties, with bond yields rising (and bond prices falling) in the early months as central banks signalled a cautious approach to monetary easing. The US Federal Reserve and the Reserve Bank of Australia were patient in their outlook, delaying rate cuts until inflation was firmly under control. This environment put pressure on interest rate-sensitive sectors like real estate and infrastructure. By mid-year, bond yields began to fall as economic data suggested a gradual weakening in growth, which tempered expectations for aggressive monetary tightening. In contrast, central banks in Europe and Canada took steps to ease policy.

The second half of 2024 was characterised by increased volatility, driven by geopolitical uncertainties, including the US Presidential Election. Investor sentiment fluctuated as weaker economic data and labour market trends heightened fears of recession and influenced expectations for interest rate cuts. The election outcome then provided a significant boost to markets, with US shares rallying and Australian markets reaching new highs. The technology and financial sectors led gains, while the resources sector faced challenges due to weak Chinese economic data and fluctuating commodity prices.

As 2024 draws to a close, global share markets are ending the year strongly, supported by expectations of eventual policy easing. Fixed interest markets reflect this optimism, with bond yields declining modestly from mid-November. In Australia, the RBA remained cautious, with rate cuts pushed into mid-2025 as inflation remains above target and the labour market remains tight.

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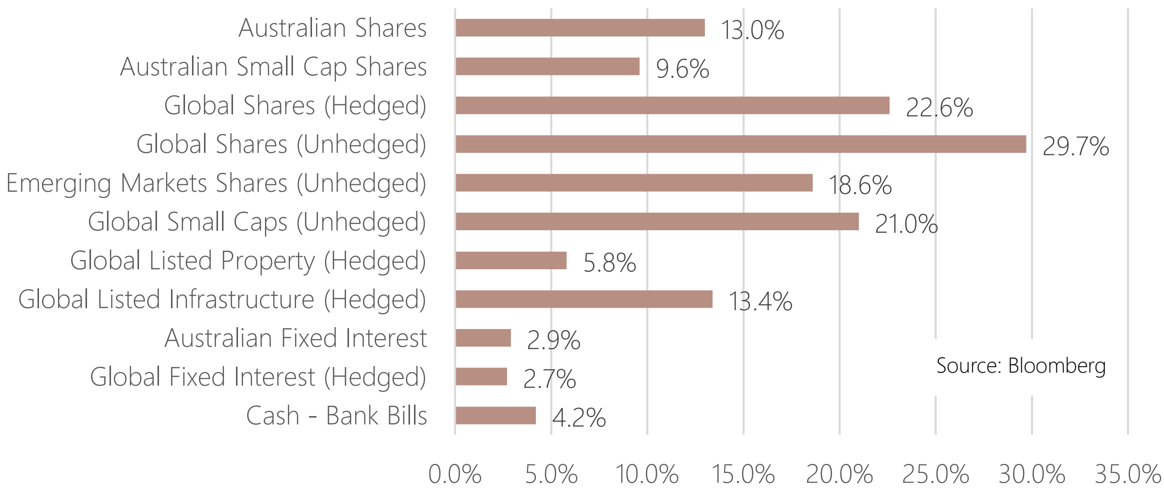

MARKET OUTLOOK

As we enter 2025, several positive factors support a constructive outlook. Rate cuts are expected to continue as inflation moderates, economic growth is likely to align with long-term trends, and global corporate profits are forecast to grow by around 8% over the next year. Additionally, stimulatory fiscal policies worldwide are bolstering aggregate demand. These elements are favourable for valuations of shares and earnings growth, fostering optimism in financial markets.

However, valuations suggest that shares are priced for perfection, meaning strong earnings growth is necessary to meet market expectations. Any downward revision in growth forecasts could trigger a market correction. These stretched valuations are a key reason for our cautious stance on overweighting shares as we head into 2025.

That said, there are potential upsides. Advances in AI could significantly enhance productivity, driving a structural shift in business operations and earnings growth. Despite high valuations, bull markets can run for many years, and AI-driven productivity may well be a catalyst for this rally to extend throughout 2025.

Key risks for 2025 include:

- The extent of US tariffs and their impact on global trade, inflation and the US dollar.
- China's ongoing economic challenges and the effectiveness of its stimulus efforts to revive the property market and domestic consumption.
- Persistent US wage and services inflation, coupled with political uncertainty, which may lead the US Federal Reserve to delay rate cuts.
- Australia's slowing economy and weaker household consumption, combined with sticky inflation, could create headwinds for both the domestic economy and the share market.

Overall, while we remain optimistic about global earnings growth, we are cautious due to high valuations and potential risks that could temper expectations. Encouragingly, share market strength is broadening beyond US mega-tech, with small caps, real assets and financials catching up with the rally. This broader rally should benefit our actively managed funds.