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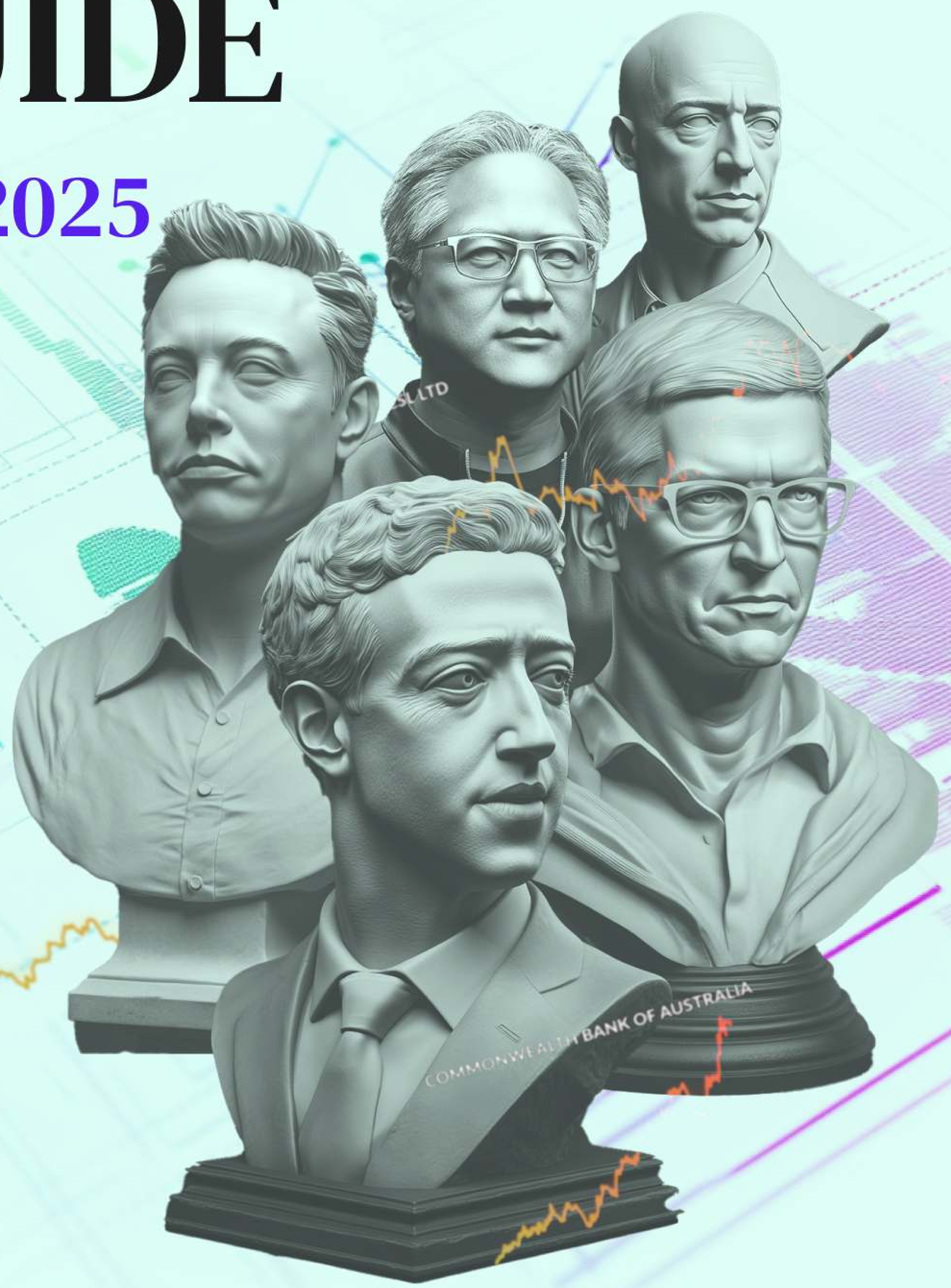
THE ULTIMATE INVESTING GUIDE

FOR 2025



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Tim Toohey
Head of Macro and Strategy

Yarra Capital Management

FOREWORD

Market Outlook – From Reflation to Rotation

With global and local equity markets on track to record 25-30% returns in calendar 2024, there is no question this was a year of financial market reflation. The big question is what comes next? In short, we think the economic environment will support risk asset optimism in early 2025, but ultimately we believe President Trump's policies will be a net negative for 2025-26 and expect investors to rotate into bonds progressively through the remainder of the calendar year.

The impact of Trump and his policies

It is highly likely that the next four years will bring heightened volatility as markets return to being reactive to Trump's predilection to make shock announcements.

If Trump's plan was implemented in full, we believe US inflation would be ~1% higher than the baseline scenario and US economic growth would be ~0.75% lower in 2025-26. The impacts are smaller if the US only impose tariffs on China, but there is no scenario in which an escalation in trade restrictions boosts economic growth and lowers inflation. If fully implemented, we believe Trump's US$7.5 trillion in election promises will push government debt to economically unsustainable levels over the next decade.

The response from the rest of the world

Trade policy is not a zero-sum game. Increasing tariffs in one country that leads to retaliation in other countries not only lifts the costs of traded goods, it also increases uncertainty and ultimately reduces investment, employment and global economic growth.

Our base case is that tariffs will be selectively applied by the US to Europe as well as China and 5% generalised tariff will be implemented. In response, the ECB will be forced to ease policy further, European governments will be forced to divert more expenditure to its own defence, and ultimately will allow greater access for US products into the European market at the expense other trading partners. This is ultimately a negative story for Europe.

From Australia's perspective, it is feasible that Australia's exports to China will be largely insulated from the impact of a US-China trade war. Moreover, Australia will likely be a recipient of cheap manufactured product from China as goods are diverted to countries without tariff restrictions. In this respect, it is not clear that inflationary impact from a US-China trade war will be material for Australia. It is possible that it proves disinflationary depending on just how much excess China production is diverted to our market.

On balance, we expect global economic growth to average 2.8% in 2025, starting the year with solid economic growth momentum before faltering somewhat through 2H25.

Australia in 2025: Improving off a low base but policymakers have been more of a hindrance than a help

This time last year, it was commonplace for forecasters to suggest that there was a high risk of recession in Australia in 2024. Our view was that tepid growth conditions would persist into early 2024 and that growth would see some modest, sequential growth through 2H24. At the time of writing, we are yet to see the hard evidence of this modest recovery, outside of better confidence readings at the consumer and business level.

Disappointing economic data into the close for 2024 confirm the RBA is yet again cum-downgrade for their economic growth forecasts. More importantly, we believe that the RBA is misreading the inflation dynamics in Australia. There are three main reasons:

- Currently, 49% of the items in the CPI basket are expanding at a pace below 2% - the bottom end of the target band of 2%-3%. Typically, the RBA is well into an easing cycle with a distribution of inflation that is this supportive.

- Electricity and rental subsidies have contributed to weak inflation in recent months, but it is important to note that the RBA's assumption that these subsidies will lapse in 2025 is likely wrong. The Treasurer has repeatedly signalled his intent to extend the subsidies. Thus, the RBA's forecast for CPI is likely to be close to 1% too high through 2H25.

- The RBA's primary argument is that private sector services inflation remains too high due to excessive demand. However, just 9% of the basket is discretionary services. Overwhelmingly, the source of high services inflation is in non-discretionary publicly administered prices which is mostly a function of lagged indexation from the prior year. This force of inflation will mechanically fade quickly in 1H25.

We estimate financial conditions are restrictive and to achieve a neutral setting 125bps of easing in the cash rate is required. We continue to expect 100bps of easing in 2025 commencing in February.

Private demand recovery. Public sector headwinds.

Despite the current economic malaise, a private sector recovery is still likely. This recovery will be driven via improved real income growth supporting a modest consumer recovery and ongoing private investment growth. There is also evidence that single-home construction is being dragged higher by a sheer scale of the shortage of homes, despite record lows for housing affordability and lacklustre apartment approvals.

Two of the main domestic challenges for 2025 will be largely political in nature. A minority government is possible, if not probable, and that will do little to alleviate investment uncertainty and additional fiscal spending looks unlikely at this stage. The biggest swing factor may well come down to the competition between the major parties to expedite a slowdown in population growth. While the intention is to help alleviate pressure on infrastructure and rents, a sharp policy-induced slowdown in population growth could easily become the biggest hurdle to economic growth in Australia in 2025 and 2026.

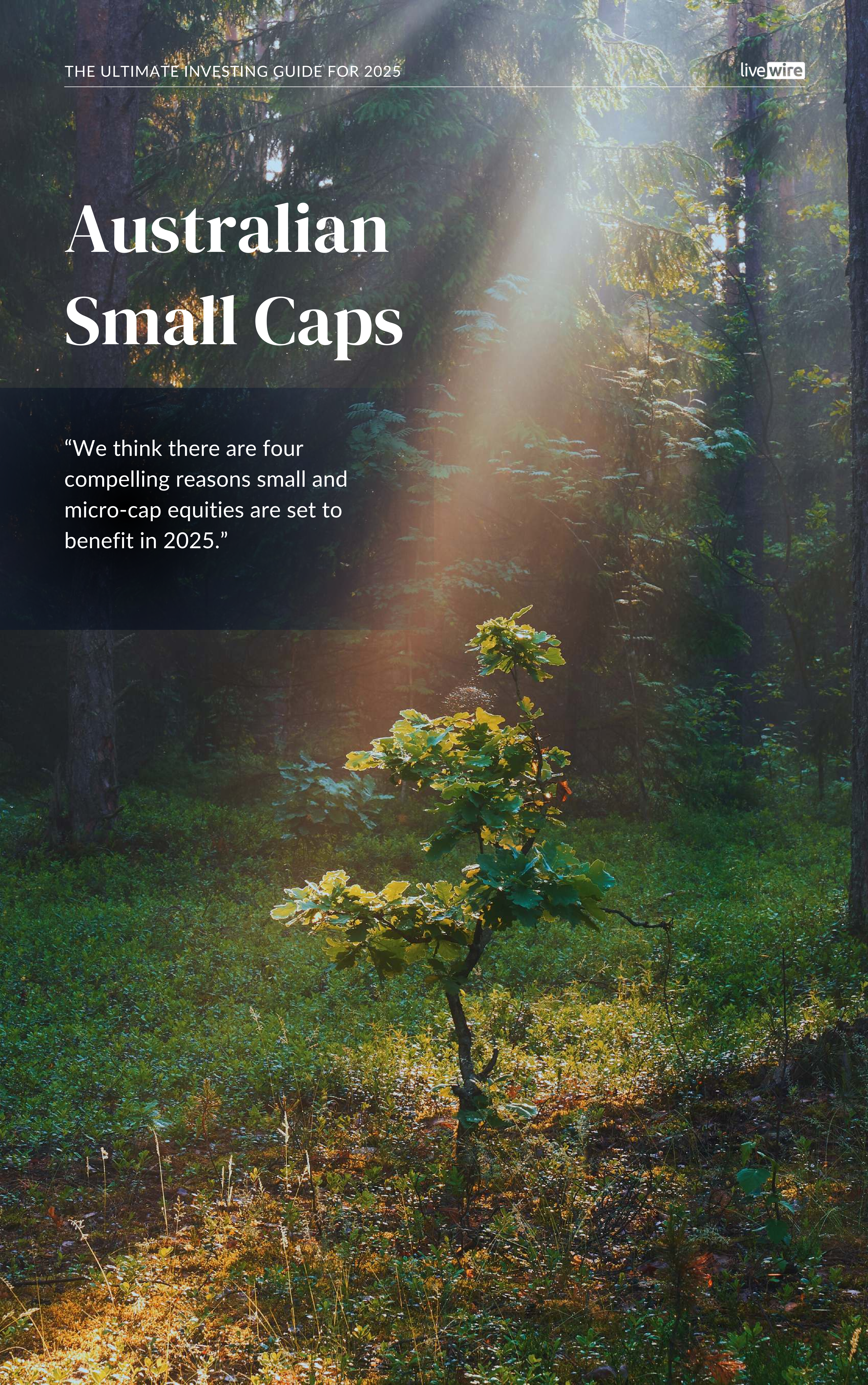
Tactical positioning: Rotating from equities to bonds as the year unfolds

A modest economic recovery won't provide the type of cyclical leverage that will drive a material uplift in EPS growth in 2025. After two years of negative EPS growth, Australian market multiples are demanding and equity risk premia is historically low. With bonds closer to fair value, given the prevailing economic conditions, we can see the attraction of carrying a more even weighting towards fixed income and equities as we move through 1H25.

In the nearer term, we expect that loose US financial conditions will inspire some nearer-term economic and EPS upgrades in the US before Trump's policies ultimately weigh on future growth expectations. As such, equities may remain in favour in the early part of 2025, but we expect sentiment will turn before mid-2025. In the interim we expect bonds to bake in higher inflation risks and renewed fears of excessive debt issuance in early 2025, providing an opportunity to lift bond holdings in the remainder of 2025.

Australian Small Caps

"We think there are four compelling reasons small and micro-cap equities are set to benefit in 2025."



Arden Jennings
Co-Head Emerging Companies, Portfolio Manager, Small & MicroCap

Ausbil Investment Management

4 compelling reasons to add small companies in 2025

Australian small and micro-cap equities have been promising a resurgence in returns. We think there are four compelling reasons small and micro-cap equities are set to benefit in 2025.

1: A positive macro-economic environment for equities in 2025, particularly small caps

Emerging markets equities have derated for more than a decade. Despite very attractive valuation, the majority of investors are only "lightly" positioned in the asset class. Investor sentiment remains lukewarm.

The reality is rather more exciting because the fundamentals of these economies are robust, and they offer sustainable economic growth in a slow global environment. Many of these EM economies are in better fiscal and financial health in comparison with the developed world. These economies stand to deliver healthy and consistent economic growth in the coming years.

2: In the positive economic environment, we are expecting a resurgence in relative performance

2024 was a good year for equities. Since the date of the last rate hike, small and micro-cap equities have generated a significant return alongside the broad market S&P/ASX 300. For the year to 31 October, the S&P/ASX Small Ordinaries Accumulation Index delivered a return of +27% while the S&P/ASX Emerging Companies Accumulation Index achieved a return of +28%. Not only has the market rallied, we are also seeing a broadening across sectors and key return drivers, including cyclical and structural growth.

We believe this return partly represents the positive impact that interest rate normalisation has had on equity markets. However, we believe that with interest rates stabilised, and inflation adjusting downwards, that companies are now in an equity-positive environment backed by an improving economic growth outlook. For some context, despite a strong year of returns for equities in 2024, there remains a significant performance disparity between small and large-cap equities (Figure 1).

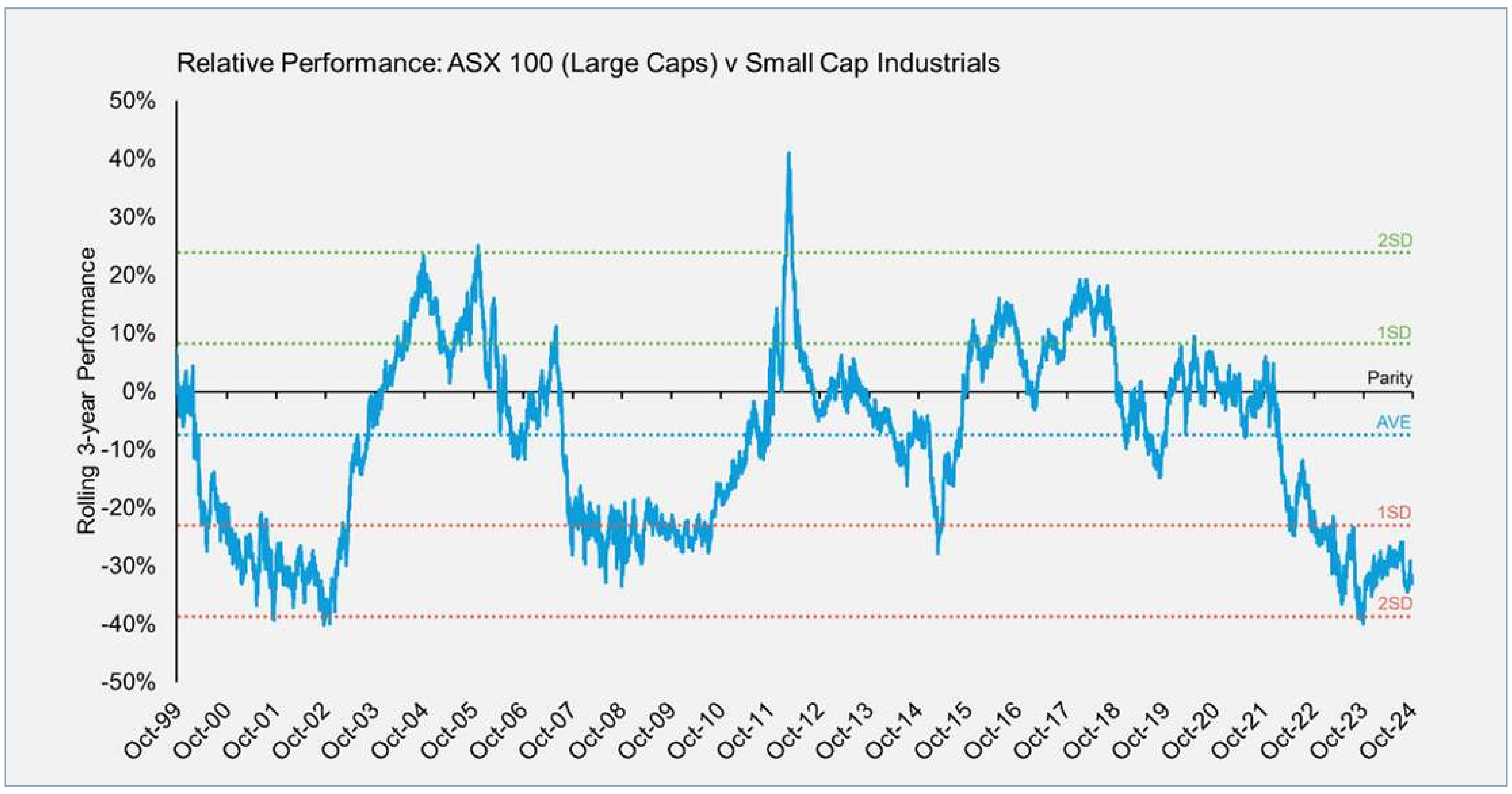


Figure 1: On relative performance, small caps are due a positive reversion
Source: Ausbil, Bloomberg as at October 2024.

With relatively low liquidity (Figure 2) compared to the past, we believe the small cap market is not overcrowded, meaning that more opportunity currently exists for astute active small and micro-cap investors.

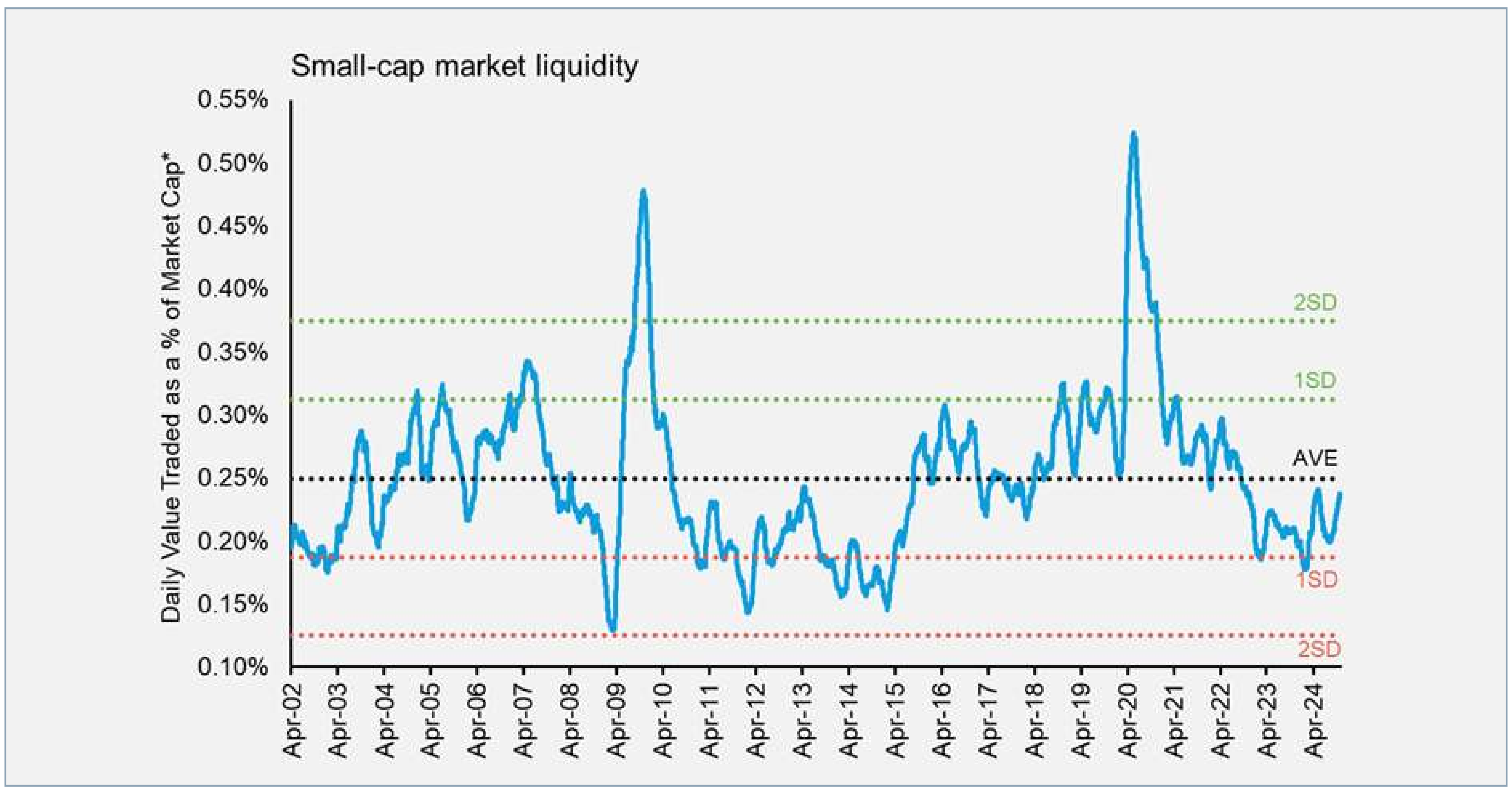


*Figure 2: Small-cap liquidity is on the rise (*rolling three-month average)*
Source: Ausbil, Bloomberg

However, more recently, market liquidity has improved as cash moves into equities, particularly from passive investors and larger equity managers, to chase better returns in small caps, which should assist with a broader small-cap market re-rate.

3: Small companies tend to be more rewarding for active strategies

The rich environment for generating outperformance in small caps is demonstrated in Figure 3, which looks at small-cap manager returns over the last 20 years compared to the benchmark. From the chart, even small cap managers that had generated 20 years of returns that put them into the lower quartile of managers were able to beat the index over the long-term. This is because active investors can seek edges that have shown to deliver better results than the overall market, for example companies that are founder-led, have globally addressable markets and observable barriers to entry for their businesses. Active investors can also engage the leadership of companies and assess the quality and vision of the teams involved, often yielding a clear picture of whether a company is setting itself up for the future or is doomed to underperform.

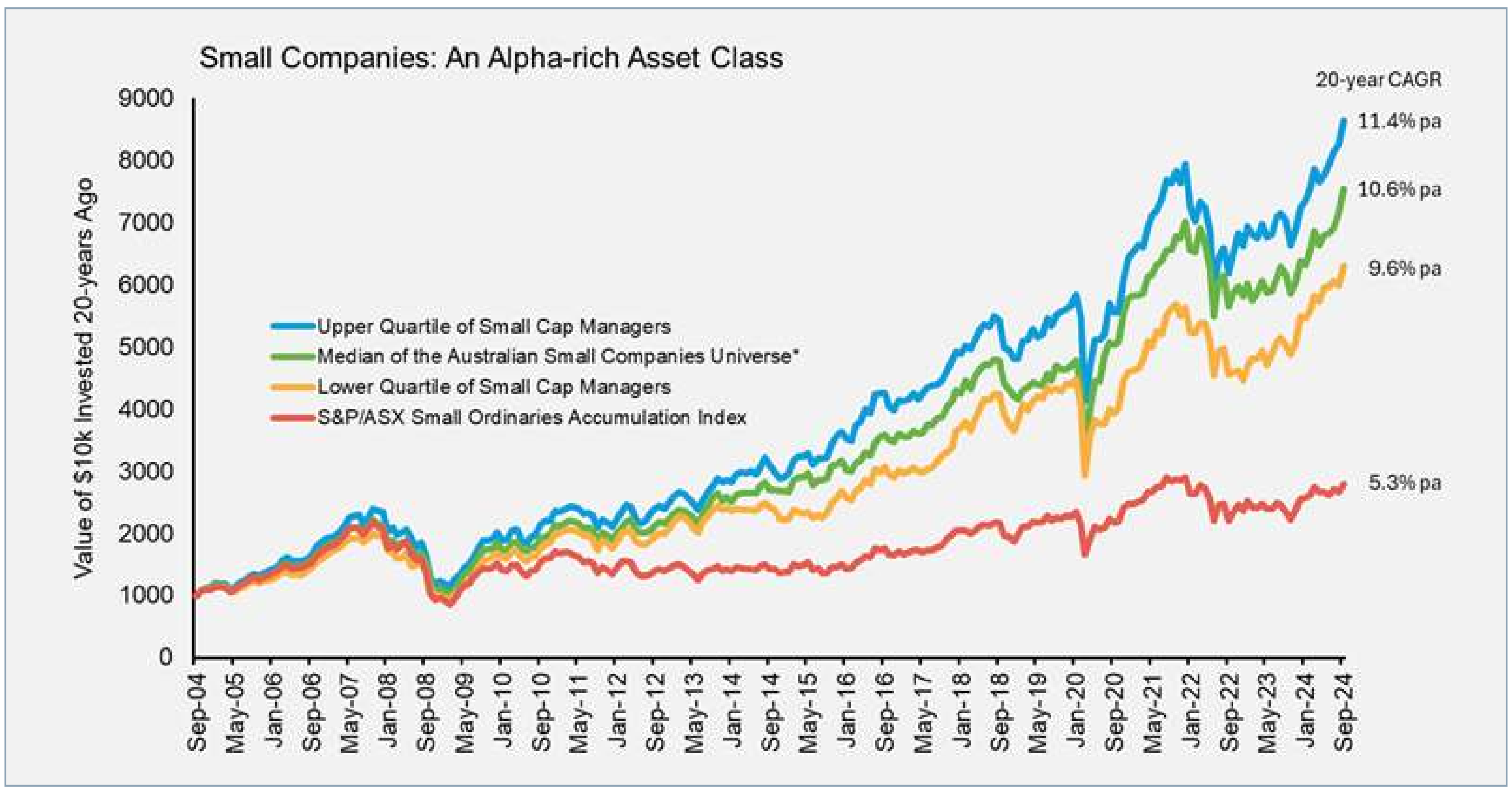


Figure 3: Small caps tend to reward active management
**Universe of small cap managers covered by Mercer research. Source: Mercer, Ausbil. All series in this chart are accumulation series. Data to September 2024 and based in September 2004.*

4: Some small caps stocks are offering compelling earnings growth potential in 2025, but some sectors are not

A number of structural growth companies are offering considerable future potential, especially in the financial sector, like **Generation Development Group (ASX: GDG), HUB24 (ASX: HUB) and Netwealth (ASX: NWL)**. We believe these companies have been able to leverage leading technology platforms to offer greater choice and a superior customer service experience at a comparable or lower cost in the forever compounding wealth and superannuation sector.

Focusing on GDG, the company is a specialist provider of financial solutions such as investment bonds, market-linked annuities and managed accounts. We like GDG's recurring and predictable revenue stream, underpinned by structural tailwinds in their investment bond business and the Lonsec business. Funds under management for the Investment Bond business are up 30% YoY, with the potential for flows to accelerate.

The Lonsec Managed Accounts business is forecast to grow at around 17% per annum for the next five years. Both these businesses are driving what we think is a double-digit earnings growth outlook in the coming years, making GDG a compelling structural growth opportunity.

Communications companies are benefitting as the enablers and distributors of new technology, applications, increasing digitisation and exponential data demand with AI. This includes NBN challengers in **Aussie Broadband (ASX: ABB) and Superloop (ASX: SLC)**, the David Teoh-backed Southeast Asian telco disrupter **Tuas Ltd (ASX: TUA)**, and global communications company, **Codan (ASX: CDA)**. NBN challengers like ABB and SLC are taking NBN market share from incumbent players like Telstra, Optus and TPG. Challengers were at only around 10% market share in 2022 but have since grown to approximately 20% of the market in 2024 by providing superior customer service at a comparable or lower price for the same speed tier. SLC has around 6% of the market with ABB at 8%, and we believe this challenger segment of the market can reach over 30% in market share, representing a 50%+ revenue growth opportunity for these businesses.

SLC's planned build-out of its infrastructure-like assets and its recurring revenue streams is something for which we think the market will pay a higher multiple than other peers in the sector. ABB is a founder-led business with strong industry dynamics that are providing telco challengers with a clear growth trajectory over the coming years. ABB has just reiterated guidance with a number of Enterprise customers signed, and a significant energy customer win in Red Energy.

Another opportunity that has caught our interest is **Zip Co (ASX: ZIP)**. Zip offers US Dollar exposure in a huge addressable market and with the benefit of a strong US Dollar tailwind for earnings. The beginning of a rate easing cycle in the US has seemingly been the catalyst for a rerating of ZIP, and the business has scope to further build out the merchant and payment ecosystem in the US (in addition to Stripe).

Areas to avoid given prevailing conditions include capital intensive, low growth and indebted real estate investment trusts, small resources with poor cashflow and low-quality assets, speculative retail dominated meme stocks, and overpriced tech names that are not benefitting from fundamental structural demand drivers.

Australian Large Caps

“It is important for investors to be aware of potential sector rotation in the market, as history shows that top-performing sectors can become poor performers in subsequent years.”

Casey McLean
Portfolio Manager, Fidelity Australian High Conviction Fund

Fidelity International

Beware of the rotation coming in ASX large cap companies

2024 recap - Strong amidst uncertainty

Amidst a sea of geopolitical, election and macroeconomic uncertainty, the ASX 200 broke through its record high in January 2024 and has not looked back with another year of strong returns.

The key themes that drove the Australian market higher in 2024:
- Global decline in inflation as supply chains normalised and demand for goods eased, coupled with interest rate hikes having their intended effect.
- Initiation of interest rate cuts by central banks in major economies, with the US commencing its rate reduction journey in September.
- Resilient global growth, with robust performance in the US offsetting slower growth in China, and Europe and Japan flirting with recession.
- Commodity prices, whilst mixed, overall strength was observed, particularly with record highs in gold and copper, and solid performance in iron ore and coal throughout most of the year.

2025 outlook

We believe investors should always pay heed to valuation, so let's address this first.

As I put pen to paper at the end of November, the Australian market is valued at levels that have only been surpassed during the COVID period- which does warrant some caution.

However, we believe the structural re-rating can be justified to some extent as we see improvements in the quality of the market due to changes in its composition. Furthermore, it's not unexpected for the market to be highly valued at this stage of the cycle - it often rallies at the beginning of rate-cutting cycles in anticipation of future earnings upgrades. But, for the market to maintain its current rally, earnings will need to demonstrate growth.

The earnings cycle

ASX 200 earnings estimates have been in a downgrade cycle since June 2023, but there are tentative signs that the cycle has reached its nadir.

Australia is a relatively small, open, export-oriented economy heavily reliant on commodities, so it is not surprising that the market is significantly influenced by global growth. In previous cycles, the Global Purchasing Managers' Index (PMI), a key indicator of global growth, has reached its lowest point between two and ten months before the decline in earnings.

In this current cycle, the Global PMI potentially reached its lowest point in July 2023 and is showing signs of recovery, albeit in a volatile pattern. Breaking the Global PMI down further into the Manufacturing and Services components, it is clear that manufacturing has been weak and services strong. A sustained recovery requires the Manufacturing component to recover whilst the Services component maintains it strength, particularly in the US. The encouraging news is that the necessary conditions for this recovery are in place.

Soft landing

Focusing on the US Manufacturing PMI, which has hovered in mild contractionary territory for much of the year, we see a clear relationship with interest rates. In previous cycles, the US Manufacturing PMI reached its lowest point around the halfway mark of an interest rate cutting cycle.

Current market expectations point to an approximately 200 basis points (bps) cut in US interest rates, aligning closely with the median of the US Federal Reserve (Fed)'s own projections by the end of 2025. With the Fed having already implemented a 75bps cut, we are nearing the halfway mark. In fact, current market pricing indicates that this point could be reached early in 2025.

Whilst the risk of a recession is abating, it is difficult to completely rule it out considering the trigger of recession indicators such as the inverted yield curve and the ‘Sahm Rule’.

The Sahm Rule, a concept developed by Fed economist Claudia Sahm, poses that the economy is in a recession when the three-month average unemployment rate rises 50bps from the prior 12-month low - a condition met in July 2024. However, when comparing a range of cyclical indicators for the US economy at the time the Sahm Rule was triggered, it is evident that by all the key indicators economic conditions are notably stronger than in previous cycles.

Overall, it appears that the elusive soft landing remains on track. This is positive signal for the potential earnings recovery and equity market returns.

China: Tariffs and stimulus

China has the potential to be either a headwind or a tailwind to Australian and global growth, depending on a few key factors. These include how aggressive the new Trump administration is in implementing planned tariffs and how China responds with domestic stimulus and potential currency depreciation. Some optimism can be garnered from the noticeable pro-growth pivot in Chinese policymakers’ stance over the second half of 2024 and the significant savings Chinese consumers have built up over the last few years.

Elections: Fiscal stimulus

Elections are another key swing factor with Australians set to go to the polls by May 2025. If we look at overseas elections in 2024 as a guide, there is potential for a notable swing in votes away from the incumbent government due to cost-of-living pressures. With opinion polls now finely balanced, there is a possibility of fiscal stimulus in the form of more spending, tax cuts and more job creation, which is likely to provide support for economic growth. It is reassuring to note that Australia can implement such measures, thanks to the windfall from higher-than-budgeted commodity prices over the last few years. However, there is a downside risk that a minority government could potentially impose limits on the amount of stimulus, leading to a reduction in growth.

Sector rotation

It is important for investors to be aware of potential sector rotation in the market, as historical evidence shows that top-performing sectors can become poor performers in subsequent years. In the Australian market in 2024, there was a notable divergence between the banks and resources sectors. If sentiment towards China improves or domestic conditions deteriorate, it could lead to a rotation in these sectors. Therefore, we believe investors should be vigilant and keep an eye on these potential changes in the market moving forward.

Attractive opportunities amidst volatility

In summary, the Australian market presents an attractive investment opportunity in 2025 with improving fundamentals. Sectors that could benefit from the revival in global growth include Resources and Industrials sectors, whilst the Technology sector is likely to continue to exhibit robust growth.

Conversely, the Banks and Consumer sectors, which have been the winners of 2024, are now highly valued and could see some pressure from rotation. However, it is essential to be mindful of the that volatility will likely remain a consistent feature in an uncertain world. So, it is important to invest for the long term and take advantage of any short-term dislocations on the journey to building wealth.

All information is current as at 29 November 2024 unless otherwise stated.

Residential Property

"The areas that are likely to outperform in 2025 are those where demand is set to remain strong and supply levels tight."

Tim Lawless
Executive, Research Director, Asia-Pacific

CoreLogic

Housing: The year that was and what to expect from 2025

The past year saw the housing sector move through a key milestone, with the value of the asset class surpassing the $11 trillion mark in August (up from $6.97 trillion five years ago). We also saw housing values continue to move through a sustained growth cycle, clocking up 22 months of consecutive gains by the end of November. This has taken values 14.5% higher since the growth cycle commenced in February 2023, and 5.9% above the previous peak in April 2022.

Although the macro trend saw values consistently rising through most of 2023 and 2024, the trends have evolved with the speed of growth losing momentum and conditions becoming more diverse across the capital cities and regions.

At one end of the spectrum, we have the mid-sized capitals of Perth, Adelaide and Brisbane delivering double-digit growth through the 12 months to November, with values up 21.0%, 14.0% and 12.1% respectively. At the other end is Melbourne, where values fell -2.3% over the same period, along with Hobart (-1.0%) and Canberra (-0.1%), where values also slipped lower over the year.

The nation's largest and most expensive capital city, Sydney, moved into the early stages of a downturn late in 2024, with monthly value changes edging into the negatives in October and November but still 3.3% higher over the 12 months ending November.

Regional markets have also shown diverse conditions with growth led by areas in Queensland and Western Australia, including Qld's Gladstone, Townsville and Mackay and WA's Mid-West and Bunbury regions each recording 20%+ annual gains. The weakest regional markets are concentrated in Victoria, where values were down -2.8% over the 12 months ending November.

	Annual change in dwelling values				Median house value	Median unit value
	12 months to Nov 24	Past 5yrs	Past 10yrs	Past 20yrs		
Sydney	3.3%	6.6%	5.6%	5.0%	$1,482,750	$865,422
Melbourne	-2.3%	2.6%	4.2%	5.0%	$923,422	$610,622
Brisbane	12.1%	11.4%	6.6%	5.0%	$974,396	$677,810
Adelaide	14.0%	11.8%	6.8%	5.3%	$865,563	$587,035
Perth	21.0%	12.5%	4.4%	5.2%	$842,227	$584,959
Hobart	-1.0%	6.0%	6.5%	4.5%	$694,388	$531,351
Darwin	0.9%	4.3%	-0.6%	2.7%	$580,091	$363,888
Canberra	-0.1%	6.3%	5.1%	4.3%	$972,753	$583,921
Regional NSW	3.2%	9.2%	7.2%	4.2%	$771,931	$614,506
Regional Vic	-2.8%	6.5%	5.7%	4.1%	$597,303	$403,022
Regional Qld	10.9%	11.5%	6.5%	4.0%	$690,753	$677,906
Regional SA	11.6%	11.6%	5.5%	4.4%	$459,014	$318,657
Regional WA	17.1%	12.3%	3.8%	4.4%	$557,886	$367,009
Regional Tas	2.4%	9.1%	6.7%	4.6%	$537,607	$402,204
Combined capitals	5.4%	7.0%	5.3%	5.1%	$1,009,778	$689,474
Combined regionals	6.0%	9.9%	6.4%	4.2%	$664,212	$574,807
Australia	5.5%	7.7%	5.6%	4.9%	$876,977	$670,398

Figure 1: Summary of housing value movements to end of November 2024
Source: CoreLogic

The easing in growth conditions has been accompanied by a rise in advertised stock levels. Capital city listings were tracking 4% higher than a year ago at the end of November, with the flow of new listings held above the five-year average through most of the year. The weakest cities have seen the largest rise in listings with Melbourne stock levels tracking 9% above the previous five-year average, Sydney up 10% and Hobart listings 22% above average levels. The rise in available supply is good news for buyers, but it means selling conditions have deteriorated through the spring and early summer selling season, with auction clearance rates holding firmly below the 60% mark since late October.

Rental markets have also eased, albeit from extremely tight conditions. After moving through a record low of 1.4% a year ago, rental vacancy rates rose to 1.8% nationally by November. Although the vacancy rate is trending higher, it is still well below the pre-pandemic five-year average of 3.3%.

Annual rental growth has also eased back to 5.3% over the 12 months to November, down from 8.1% annual growth a year earlier and more than 9% annual rental growth in 2021 and 2022. A few capital cities, including Melbourne and Canberra, recorded a decline in rents over the three months ending November, with other major capitals like Sydney and Brisbane seeing a levelling out in rental growth, a stark turnaround relative to the past few years.

The outlook for housing markets has arguably deteriorated towards the end of 2024, with core inflation holding high, labour markets remaining tight, and the chances of a rate cut early next year becoming less likely, not to mention rising geopolitical risks and domestic affordability constraints.

A year of two halves? Until interest rates come down, it’s hard to see the weakening housing trend turning around. There is a good chance the rate-cutting cycle won’t commence until mid-next year. A lower cash rate will be a positive factor for housing markets, with lower mortgage rates providing a lift to borrowing capacity, and, along with lower inflation, strengthening serviceability assessments and supporting a further rise in consumer sentiment.

A couple of rate cuts might be enough to shore up a declining trend in home values, but it’s hard to see any material upward momentum returning to home values until interest rates reduce more substantially and affordability barriers are less formidable.

Alongside the uncertain economic outlook, housing markets are likely to be arriving in 2025 on a relatively weak footing, with value growth losing steam or falling, advertised stock levels rising, unaffordability at record highs and signs that demand is no longer keeping pace with the flow of new listings.

Rising levels of geopolitical risk add to the uncertainty of the 2025 outlook, with wars in the Middle East and Ukraine, and the implications of a new Trump presidency yet to become clear. Additionally, a federal election is around the corner, which is likely to feature housing policies front and centre, adding to the complexity.

An undersupply of newly built housing is likely to provide some support for housing values. Although population growth is expected to ease further in 2025, the record levels of population growth seen since international borders re-opened has resulted in a cumulative undersupply of housing across Australia.

The residential construction sector continues to face feasibility hurdles in getting new housing stock to market, with material and labour costs surging over the past five years.

While construction costs aren't rising as rapidly as they were through the pandemic, they are still rising at around 1% a quarter. Significant competition from major public sector infrastructure projects is likely to keep prices for labour and materials high across the residential construction sector.

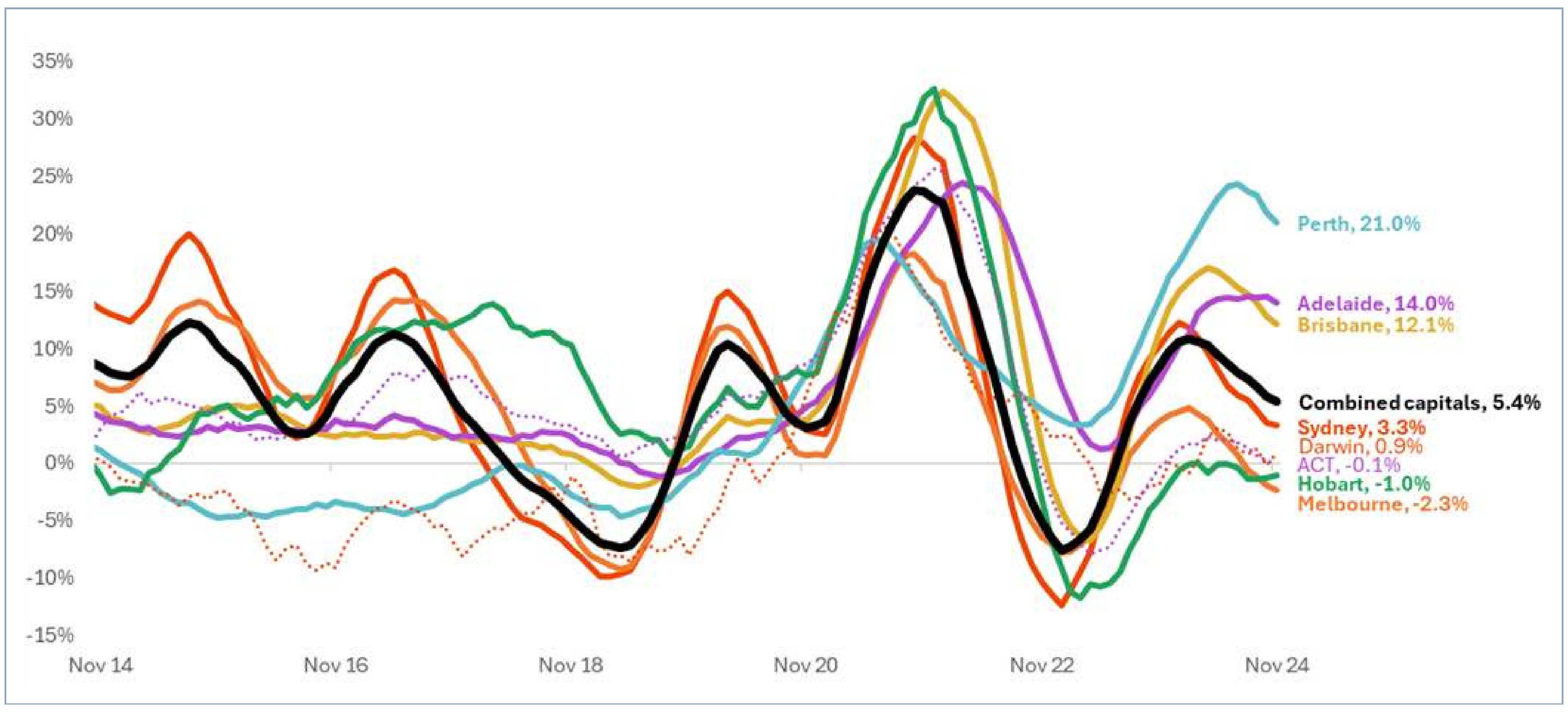
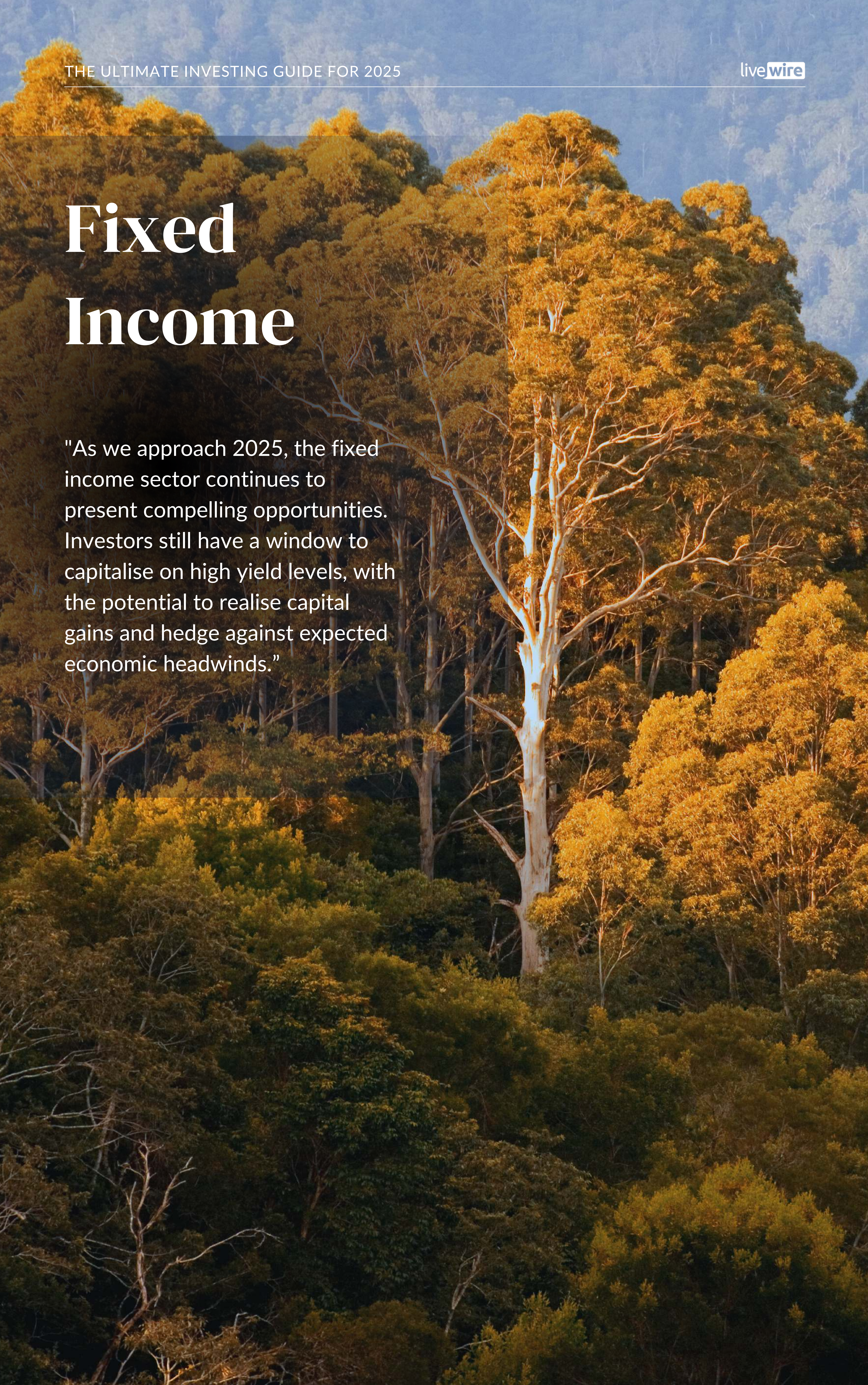


Figure 2: Annual change in capital city dwelling values over the past 10 years
Source: CoreLogic

The best-performing markets?

The areas that are likely to outperform in 2025 are those where demand is set to remain strong and supply levels tight. Although the rate of value growth is easing, Perth and Brisbane stand out for their stronger underlying fundamentals of high population growth, including above-average rates of interstate migration, low housing supply and generally strong economic conditions.

Melbourne is also worth considering, given the renewed affordability advantage that has become apparent over the past few years. Melbourne is the only major capital where affordability is improving, and gross rental yields are rising. While Melbourne isn't likely to win the growth stakes in 2025, buying with a medium to long-term objective in mind could be a good strategy amid the city's strong buying conditions.



Fixed Income

"As we approach 2025, the fixed income sector continues to present compelling opportunities. Investors still have a window to capitalise on high yield levels, with the potential to realise capital gains and hedge against expected economic headwinds.”

Adam Bowe
Portfolio Manager

PIMCO

Time to shine: Why bonds offer compelling opportunities in 2025

Over the past year, the fixed income landscape has demonstrated resilience, with bonds returning an impressive 7% as measured by the Bloomberg AusBond Composite 0+ Yr Index in the 12 months through to the end of October. For several years, the prevailing high cash rate has led many Australian investors to maintain substantial cash reserves in the form of term deposits. While the Reserve Bank of Australia (RBA) has yet to initiate its easing cycle, expectations are building for rate cuts to commence in the first half of 2025. In anticipation of this shift, Australian banks have already begun to reduce term deposit interest rates, a development that carries significant implications for savers reliant on consistent income streams.

Consequently, there has been a marked increase in investor appetite for bonds, driven by the desire to capitalise on current attractive yields before the anticipated rate cuts take effect. This strategy not only offers the potential for capital appreciation as interest rates decline but also positions investors to benefit from a more stable income source.

Looking ahead to 2025: Yield advantage and diversification benefits

As we approach 2025, the fixed income sector continues to present compelling opportunities. Investors still have a window to capitalise on elevated yield levels, with the potential to realise capital gains and hedge against expected economic headwinds. The current environment of volatility and economic uncertainty is particularly conducive for active asset managers, who can navigate these challenges to uncover value.

High-quality core bond portfolios are currently yielding between 5-6%, presenting a persuasive case for investors to lock in these elevated yields. Historically, starting yields have served as a reliable predictor of returns over the subsequent three to five years, reinforcing a positive long-term outlook for fixed income. Importantly, these yields can be secured on high-quality bonds without exposing investors to excessive interest rate, credit, or liquidity risks. As the RBA embarks on its rate-cutting journey, the potential for further capital appreciation becomes increasingly attractive.

Moreover, as inflation expectations stabilise, the inverse correlation between fixed income and riskier asset classes, such as equities, is re-emerging. This restoration of the inverse relationship underscores the diversification benefits of bonds, which can serve as a crucial buffer against equity market downturns.

Navigating risks in 2025

However, Australian investors must remain vigilant regarding potential risks within the fixed income market. A particular area of concern lies within the highly levered floating-rate segments, including senior secured loans and certain private credit markets. For years, the economic backdrop boosted these sectors given we haven’t seen a major recession since 2009, with lower-quality credit performing strongly. However, we could be at a significant turning point.

In the recent era of high interest rates, floating-rate lending has meant full pass through of restrictive policy, which has been causing distress for highly levered borrowers. As interest rates come down next year, particularly if that coincides with a period of economic weakness, then investors in floating-rate instruments could face a situation of falling yields, rising distress and default rates, along with liquidity challenges. This contrasts with higher-quality fixed-rate bonds where declining market yields drive capital appreciation for these instruments.

Given the uncertain macro backdrop in the context of credit spreads that are on the tighter end of historical ranges, we are adopting a highly selective approach to corporate bonds, focusing on high-quality investment-grade holdings that offer attractive yields without excessive credit or liquidity risks. We anticipate these investments will perform well in a low growth environment.

Additionally, geopolitical risks remain a significant source of global uncertainty, with potential ramifications for markets and economies. The prospect of Donald Trump's second presidential term raises concerns over more aggressive US tariffs, which could adversely affect global growth and inflation.

High quality segments of the bond market offer the most attractive opportunities in 2025

Investors need not expose themselves to material credit or liquidity risk to secure attractive income from the bond market in 2025. Some of the most attractive segments of the bond market right now are yielding above 5% while maintaining robust AAA or AA credit ratings.

Heavy borrowing demands from many state governments in Australia have pushed their spreads to Commonwealth government bonds to the widest levels in many years. Although this fiscal loosening has led to some deterioration in credit metrics, the semi-government bond market remains a resilient AA-rated sector. With 10-year bond spreads ranging from 75 basis points (bps) to 95 bps over Commonwealth government bonds and with yields north of 5%, this sector offers attractive real income, diversification from riskier assets, and resilient return prospects in a broad range of economic scenarios over the next year.

The AAA-rated securitisation market in Australia stands out as an appealing avenue for fixed income investors in 2025. Predominantly composed of residential mortgage-backed securities (RMBS), this sector also includes securities backed by other loans, such as autos, personal loans, and green energy loans for solar panels and batteries. Notably, Australia is poised to become the second-largest market for public securitisation outside the U.S. in 2024. This influx of supply has kept spreads elevated, even as credit spreads have tightened materially in other sectors of the bond market.

These AAA-rated, floating-rate bonds offer spreads exceeding the cash rate by 90 to 120 bps and are designed to self-liquidate as the underlying loans are repaid over a weighted average life of one to three years.

To further enhance portfolio yields, investors can explore select pockets within the Australian investment-grade corporate bond market that benefit from strong macroeconomic tailwinds and offer compelling valuations relative to comparable global markets. Notable examples include infrastructure assets, such as toll roads, airports and regulated utilities. These sectors are bolstered by strong population growth, revenues linked to inflation, and predominantly fixed cost structures. In a challenging macroeconomic environment, they are expected to demonstrate resilience, offering yields in the range of 5.5% to 6.0%.

Seize the opportunities in fixed income in 2025

Looking ahead to 2025, the bond market presents a compelling opportunity, marked by attractive yields, potential for capital appreciation, and diversification benefits that outshine riskier assets. The current climate of uncertainty and volatility favours active fixed income investors, while high-quality bonds have proven resilient through various economic cycles, including soft landings and recessions.

Reinvestment risk is real – investors sitting on cash could be missing out on the lucrative returns that bonds can offer. With interest rates remaining high and equity valuations elevated, now is the perfect time to diversify portfolios by adding core bonds.

Global Equities

"It's tempting to interpret current equity market valuations as a sign that a sell-off is imminent. However, they have little utility in forecasting performance over shorter, one-year horizons."

Dr David Allen
Portfolio Manager, Plato Global Alpha, Head of Long/Short Strategies

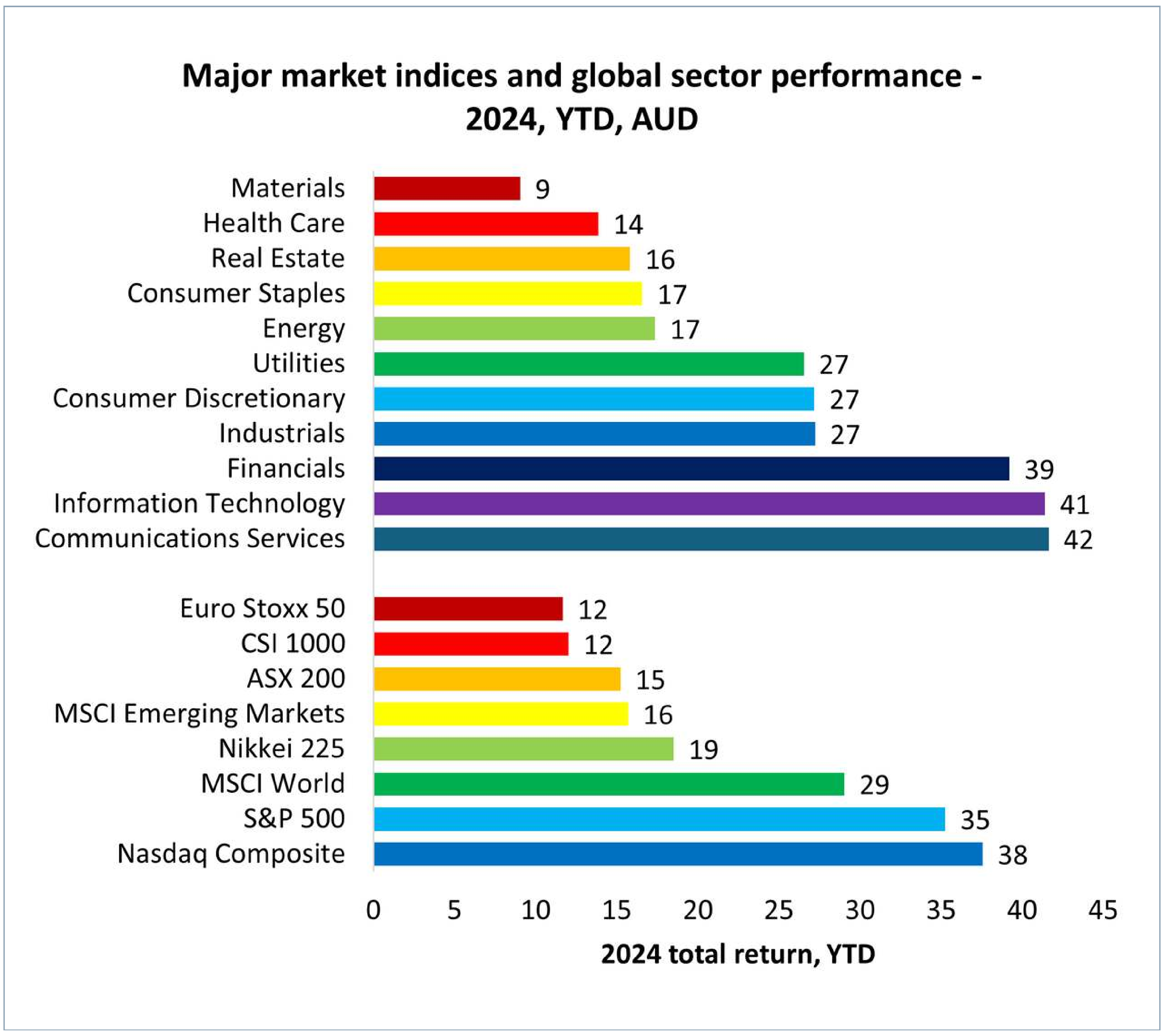
Plato Investment Management

Global growth and shorting opportunities abound

Summary of asset class performance in CY24

2024 was a stand-out year for global equity markets. The tech heavy NASDAQ index has generated 37.6% year to date, made all the more impressive by its 44.9% return in 2023. The superb performance of the U.S. market has been largely driven by the Magnificent Seven of Nvidia (183%), Meta Platforms (74%), Tesla (41%), Amazon (40%), Apple (26%), Alphabet (23%) and Microsoft (16%). The ASX 200 has returned a very respectable 15.7% in 2024, while the worst performing major index, the Euro Stoxx 50 still managed to produce a double-digit return of 11.7%.

There has been a wide divergence in returns by sector, with the MSCI World Materials sector delivering 9%, weighed down by a slowing China, while Financials, IT, and Telcos delivered returns of around 40%.



Source: Bloomberg, total returns including dividends, AUD

What to expect in 2025 from the asset class?

The elevated interest rates of 2024 provided a favourable environment for Plato Global Alpha's short positions, allowing us to capitalize on pressure faced by overvalued, debt-heavy companies. This strategy has been a cornerstone of our performance, with 70% of our outperformance since inception stemming from shorts, including notable successes such as **Tabcorp (ASX: TAH)** and **Liontown Resources (ASX: LTR)** in the lithium sector.

Looking ahead, the global rate cycle appears to have peaked in most major economies. In the U.S., our base case projects a gradual easing of the Federal Reserve's lower bound target to approximately 3.1%. Meanwhile, the Reserve Bank of Australia (RBA)—notably one of the last central banks to raise rates—is likely to be among the slowest to implement meaningful cuts. We expect the RBA's cash rate to settle around 3.6% by Q4 2025.
As global rates trend lower, this shift should benefit our long positions, particularly in high-beta growth stocks. Companies like **NVIDIA Corporation (NASDAQ: NVDA)**, a leader in AI, and **Salesforce, Inc. (NASDAQ: CRM)**, a key player in cloud technology, are well-positioned to thrive in a more accommodative monetary environment.

It's tempting to interpret current equity market valuations as a sign that a sell-off is imminent. For example, the Shiller Price-to-Earnings (P/E) ratio of the S&P 500, named after Nobel laureate Robert Shiller, stands at 36—placing it among the most expensive 3% of valuations since 1881.

However, while valuations are reliable predictors of long-term market returns, they have little utility in forecasting performance over shorter, one-year horizons. The correlation between valuation metrics and annual returns is near zero. Over shorter timeframes, market psychology and sentiment tend to outweigh fundamentals, and at present, sentiment remains robust.

Where is the value and the opportunity?

We believe we are in the midst of a decade-long mega-trend of unprecedented defence spending. Geopolitical tensions in regions like the Middle East, Taiwan, and Ukraine, coupled with U.S. strategic ambivalence, have only accelerated this shift. Within this space, we see significant opportunities in **Lockheed Martin (NYSE: LMT), BAE Systems (LON: BA), and Rolls Royce (LON: RR)**. Beyond their exposure to rising defence budgets, these companies provide an additional advantage: their defensive nature in portfolios, often performing well during periods of heightened geopolitical instability.

In the healthcare sector, we've had strong convictions in **Novo Nordisk (CPH: NOVO-B)**, the makers of the groundbreaking anti-obesity drug Ozempic. However, we are even more bullish on **Eli Lilly (NYSE: LLY).** Their drug Mounjaro has demonstrated approximately 50% greater efficacy at a lower cost, positioning it as a potential market leader. These drugs are being hailed as the "Swiss Army knives" of modern medicine, with emerging data showing potential applications for conditions as diverse as heart disease, diabetes, infertility, Alzheimer's, arthritis, and addiction.

One company we're closely watching is **Vertex Pharmaceuticals (NASDAQ: VRTX)** in the U.S. The opioid crisis remains a global epidemic, with The Lancet Regional Health – Americas estimating that 60 million people struggle with opioid addiction and over 100,000 die annually from overdoses. The demand for a non-addictive, effective painkiller is immense, and Vertex Pharma may have the solution with their new drug, Suzetrigine. Having successfully completed Phase 3 trials for treating chronic pain, Suzetrigine is expected to receive FDA approval and enter the market in 2025. This breakthrough positions Vertex as a potential game-changer in addressing one of the world's most pressing health crises.

Closer to home, we see continued upside in **Qantas (ASX: QAN)**. Last September, during a period of intense public and media scrutiny—and a short-selling frenzy—we articulated a bullish case for the national carrier when speaking to Chanticleer. Despite the controversy, we focused on its compelling valuation, structurally higher (+40%) sales per employee post covid, and a dominance (65% market share and growing) in the domestic aviation market. Since then, Qantas shares have climbed 66%, and we believe the stock still has more runway ahead.

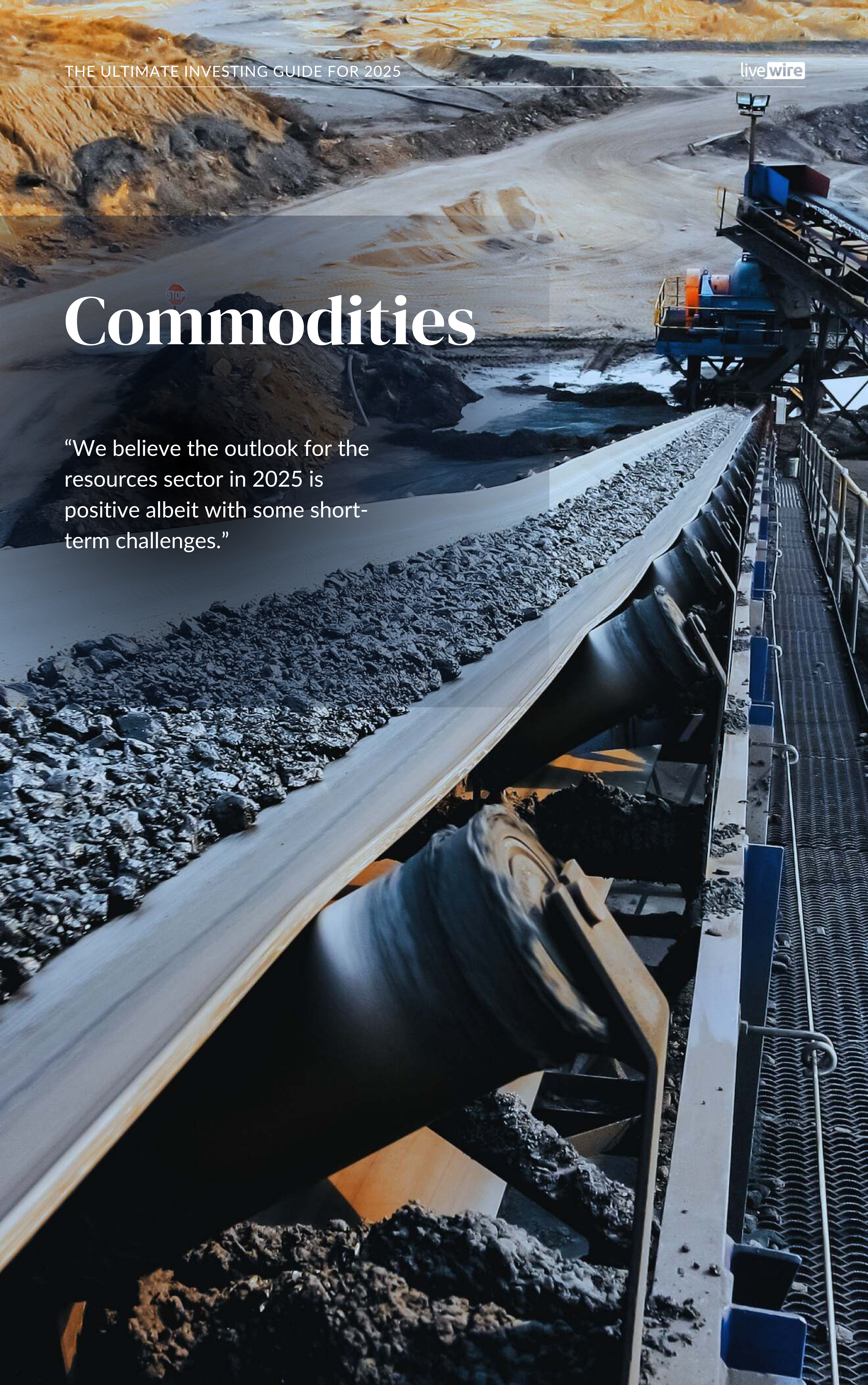
The recent exit of Rex from certain routes further solidifies Qantas's market dominance, reinforcing our positive outlook.

Where are the risks?

Plato Global Alpha has the advantage of being able to take short positions in companies we believe will underperform. We look for companies with a high number of Red Flags using Plato's proprietary model. In Australia we are short **Tabcorp (ASX: TAH), Mineral Resources (ASX: MIN)**, and **Corporate Travel (ASX: CTD).**

Commodities

“We believe the outlook for the resources sector in 2025 is positive albeit with some short-term challenges.”



Emanuel Datt

Principal

Datt Capital

2 ASX stocks giving you access to a misunderstood but highly profitable commodities theme

Natural resources are vital for daily life and underpin global economic and social progress. Growing populations, urbanisation, and rising prosperity, especially within developing economies, are driving increased demand for minerals and energy.

As developed nations transition to renewable energy and electric vehicles, building new infrastructure creates investment opportunities. Meanwhile, constrained farmland, cautious mining investments, and oil companies focusing on debt reduction and stock buybacks strengthen the resource sector's supply dynamics.

Natural resource producers often have robust balance sheets, enabling them to navigate volatility and seize opportunities. Investment areas can include oil producers, gold, lithium, copper, and other industrial metals — sectors poised for growth as the world's economies mature and transition. This alignment with global trends makes resource-focused investments increasingly attractive to investors.

Why should investors consider resource exposure in 2025?

The Resource sector provides attractive investment opportunities given its often highly inefficiently priced with a large, diverse investible universe on the ASX. This is because it's a sector that is not well understood by the institutional market, especially outside the ASX 50 stocks.

Accordingly, there is the ability to generate consistent alpha via the right investment managers who can express global themes on local markets. Exposure to the sector itself may act as a natural hedge to adverse local conditions given Australia's status as the world's premier mining jurisdiction and its export-focused, US dollar-denominated resource endowment.

This globally advantage has may provide significant advantages to local investors relative to other local export sectors. For instance, China enacted hefty tariffs on a range of Australian export products such as wine in 2020 which significantly affected earnings for local companies. Over the same period, Australian iron ore and coking coal producers were entirely unaffected by the stoush between the respective governments.

We believe the outlook for the resources sector in 2025 is positive albeit with some short-term challenges. Valuations within the sector remain attractive relative to other sectors and on a historical basis.

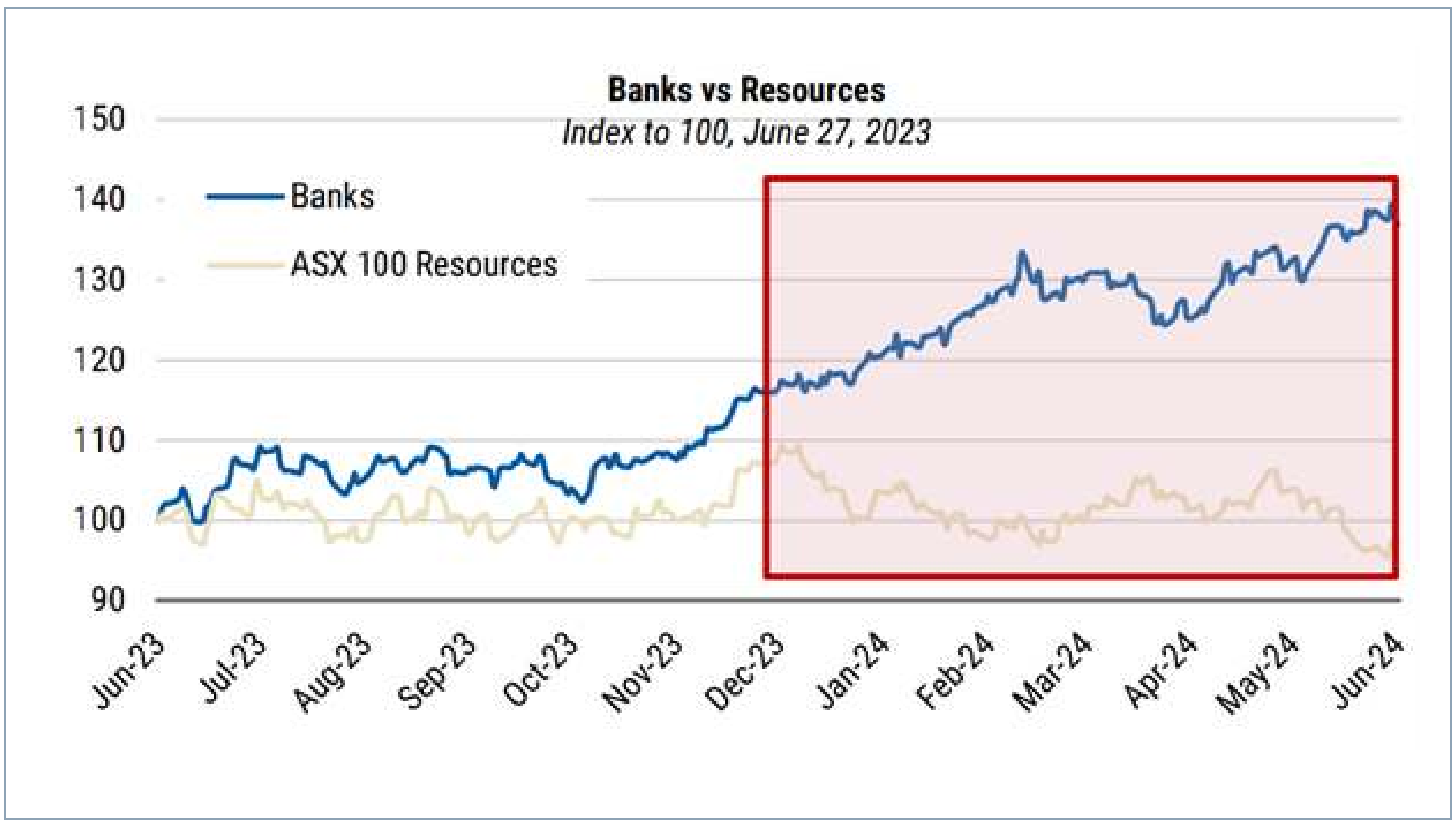


Figure 1: Banks vs Resources. Index to 100, June 27, 2023
Source: RIMES, Morgan Stanley Research. Performance for the period Dec-31, 2023 through to and including June-27, 2024

Figure 2: Relative 12M Fwd Price-to-Earnings - Resources vs Historical Average
Source: RIMES, Morgan Stanley Research.

Where are the biggest opportunities likely to come from?

An increase in global energy demand

Global electricity demand is expected to grow by 4% in 2025, the fastest rate of increase in nearly two decades.

This growth is driven by a rise in economic activity driven by a rise in living standards within developing economies. Specifically, we anticipate greater adoption of air conditioning and heating over time within these economies as broader living standards converge towards conventional Western standards.

Within developed economies we expect continuing adoption of electric vehicles, albeit at a declining proportionate rate, to drive energy demand.

Renewable energy expansion

Governments worldwide continue to pursue the development of renewable energy sources, providing strong tailwinds for mineral consumption. In addition, as intermittent electricity generation becomes a larger proportion of the grid; this has an inflationary effect on electricity and energy prices overall.

Critical minerals

We anticipate higher demand expected for resources essential for low-emissions technologies, such as copper, aluminium, and lithium. However, care must be taken to select appropriate exposures along the cost curves given the highly cyclical nature of the sector. Also notable is the relative decline in grassroots exploration spend, underpinning the value of existing resources due to scarcity value.

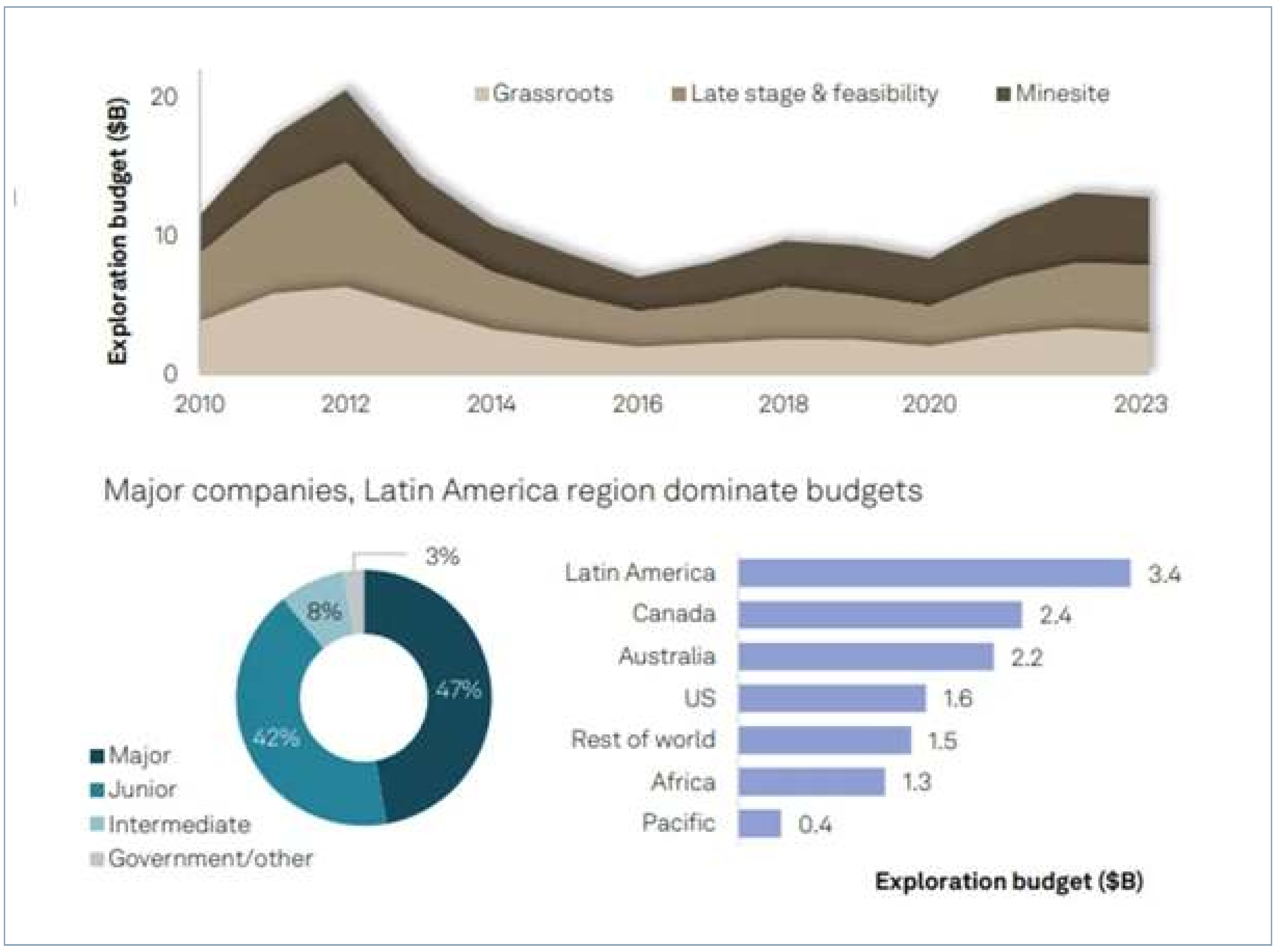


Figure 2: Grassroots exploration at all-time low share

What are the biggest risks in 2025?

The Chinese housing market remains a significant risk for the resources sector, specifically due to uncertainty around the nation's steel demand. Muted steel demand affects demand for steel-making commodities like iron ore and coking coal.

There has been a shift in the Chinese government's focus towards addressing and de-stocking existing housing inventory rather than directly supporting property developers. In addition, there has been an onus on the restructuring of municipal debt; some of which has been used to support regional property developers. The success of these measures may have an impact on steel demand.

Whilst we anticipate that Indian steel demand will grow over time as the economy matures, somewhat shoring up global demand; there is no doubt that China will remain the largest influence on global demand in the near term.

What investments have you made recently to set your portfolio up for 2025?

One of our key investment thematics for 2025 is that structurally higher cost impositions will arise from changes in government policy, providing numerous opportunities for resource focused investors in 2025.

For instance, the Chinese government recently amended its VAT refund policies for a plethora of export products which will lift the cost base of a range of finished goods considerably given the nation's status as the eminent manufacturing base of the world. In addition, we anticipate significant changes in the USA's tariff policy which will no doubt lead to many prospective opportunities.

What are your top positions?

WA1 Resources (ASX: WA1) are a mineral developer in the process of commercialising its world class Luni niobium project, located in Western Australia the world's best mining jurisdiction. Luni has an incredible resource endowment that has the potential to support a multi-generational life of mine likely to be well in excess of 100 years, at grades similar to the world's largest producing mine.

Niobium is an incredibly rare critical metal used primarily in high quality steels and has emerging uses in fast-charging battery technologies. Niobium is produced solely from three operating mines globally, two located in Brazil and one located in Canada. Niobium is a highly strategic critical metal given its importance in advanced, emerging technologies and its scarcity in supply. It is listed within the top 3 most critical metals by all leading major economies including the US, EU, UK, Japan, India, Korea and Australia.

Luni is the only commercialisable niobium asset globally that has no Chinese stakeholders and represents an important source of future niobium supply wholly controlled by a single Western company. We anticipate positive returns as the company continues along its path of commercialising the project.

Alcoa (ASX: AAI) is a global vertically integrated aluminium business. Aluminium is one of the industries most affected by the change in Chinese VAT policies previously discussed. Alcoa, as a vertically integrated producer, are likely to benefit substantially from the significant rise in their competitors cost base. This suddenly 'evens the field' for their primarily western production bases, which have historically operated at relatively higher cost bases. Accordingly, we anticipate aluminium prices to rise over time and believe the company is well poised to benefit.

Infrastructure

"If 2023's spike in real bond yields fades, we expect a significant uptick in the valuations for infrastructure companies in the next year or two..."

Ben McVicar
Portfolio Manager and Sector Head Infrastructure & Industrials

Magellan Asset Management

Core infrastructure investments: Stability and growth potential

Infrastructure serves an important role in a diversified portfolio. First, it is a real growth asset, providing inflation-adjusted growth that allows investors to build wealth over time. Second, infrastructure assets, when selected thoughtfully, offer meaningful downside protection as earnings from infrastructure assets are less economically sensitive than broader equities.

These are businesses delivering essential services – such as water, electricity, roads and communication networks – that experience stable demand even during economic downturns, unlike businesses in more cyclical industries.

Overview of 2024 performance

The asset class delivered robust returns in 2024, reflecting renewed investor interest. This strong performance followed more subdued performance in recent years as markets absorbed rapidly rising interest rates, which tend to weigh on the valuation of longer-duration defensive asset classes like infrastructure. In 2024, however, market expectations for interest rates began to stabilise. Many central banks in developed markets reduced policy interest rates for the first time since inflation spiked in the post-pandemic period. This created a favourable environment for infrastructure assets. Additionally, intermittent concerns about the global economic outlook during the year led investors to gravitate back to the defensive characteristics of infrastructure, further supporting the asset class.

A standout performer within the sectors was utilities, which saw particularly strong gains. Utilities cover services like water, gas and electricity. These assets, even within the defensive assets of infrastructure, stand out for their defensive qualities. While the underlying earnings were generally in line with expectations, the market re-rated these businesses strongly due to the defensive growth qualities and undemanding valuations.

What to expect in 2025 from the asset class

Infrastructure is well-positioned to return to delivering expected annual returns of CPI + 4–5%. This aligns with its historical performance, supported by both structural growth drivers and defensive qualities. While recent years have seen pressure from spiking inflation and therefore rapid interest rate increases, this trend is, on balance, expected to abate in 2025.

Figure 1: US Headline CPI, year-on-year
Source: Bloomberg, US Bureau of Labor Statistics

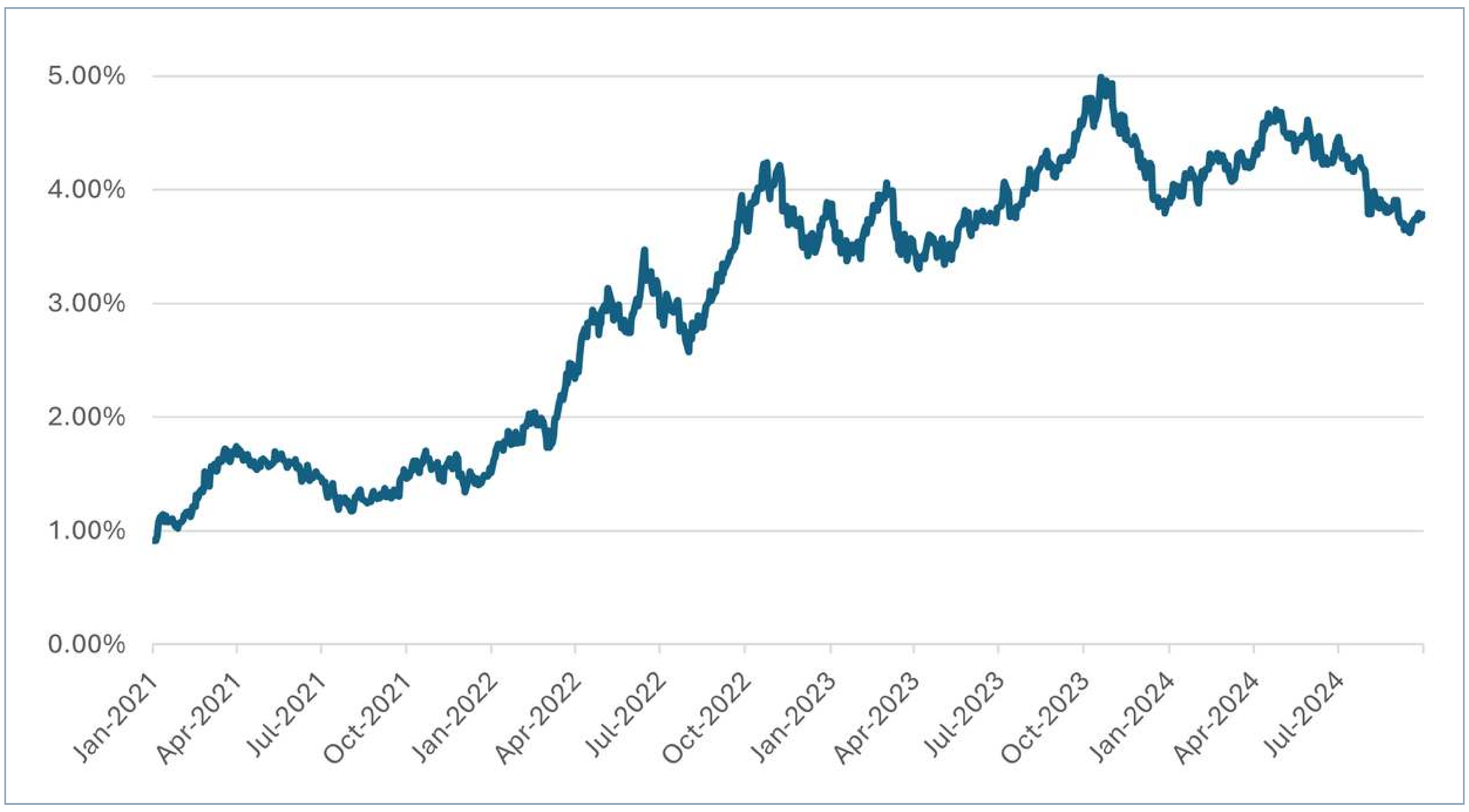


Figure 2: UST 10 Year Rates
Source: Factset

The macroeconomic landscape is likely to see:

- Continued demand for defensive, essential-service businesses in an environment of slower global growth;
- Ongoing opportunities for these businesses to continue to grow both from in-place assets and new opportunities for investment; and
- A more stable or even declining interest rate environment, benefiting the valuation of infrastructure and other longer-duration assets.

Some of the most attractive opportunities in the sector are companies trading at discounted valuations due to short-term company-specific issues, particularly in regions outside the United States. For investors willing to take a long-term view, these businesses offer strong potential upside as short-term concerns abate.

One such example is **Severn Trent (LON: SVT)**, a UK water company. Severn Trent is a straightforward utility business, focused on providing essential water and wastewater services to customers in regulated UK markets. Its revenue model is underpinned by a stable regulatory framework, ensuring predictable cash flows and consistent underlying returns on the company's regulated asset base.

Despite its defensive and regulated business model, Severn Trent's share price has been affected by an unrelated company in the sector, Thames Water, running into service and funding problems. While this creates noise and some uncertainty, the operating performance of Severn Trent has remained strong. For investors with patience, such discounted opportunities offer a combination of stability and growth potential.

Areas to avoid

Investors seeking diversification should exercise caution with more cyclical assets that purport to be infrastructure but, lack the predictable and defensive cash flows that distinguish infrastructure from other asset classes. As an example, these higher-risk assets include merchant power stations that depend on market-based electricity pricing rather than stable, regulated returns.

In our view, maintaining a focus on core infrastructure assets is critical for achieving the desired investment outcomes. Core infrastructure provides both long-term structural growth and the defensive qualities needed to weather economic downturns.

When investing in the sector, we apply strict criteria to ensure a practical and diversified portfolio. True infrastructure investments should demonstrate low correlation with other asset classes, particularly global equities. To achieve this, we avoid companies with significant exposure to commodity price risk, excessive competition or sovereign risk. Instead, we focus on monopoly-like businesses that offer essential services and face limited economic sensitivity.

Our analysis highlights the resilience of conservative infrastructure investments. Since 2010, there have been 18 instances where global equity markets experienced drawdowns of more than 5%, lasting an average of two to three months. During these periods, infrastructure investments (as defined by our criteria) fell on average only 51.5% as much as global equities. In contrast, the broader S&P Global Infrastructure Index, which has approximately 34% exposure to higher-risk, cyclical assets, experienced declines that averaged 76% of the fall of global equities during these same drawdowns. These results underscore the importance of focusing on high-quality, defensive infrastructure investments.

Conclusion

Infrastructure continues to serve as a compelling asset class for investors seeking inflation-protected growth, downside protection and portfolio diversification. As we look to 2025, the asset class is poised to deliver strong returns, supported by stabilisation in interest rates, and global economic trends.

The best opportunities will likely arise in regions outside the US and among companies experiencing temporary, stock-specific challenges – offering significant potential for patient, long-term investors. At the same time, avoiding cyclical exposures and focusing on core infrastructure assets is essential to achieving sustainable and defensive investment outcomes.

Emerging Markets

“Despite very attractive valuations, the majority of investors are only lightly positioned in this asset class. But the reality is rather more exciting.”

Dr Joseph Lai

Principal, Portfolio Manager and Chief Investment Officer

Ox Capital Management

The inflection point for emerging markets

Emerging markets equities have derated for more than a decade. Despite very attractive valuations, the majority of investors are only “lightly” positioned in the asset class. Investor sentiment remains lukewarm.

The reality is rather more exciting because the fundamentals of these economies are robust, and they offer sustainable economic growth in a slow global environment. Many of these EM economies are in better fiscal and financial health in comparison with the developed world. These economies stand to deliver healthy and consistent economic growth in the coming years.

What to expect in 2025 from the asset class?

As noted, valuation has compressed significantly over the past decade. We are likely to see a continuation of US interest rate cuts which will support currencies in EM.

Attractive stock market valuation and stable, if not strengthening, local currencies make strong tailwinds for emerging markets equities. Many stocks offer attractive dividend yields and return will be further boosted by positive currency carry. Such favourable dynamics are likely to further drive funds flow into these growing economies, driving up their valuations.

Where is the value and the opportunity?

We believe that few economies will be able to grow at a fast rate given the rising tide of protectionism, and high level of indebtedness in most major economies. Developing Asian economies have endogenous growth drivers, and their valuations are attractive.

Indonesia and Vietnam are going through significant economic developments, and the fundamentals are robust. Governments in these two countries have undertaken decades of economic reform. Infrastructure and manufacturing capabilities are much improved than in years past. They will be able to grow at a fast clip in a generally slow global economy. Another opportunity is China. The perceived structural problems in China are well known and discounted by the cheap valuations of Chinese stocks. While the property downturn has sapped confidence, the recent pivot by the government is likely to reflate the Chinese economy. Improving fundamentals and sentiment presents highly prospective opportunities.

We are focused on champion companies. The Fund has identified many promising investment ideas and will seek to add exposures as confidence and domestic macro environment improve.

What should investors avoid?

It is prudent to avoid sectors that are expensively valued while fundamentals are weakening.

Emerging market equities are generally attractively valued. One exception is India. Many Indian mid-cap stocks have reached euphoric valuations. While long term fundamentals are conceptually enticing, likelihood of producing strong returns from an already elevated sector will likely prove difficult.

Thus, it's worth watching global economic development closely. Persistently high inflation, interest rates and rising trade protectionism in the US will lead to a weakening of economic growth and rising inflationary pressure. This can impact particularly highly valued equities markets in developed economies.

Example(s) of best in asset class opportunities

Bank Mandiri (IDX: BMRI) is considered one of the best-managed banks in Indonesia. The banking market in Indonesia is oligopolistic in nature, and the major banks are highly profitable. Mandiri generates around 20% return on equity. Indonesia's household indebtedness is around 10% of GDP vs 60-100% in most developed economies. The low level of debt will enable Bank Mandiri to grow for many years. Mandiri is growing earnings at a 10% clip, offering a 6% dividend yield, making it an extremely attractive name to own.

KE Holdings (HKG: 2423) is the largest real estate agency and has the most extensive database of properties in China. Beike's competitive moat is its nationwide and extensive directory of properties facilitating 4.5 million transactions a year and over RMB3 trillion in value. Long-term, Beike is transforming into a one-stop residential services platform providing access to services such as home renovation, rental, property management, and even senior care. In China, only 1.1% of the housing stock is transacted in the market, low relative to developed markets like the US. As China's real estate market matures, transaction volumes will rise to more reasonable levels, and Beike is set to benefit significantly from this structural change. Earnings are expected to grow around 20% per annum next three years and will accelerate as the domestic property market improves.

Trip.com (HKG: 9961) is a leading online travel agency ("OTA") in China and it is now expanding into a global franchise. For example, in ASEAN, Trip.com has gained roughly 20% of the OTA market by active users over the past 8 years from their global peers. Trip.com directly negotiates with the merchants for wholesale pricing, a dominant supply chain advantage in China and enhances its market competitiveness offering diversified travel options. The company charges around half the commission rate (Trip.com: 8-9% vs Booking.com: 15-19%) while achieving the same level of net profit margin.

Thus, Trip.com can offer more attractive pricing, driving customer loyalty and growing its market share. Moreover, the cross border travelling between China and the rest of the world is becoming a new and structural profit driver. Governments are expanding their visa free inbound programs to more nations to encourage visitors. The shares are attractive trading at mid-teens multiple with strong earnings growth, ample cash with a solid balance sheet, and plans for share buybacks.

Asset Allocation Outlook

Watch the full interview by scanning the QR code with the camera on your phone

James Marlay
Co-Founder &
Executive Director,

Livewire Markets

How to invest $1 million in 2025

The past few years have been kind to investors. A glance over 2024 asset class returns suggests that most Australian investors have been sitting on healthy gains for the past 12 months, with the much-loved banks leading the charge. Global equity exposure will have sweetened returns, with the S&P 500 clocking up consecutive years of +20%. Even conservative investors have been rewarded with returns on cash, which is the best we've seen in decades.

It's in our nature to resist making changes to a winning formula. However, with market leadership being highly concentrated and, for the most part, coming from high-growth stocks, there's a decent chance that your portfolio has developed a few biases and overweight positions.

Why does this matter? Markets have repeatedly reminded us that good times don't last. Reviewing your portfolio and making tweaks or rebalances is prudent. This ensures you harvest some of those gains and position your portfolio for all market conditions. Professional capital allocators keep an eye on the macro picture. However, their asset allocation framework is the foundation of how and where they invest capital. This discipline allows them to identify where excessive risks may lie within portfolios and helps remove emotions from investment decision-making.

I recently spoke with Charlie Viola from Viola Private Wealth and Ben Clark from TMS Private Wealth to explore the factors they think matter for 2025, get some pro-tips on rebalancing and discuss how they are allocating capital for the year ahead.

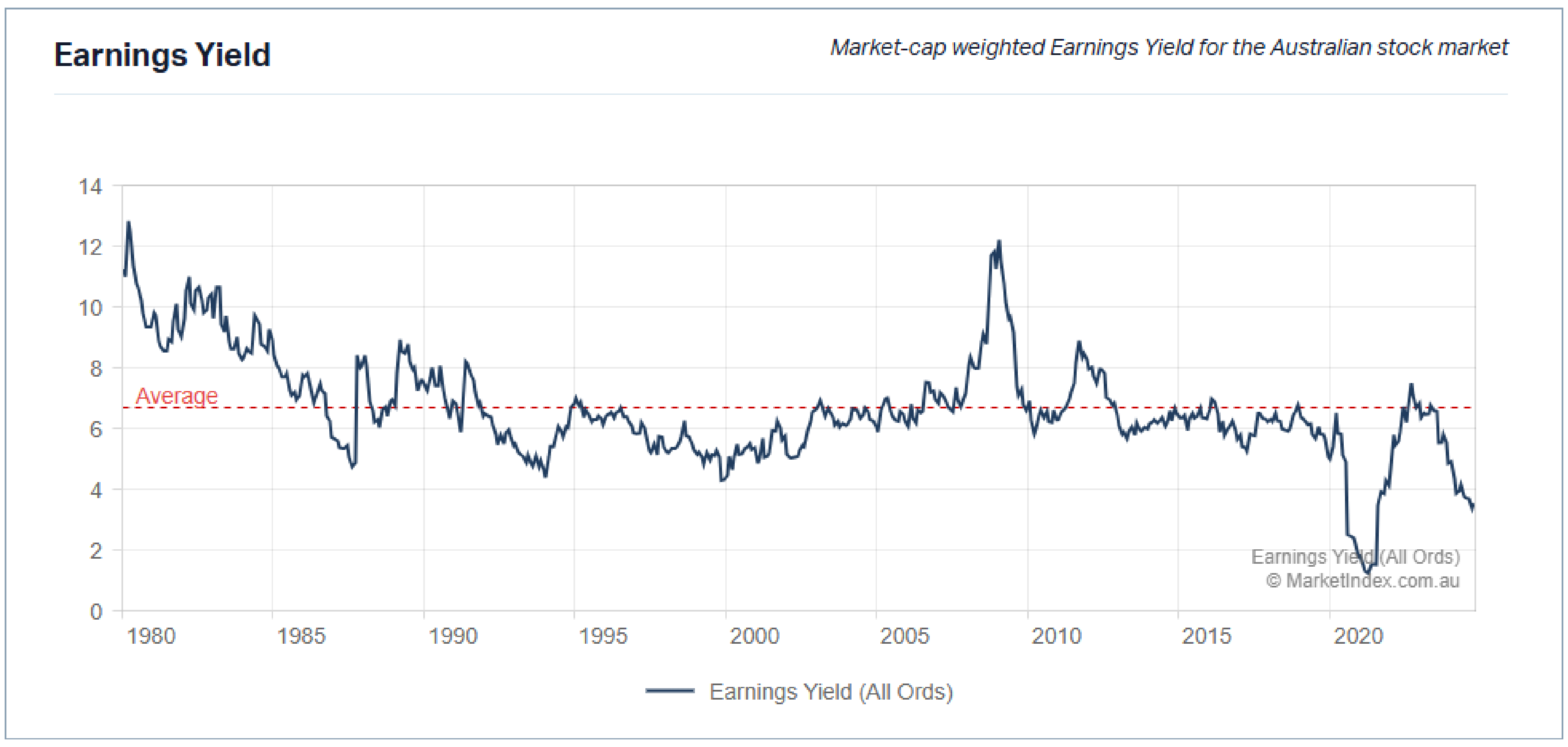
The big picture for 2025

Before we discuss how our guests are allocating for 2025, it's important to understand the factors underlying their views. I asked Charlie and Ben to share the top three factors shaping their opinions on where opportunities lie in 2025.

#1 Valuations

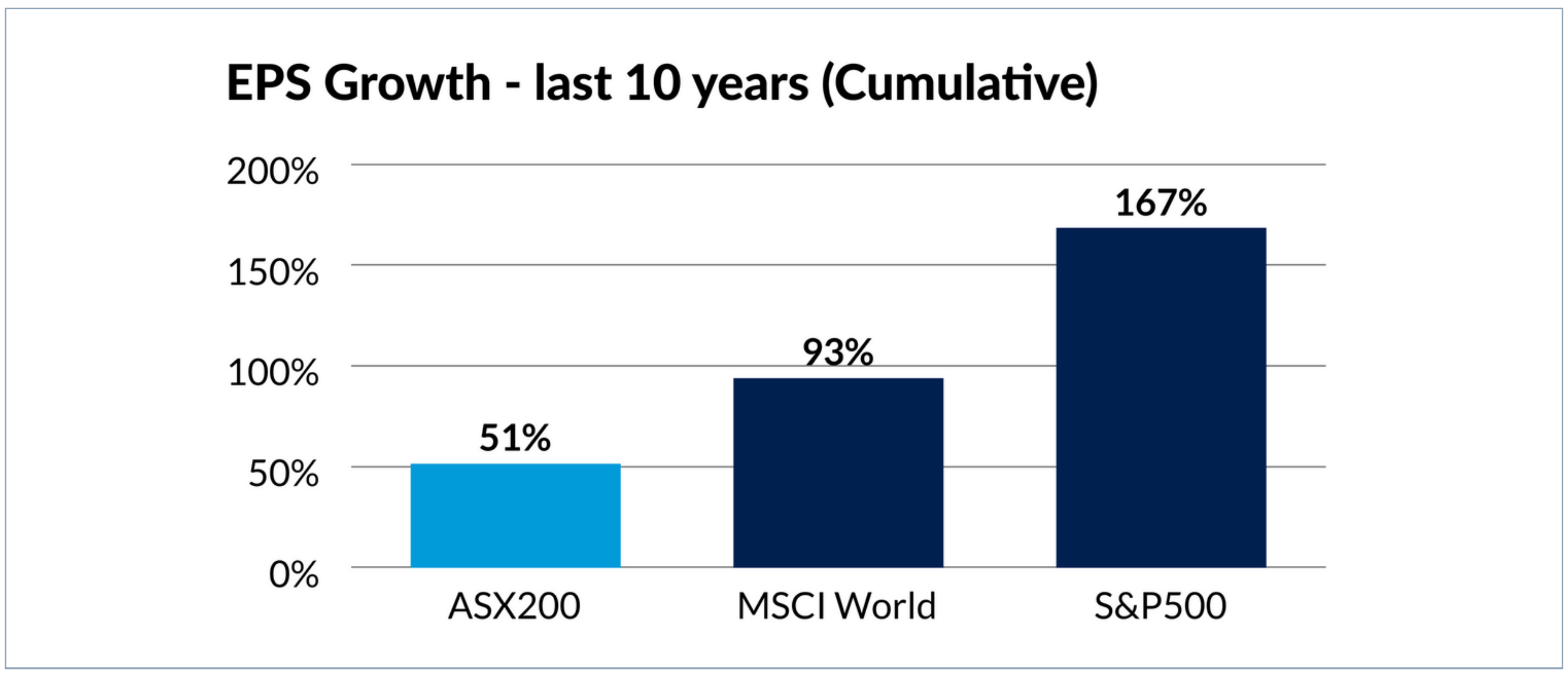
After a few good years, it's unsurprising that an element of caution is creeping in around equity valuations. For Viola, this means two things. First, he wants to trim or take profits from some big winners that have generated returns and become bigger portfolio positions. In addition, higher valuations mean that he is being more cautious when allocating new money into equities and with a focus on quality.

Clark has a similar view, especially when it comes to investing in the ASX. The chart below shows the ASX's earnings yield, now below 4%, an anomaly over the long term. Clark does see pockets of value and highlights miners as an unloved sector on the Australian market, where sentiment is poor; a rally could easily be fueled by a rotation out of bank shares, which trade on record valuations despite low to no growth in earnings.



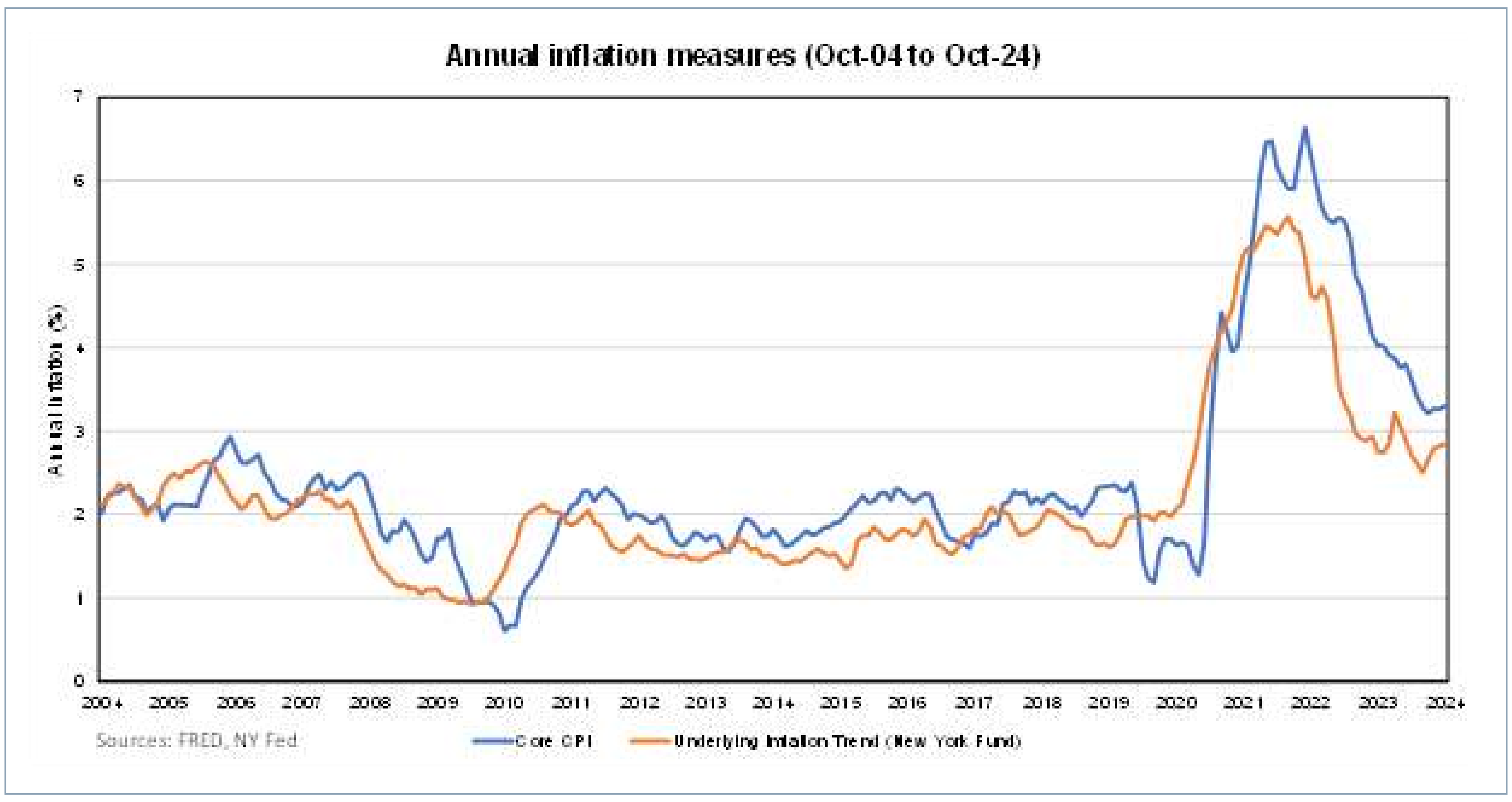
He has a different view on global equities and is happy to let global exposure run. US blue chips undertook an aggressive cost-cutting process during Covid, yet their revenues continued to grow.

The result is that US stock earnings have been far superior to those of Australian blue chips, where there's little growth - a trend he says could continue for the next decade.



#2 Inflation and rates

Inflation has influenced markets and investors in the post-Covid era, and we're still not out of the woods. Expectations remain that inflation will return to long-run averages and that rates will follow the same trajectory. These expectations have no doubt contributed to the bullish sentiment in equities. Viola sees this as a risk, and we've seen evidence in late 2024 of how markets will react to any suggestion that the lower path could be delayed or not come to fruition.



Trump's pro-business stance is a threat, particularly in the US, where interest rate expectations are being dialled back. This view underpins his desire to take some profits and keep his defensive allocation in floating-rate assets over longer-duration assets, like government bonds.

Clark has a slightly different take and is willing to allocate a portion of his defensive allocation away from the floating rate and start locking in some longer-duration exposures. This is not an all-in bet, but his view is that Australia is about to embark on a rate-cutting cycle. If this plays out, long-duration bonds can deliver income and capital growth.

#3 Private markets

Whilst valuations in public markets have moved quickly, private markets have not kept pace. This is partly due to the asset class's less liquid nature but also reflects some of the challenges, such as the lack of IPO activity allowing private equity firms to create exits. In recent years, the breadth and depth of private markets have become more apparent to investors, and the ability for investors like you and me to invest in this space is improving. Viola and Clark agree that allocating to private markets is a sensible way to redeploy capital harvested from public markets to provide diversification while setting your portfolio up for the next decade.

A few rebalancing tips

Viola and Clark shared the following tips if you're keen to undertake some rebalancing but unsure where to start.

Don't be afraid to trim winning positions: An asset allocation framework will help you identify where your portfolio has become overweight or underweight. There's nothing wrong with taking some profits.

Make incremental changes: Avoid making all-in or all-out bets. Markets constantly wrongfoot you, so making incremental changes is better than making big moves in and out of the market.

Diversification: Take advantage of asset classes that provide genuine diversification. Alternatives such as private equity and private credit can cushion the volatility of public markets.

Liquidity: There will be darker days at some point. You don't want to be forced to sell distressed assets, so having an eye for where liquidity will come from when markets turn will allow you to capitalise on that opportunity.

> *"We all know there'll be a dark day at some point again. There'll be times, as Warren Buffett said, when it is raining gold and you just need to walk outside with a bucket." Ben Clark, TMS Private Wealth*

How to invest $1 million for 2025

The tables below indicate how Viola and Clark are allocating for 2025. While these are not tailored to an individual's specific needs, they reflect the positioning these two advisers are taking with their clients in the year ahead.

Charlie Viola's Asset Allocation for 2025

Asset Class	Allocation (Target)	Allocation (Current)	Difference
Australian Equities	26	21	-5
Global Equities	26	30	4
Fixed Income	15	6	-9
Growth Alternatives	8	13	5
Defensive Alternatives	15	20	5
Cash	10	10	0

Key Points:

- Weights suited to a more defensive-orientated investor.
- Reducing ASX exposure prefers global equities.
- Avoiding duration in fixed income.
- Actively allocating to growth and defensive alternatives.
- Happy to hold some cash to deploy as opportunities arise.

Ben Clark's Asset Allocation for 2025

Asset Class	2024	2025	Difference
Australian Equities	51	40	-12
Global Equities	20	23	3
Fixed Income (IGBs + Credit)	15	15	0
Property / Infrastructure	8	5	-3
Alternatives	0	10	10
Cash	6	7	1

Key Points:

- Weights suited to a more growth-orientated investor.
- Lowest exposure to ASX in a decade.
- Happy to run with global equities.
- Actively allocating to growth alternatives.
- Starting to add duration through government bonds.

All the best for 2025

One thing I've learned over the past decade at Livewire is that there are many ways to invest. The goal of this article is to give you some insight into how professional allocators think about building portfolios to grow wealth over long periods of time. Many of you will have developed your own approach to investing that works for you but we can always find ways to learn and improve. All the best for 2025, let's hope it is another good year for markets.

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