Principia

Investment Consultants

Quarterly Market Report

December 31, 2024

A Quiet End to a Dramatic Year

Global share markets hit record highs in 2024, and for the most part the rally continued into the last quarter, although faltered in the final weeks of the year. In a year dominated by speculation around interest rates, the December quarter saw three cuts to the cash rate from the Federal Reserve, driving the US market to another dominant performance.

Financial markets have been on an unpredictable ride this year, driven by geopolitical tensions, from escalating tensions in the Middle East to Russia's war with Ukraine, China's economic wobbles, and Donald Trump's sweeping election victory. For the most part though, markets tended to ignore the global uncertainties and continued to move higher and higher.

The December quarter got off to a strong start when the US Federal Reserve began their rate cutting cycle with a larger-than-expected 50 bps cut at the meeting held on the 18th of September. The rally continued with renewed enthusiasm with the election of Donald Trump to another term in the White House on November the 5th, followed by a further 25 bps cut to the cash rate two days later.

Initially markets were excited by the President-elect's policies that included further tax cuts and deregulation, and December saw the traditional "Santa Rally" where markets seemingly ignore economic warning signs and just continue to bid up the price of assets. By mid-December the S&P 500 was up 28% for the year, and possibly heading for one of the greatest returns ever.

The final meeting of the Fed also saw another 25 bp cut, but this time it put the brakes on the rally, as the post-meeting statement from the Fed indicated that there would be fewer rate cuts in 2025 than the market was expecting. Furthermore, President-elect Trump's tariff plans are seen as potentially inflationary, negating the case for monetary easing and prolonging further rate cuts. Between Christmas and New Year the S&P 500 fell by 2.6% while the tech heavy Nasdaq index fell by 3.5%.

In Australia, the Reserve Bank at their December meeting kept interest rates on hold for the ninth consecutive meeting and reiterated that inflation remains too high. A slowing economy and high interest rates have led to a quiet end to a dramatic year. For many, waiting for the Australian cash rate to come down feels a bit like waiting for Godot to arrive…

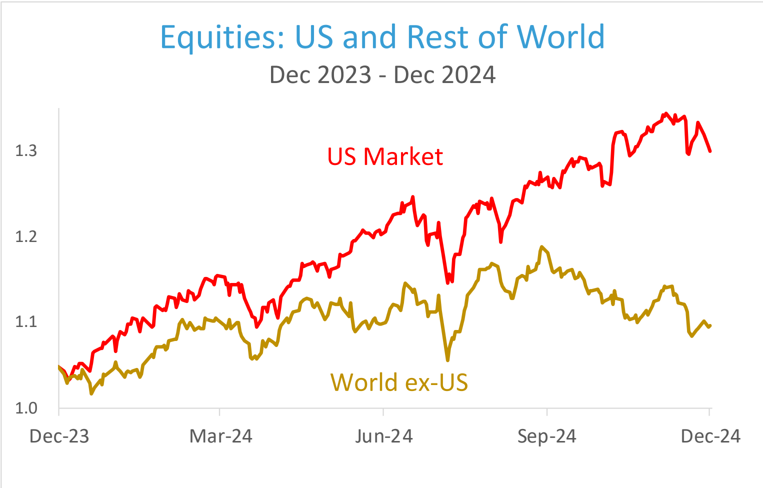
Equity and Bond Market Overview

A FLAT QUARTER FOR THE ASX AS INFLATION REMAINS HIGH.

The Australian market had a strong year, returning 11.4%, but a weak quarter, returning -0.8%. The so-called Santa Rally ran out of steam towards the end of the year as the RBA meeting kept interest rates on hold for the 9th consecutive meeting and gave no clear indication of when the first rate cut may happen.

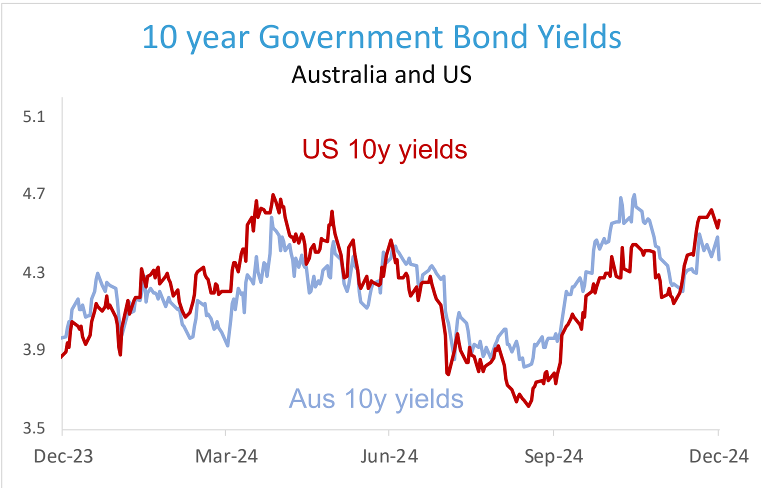
THE US MARKET CONTINUED TO DOMINATE OTHER MARKETS.

Other global markets also had a relatively weak quarter as expectations around inflation, economic growth and geo-politics dominated headlines. The US market however continued its extreme dislocation to other global markets. Over the quarter the S&P 500 Index returned 2.9%, while the World ex-US index returned –7.4% (in USD).



BOND YIELDS CLIMB HIGHER AS INFLATION REMAINS STUBBORN.

10-year government bond yields in Australia and the US have risen dramatically over the quarter, despite a series of interest rate cuts in the US. The Federal Reserve after their December meeting indicated that there will be fewer rate cuts in the year ahead than the market was expecting, suggesting that the Fed sees inflation remaining stubborn.



Source: investing.com

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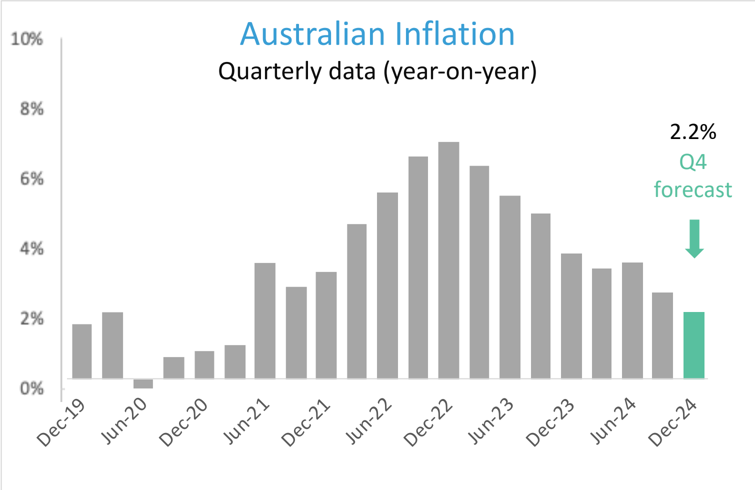
Economic Review and Forecasts

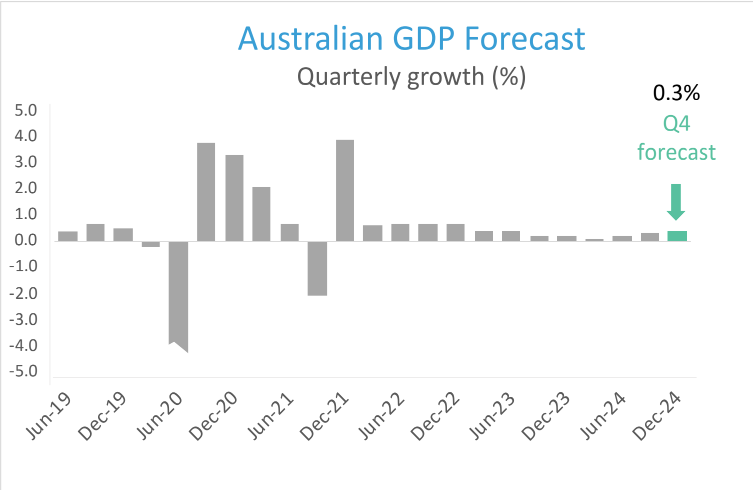
INFLATION CONTINUES TO FALL BUT REMAINS ABOVE TARGET.

Inflation has been falling since the end of 2022, and the RBA have noted that while headline inflation will decline for a time, underlying inflation remains too high. The trimmed mean CPI is expected to be 3.4% year-on-year for the fourth quarter of 2024, exceeding the central bank's 2-3% target.



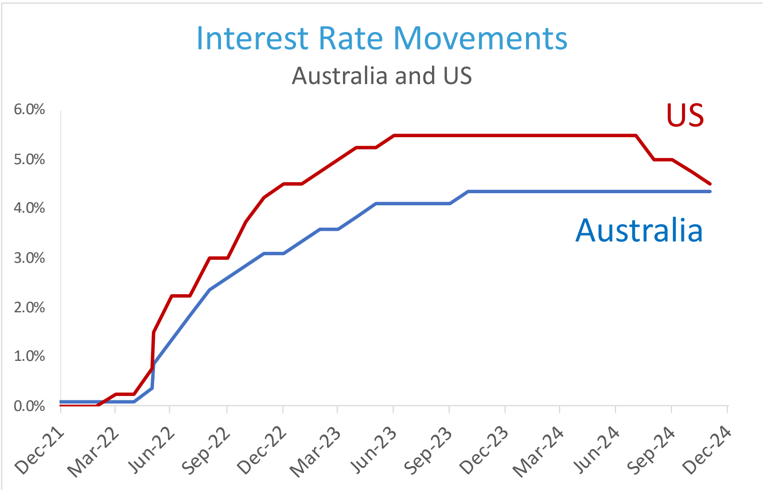
AUSTRALIA REMAINS ON TRACK FOR A SOFT LANDING.

The national economy is expected to grow by 0.3% for the three months to December as interest rates continue to force consumers to curb spending on discretionary goods. Household spending remains flat, as a rebate-driven drop in electricity spending was offset by increases in other categories.



US RATES START TO FALL, BUT AUSTRALIA ON HOLD

The Reserve Bank of Australia (RBA) retained its cash rate at 4.35% during its final meeting on December 10th, keeping borrowing costs unchanged for the ninth straight meeting. The US Federal Reserve announced another 25 bps cut to the federal funds rate at their meeting on December 18th, marking the third consecutive reduction this year.



Source: tradingeconomics.com

Market Returns to 31 December 2024

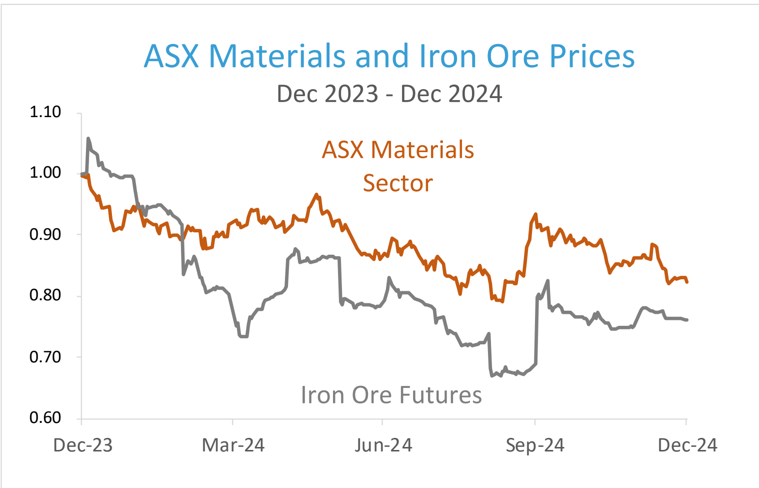
Asset Class	3 Months	1 Year	3 Year	5 Year	10 Year
Cash	1.1%	4.5%	3.2%	2.0%	1.9%
Australian Bonds	-0.3%	2.9%	-0.8%	-0.2%	2.0%
Global Bonds	-1.2%	2.2%	-1.9%	-0.5%	1.8%
Australian Equity	-0.8%	11.4%	7.4%	8.1%	8.5%
Developed Markets	12.1%	31.2%	12.2%	14.1%	13.2%
Developed Markets (hedged)	1.9%	20.7%	6.4%	10.5%	10.3%
Emerging Markets	3.1%	18.5%	3.5%	4.3%	6.6%
Australian REITS	-6.0%	18.5%	3.5%	5.9%	8.4%
Global REITs	1.9%	13.3%	0.2%	3.0%	5.9%

Source: MSCI, Bloomberg, S&P Global

- Record highs were set in 2024 by equity benchmarks in the US, Japan, Europe and Australia, although markets have come off these highs in the last week's of the year.
- In particular the Australian market recorded a negative quarter, as the strong rally in financials was offset by the weakness in the mining and energy stocks.
- The US equity market had already been rallying throughout the year on the prospect of interest rate relief by the Federal Reserve, but gains accelerated in November after Trump was elected President. The artificial intelligence boom again was a major driver of US stocks, which in turn was the driver of the broader developed market index.
- Despite the rate cuts from the Fed, bond yields have risen throughout the quarter as Trump's stated policies have boosted fears around inflation heading into 2025.
- The Australian dollar is down by more than 9% on the back of a weak domestic economy and a broadly stronger US dollar. Consequently, unhedged international equities have outperformed their hedged counterparts.
- Emerging Markets are up over 18% for the year, as China - which accounts for 30% of the EM index – had strong returns despite the weak local economy.

WEAK DEMAND FOR IRON ORE PULLS DOWN ASX MINERS

Iron ore prices have tumbled by over 23% in 2024, mainly due to concerns about weak demand from China's sluggish construction sector. Consequently Australia's big mining stocks have returned double digit negative returns, and the ASX Materials sector is down -17.7% for the year.



Source: investing.com

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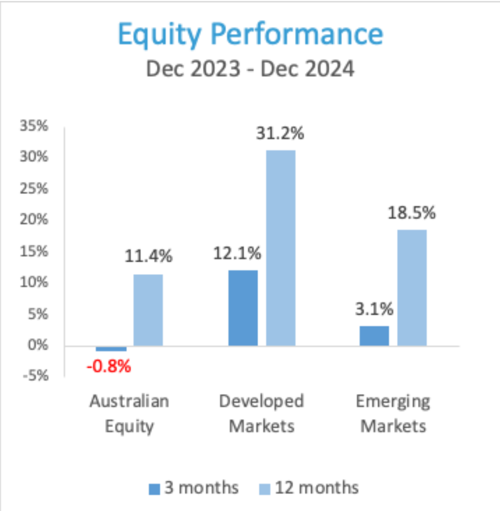
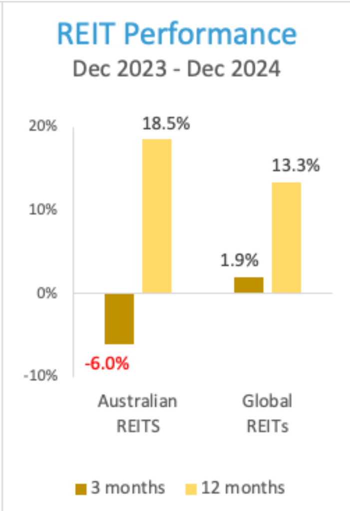
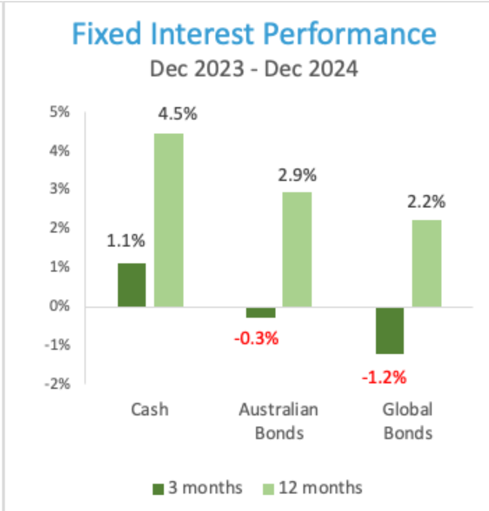
Market Returns (Chart)



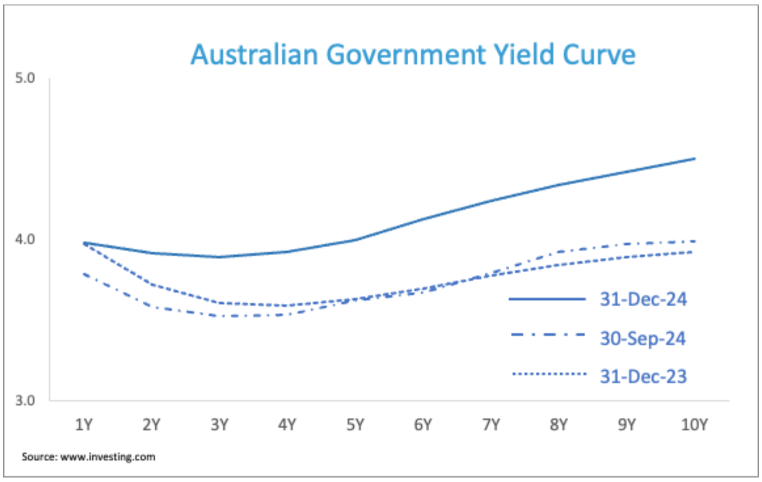




Yield Curves

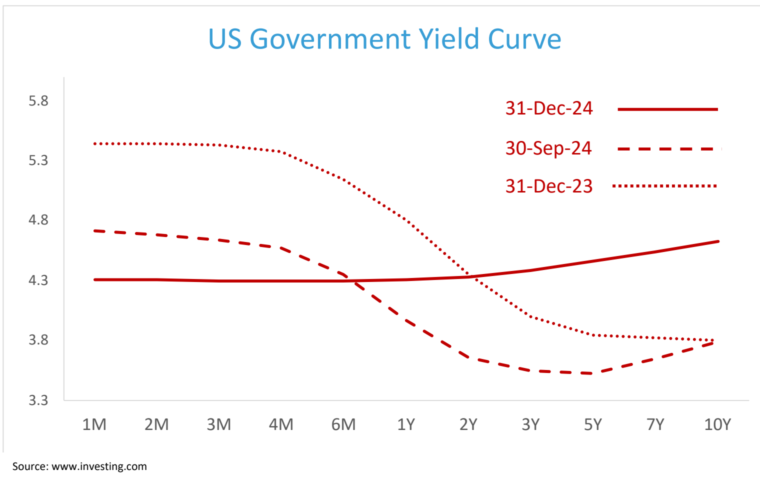
AUSTRALIA

While the RBA has kept its cash rate unchanged at 4.35%, the Australian yield curve is now reflecting an expectation that interest rates will start moving lower in 2025, although economists cannot agree when this may happen. The Australian economy is growing at its slowest pace in decades, but inflation remains stubborn and is falling only gradually.



UNITED STATES

The US yield curve is no longer "inverted", as 2 year yields are now lower than 10 year yields, the usual definition of a "normal" yield curve. Short end yields have fallen as traders price in the interest rate cuts that started in September, while longer term yields have been rising on expectations around inflation and where interest rates will end up longer term.



Source: tradingeconomics.com

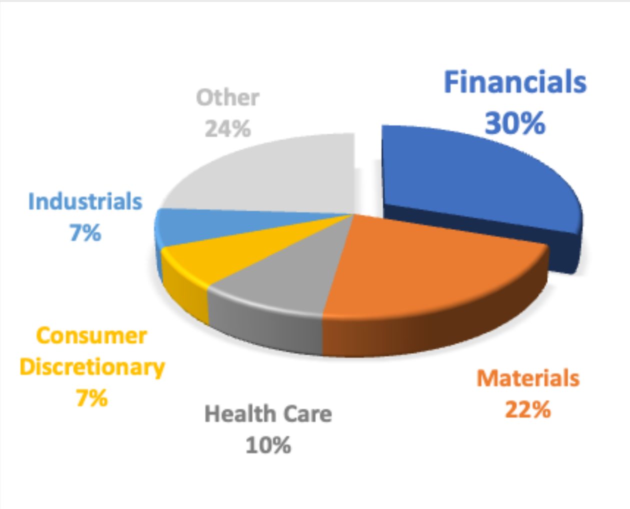
Sector Performance

AUSTRALIA

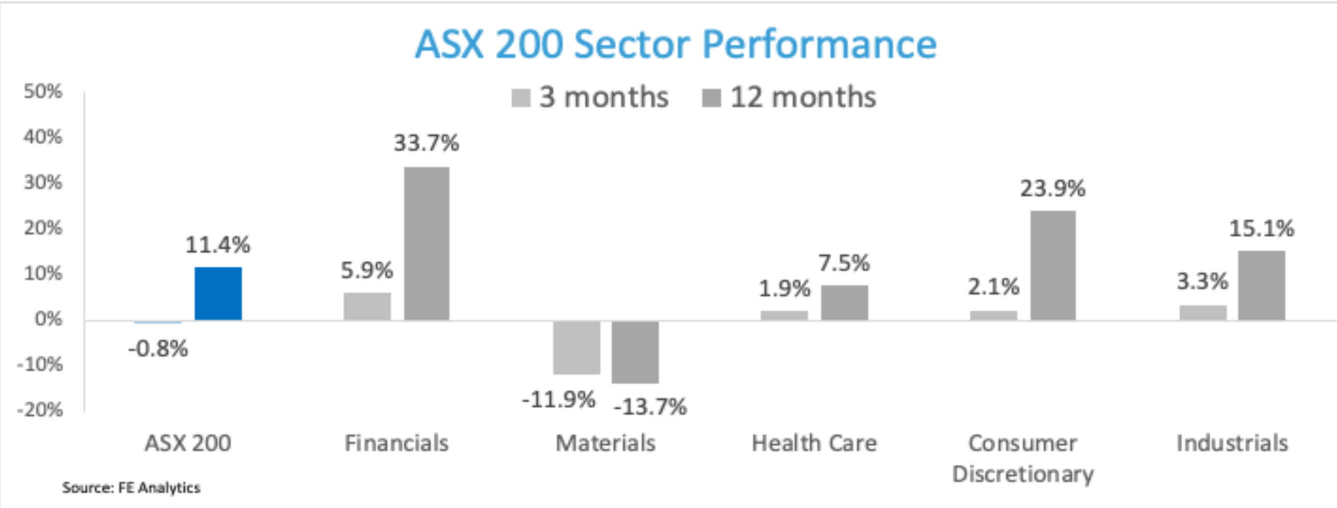
Of the largest sectors, Financials and Consumer Discretionary stocks have performed strongly over the last 12 months, while the Materials sector – dominated by the big miners – has performed poorly amidst falling iron ore prices. In particular, the last quarter has been pulled down by resources and energy stocks. The information technology sector has been the best performing sector, but it only accounts for around 3% of the overall market.

Sector	3 months	12 months
ASX 200	-0.8%	11.4%
Communication Services	2.2%	6.1%
Consumer Discretionary	2.1%	23.9%
Consumer Staple	-5.4%	-1.1%
Energy	-5.4%	-13.9%
Financials	5.9%	33.7%
Health Care	1.9%	7.5%
Industrials	3.3%	15.1%
Information Technology	0.9%	49.9%
Materials	-11.9%	-13.7%
Real Estate	-6.2%	16.3%
Utilities	1.6%	17.5%

Five sectors make up approximately 75% of the market, with the two largest constituting more than 50%. The bottom chart shows the 12-month performance of the five largest sectors.



Sector	Weight	Cummulative
Financials	30.3%	30.3%
Materials	22.0%	52.3%
Health Care	9.6%	61.9%
Consumer Disc	7.3%	69.2%
Real Estate	6.9%	76.1%
Industrials	6.8%	82.9%
Energy	5.0%	87.9%
Consumer Staples	4.1%	92.0%
Communiation Services	3.8%	95.8%
Information Technology	2.9%	98.7%
Utilities	1.3%	100.0%



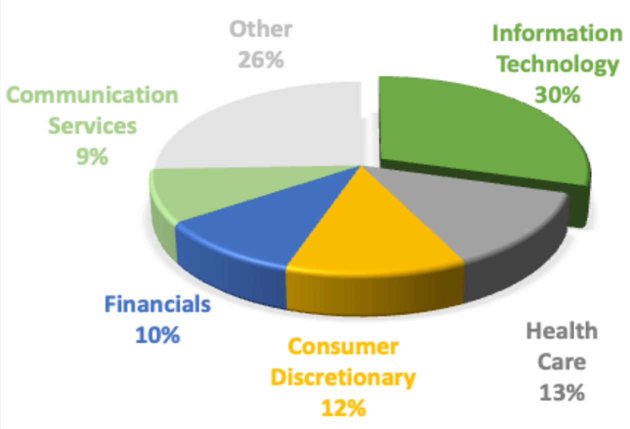
Sector Performance

UNITED STATES

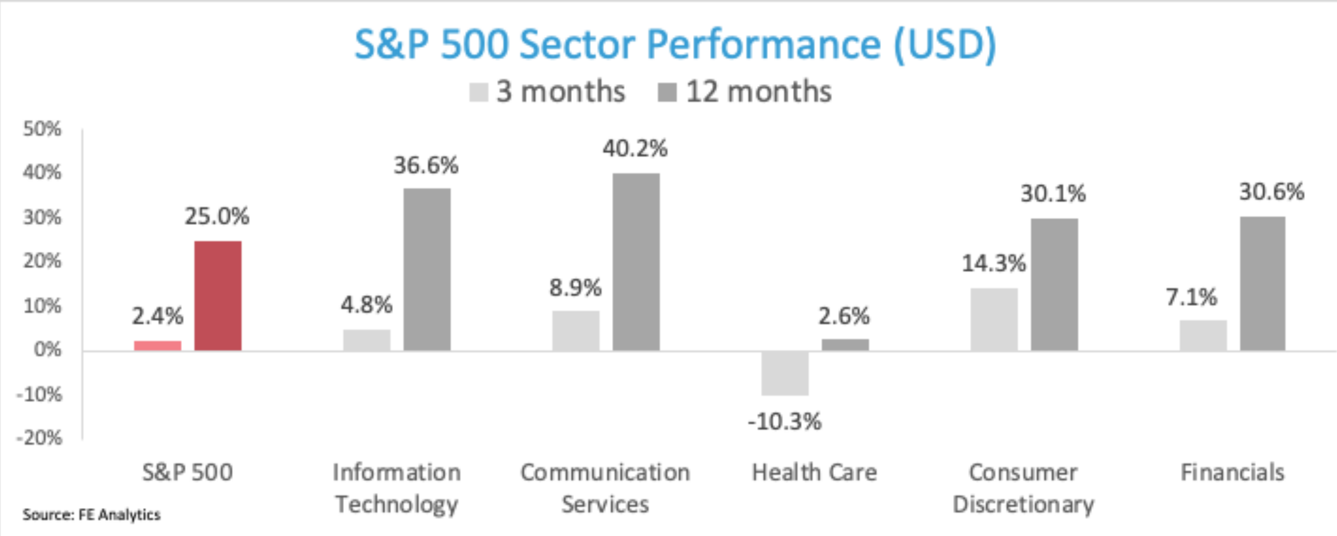
The US Tech sector (Information Technology and Communications stocks) have had exceptional 12 month returns as the large Nasdaq stocks continue to benefit from enthusiasm for AI. Of the other large sectors that dictate the overall US market performance, banks have done well but this has been offset by the poor performance of health care stocks. Consumer Discretionary stocks continue to do well.

Sector	3 months	12 months
S&P 500	2.4%	25.0%
Communication Services	8.9%	40.2%
Consumer Discretionary	14.3%	30.1%
Consumer Staple	-3.3%	14.9%
Energy	-2.4%	5.7%
Financials	7.1%	30.6%
Health Care	-10.3%	2.6%
Industrials	-2.3%	17.5%
Information Technology	4.8%	36.6%
Materials	-12.4%	0.0%
Real Estate	-7.9%	5.2%
Utilities	-5.5%	23.4%

Five sectors make up approximately 75% of the US market, with Tech companies constituting around 40%. The bottom chart shows the 12-month performance of the five largest sectors.



Sector	Weight	Cummulative
Information Technology	29.6%	29.6%
Financials	13.2%	42.8%
Health Care	12.4%	55.2%
Consumer Discretionary	10.3%	65.5%
Communication Services	9.0%	74.5%
Industrials	8.8%	83.3%
Consumer Staples	6.0%	89.3%
Energy	3.9%	93.2%
Materials	2.4%	95.6%
Real Estate	2.3%	97.9%
Utilities	2.1%	100.0%



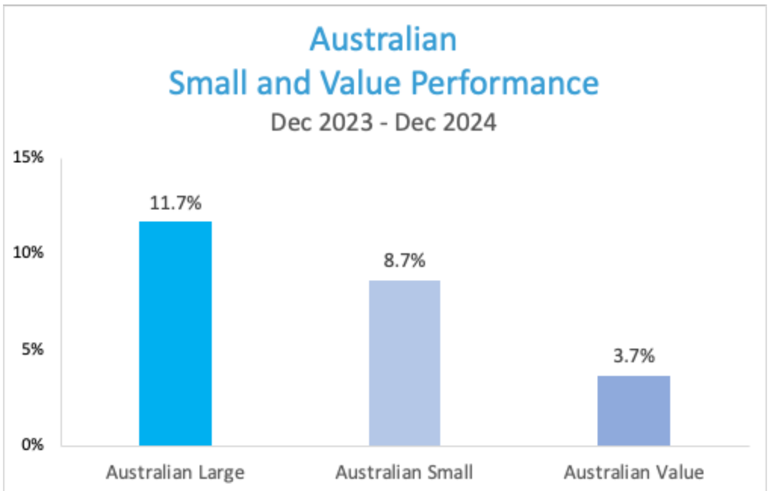
Equity Factors - Small and Value Premiums

Asset Class	3 Months	1 Year	3 Year	5 Year	10 Year
Australian Large	-0.7%	11.7%	9.1%	8.4%	8.6%
Australian Growth	3.0%	19.6%	7.7%	7.2%	10.0%
Australian Small	-3.2%	8.7%	0.7%	7.5%	8.9%
Australian Value	-4.6%	3.7%	10.0%	8.8%	6.7%
Global Large	12.2%	31.8%	12.8%	14.7%	13.8%
Global Growth	16.6%	39.4%	13.1%	18.1%	16.5%
Global Small	9.7%	20.1%	6.8%	9.7%	11.0%
Global Value	7.7%	24.1%	11.8%	10.6%	10.6%

Source: FE Analytics. See below for MSCI indices used to define Large, Small, Value and Growth.
Note that the MSCI Australia indices will be different to the S&P/ASX 200 and S&P/ASX Small Ordinaries indices.

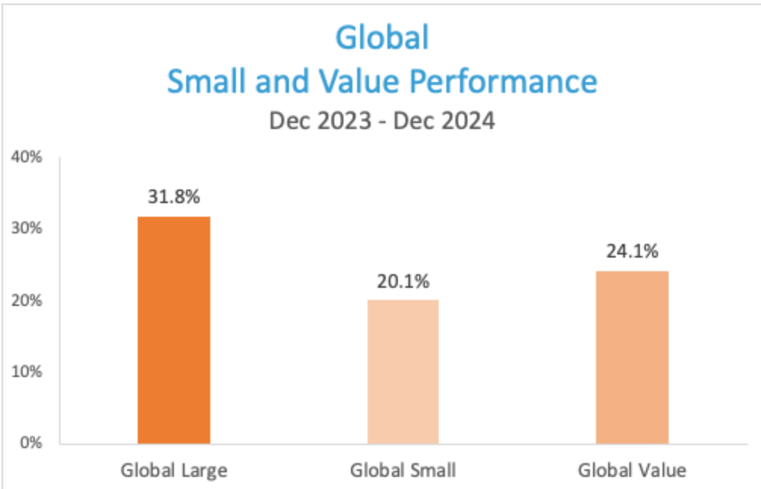
AUSTRALIAN FACTORS

Factors are very volatile over short time periods. Looking over the course of the last 12 months, Australian value stocks have underperformed growth stocks, mainly due to the performance of the higher P/E banks (CBA and NAB). Smaller companies continue to underperform large companies, although are now doing better than previous years.



GLOBAL FACTORS

The global markets are dominated by the US, which accounts for approximately 70% of the MSCI World Index. The biggest driver of US returns in the last few years has been the large growth tech stocks, resulting in value and small cap stocks underperforming the broader market. However, the MSCI World ex-USA index has delivered a value premium over the last 12 months.



MSCI Australia TR
MSCI Australia Small Cap TR
MSCI Australia Value TR
MSCI Australia Growth TR

MSCI World ex Australia Index (ATR, AUD)
MSCI World ex Australia Small Cap Index (ATR., AUD)
MSCI World ex Australia Value Index (ATR, AUD)
MSCI World ex Australia Growth Index (ATR, AUD)

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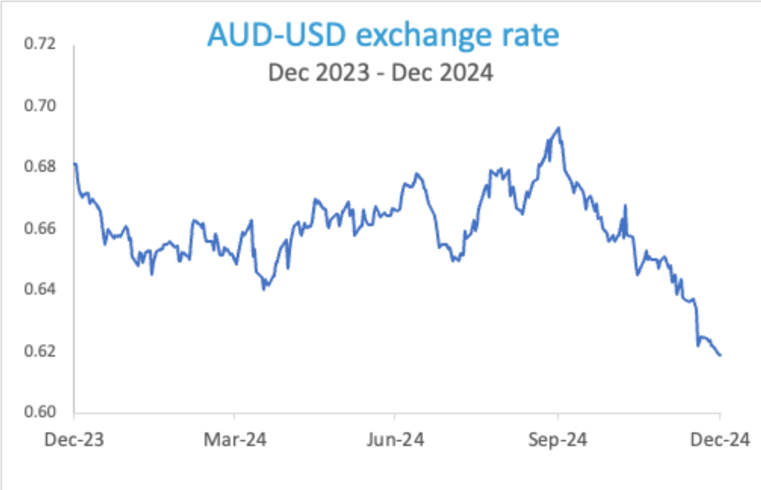
Currency and Commodities

EXCHANGE RATE

The Australian dollar ended the year below 62 US cents and down from 68 cents at the start of the year, as the weak domestic economy, concerns over China's outlook and a broadly stronger US dollar took their toll.

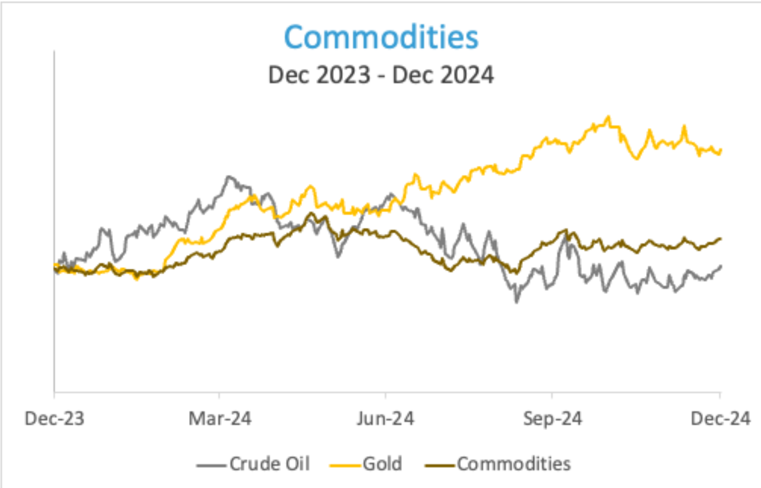
The Aussie is down -9.2% over the year, but all of that has come in the last quarter where the AUD has fallen by -10.7%.



COMMODITIES, OIL AND GOLD

The Commodity index is up 6.7% for the year, buoyed by the rally in gold which is up 27% for the last 12 months. Oil and gold make up around 30% of the Commodity index.

Gold is hovering at record levels as elevated geopolitical risks magnified support for safe-haven assets. Oil has been flat for the year on lower demand and higher supply.



Source: www.investing.com

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January 2025