PRINCIPIA

INVESTMENT CONSULTANTS

Quarterly Market Report

September 30, 2024

The September Quarter for 2024 has been marked by a number of economic events that have moved markets both up and down. Stock volatility spiked at the beginning of the quarter after the publication of disappointing economic data which sparked a sharp sell-off across global markets.

There were a number of reasons for the elevated volatility. An unexpectedly weak US jobs report, which raised renewed fears of a recession in the world's largest economy, hit at the same time as other tensions in the global economy were building. Worries about China's growth rattled commodities markets from oil to copper, and there were fresh warnings that AI's promise to benefit global economies was far from being realized, making it hard to justify valuations.

The volatility led to a flight to quality, with bond yields falling and gold hitting fresh highs in US dollar terms. With growth concerns around the US economy, short term bond yields began falling in anticipation that the Federal Reserve would begin its easing cycle. The Federal Reserve didn't disappoint and cut its policy interest rate by 0.5% at its September meeting.

This was the Fed's first rate cut in more than four years after holding it at 5.25% to 5.50% for more than a year; its highest level in two decades. Despite the market sell-off in August, the S&P 500 Index has finished the quarter up over 5% and is up by more than 35% for the previous 12 months, hitting new highs on the last day of September.

The Australian sharemarket also closed at a new record high although the economic picture is different to the US. The ASX 200 Index is up over 6% for the quarter and is up 20% for the previous 12 months. For most of this year the Australian market has been driven by banks, with the Financial Sector up over 35% for the year, but this has been hampered by the poor performance of the Resource sector, which is tied to China's slowing economy.

However, in the last week of the quarter the People's Bank of China announced measures to bolster the real estate sector and the broader economy. The China policies have broad implications across risk assets, however, one of the most immediate beneficiaries is the resources sector which recouped some of its year-to-date underperformance on the back of rebounding commodity prices.

From fears of a recession to bull market euphoria, this has been a September to remember.

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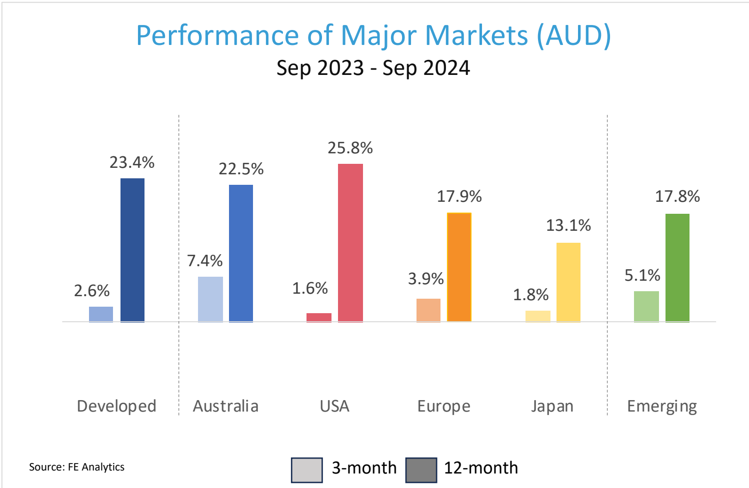
Equity and Bond Market Overview

A VOLATILE QUARTER, BUT BANKS LEAD THE ASX HIGHER.

Despite the sudden drop in the market by 7% in early August on the back of fears of a recession in the US, the ASX has returned over 6% for the quarter and over 20% for the full 12 months. The major driver has been the Financials sector, which has returned 35% for the 12 months, although the Materials sector has been a drag on the overall market.

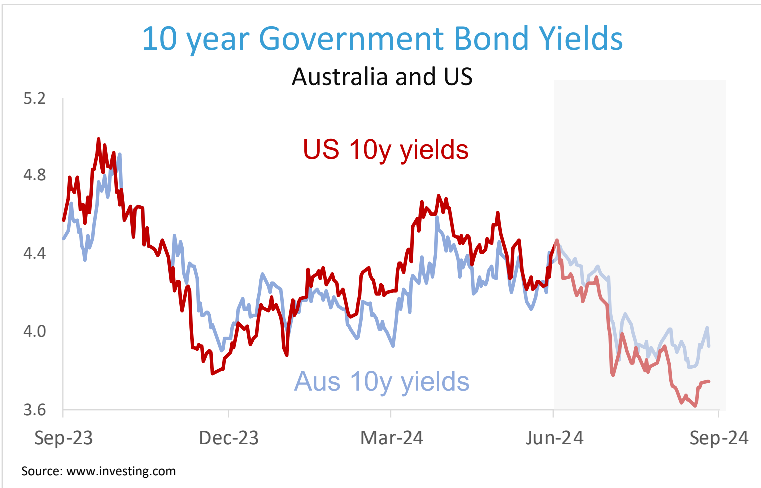
STRONG RETURNS IN OTHER MAJOR MARKETS

Other global markets all had excellent returns over the quarter and over the previous 12 months. The US was again the standout market. The Chinese stimulus package fired up the MSCI China index by more than 20%, which in turn helped the Emerging Markets have one of their best quarters in years.



BOND YIELDS COMING DOWN AS INFLATION SLOWS

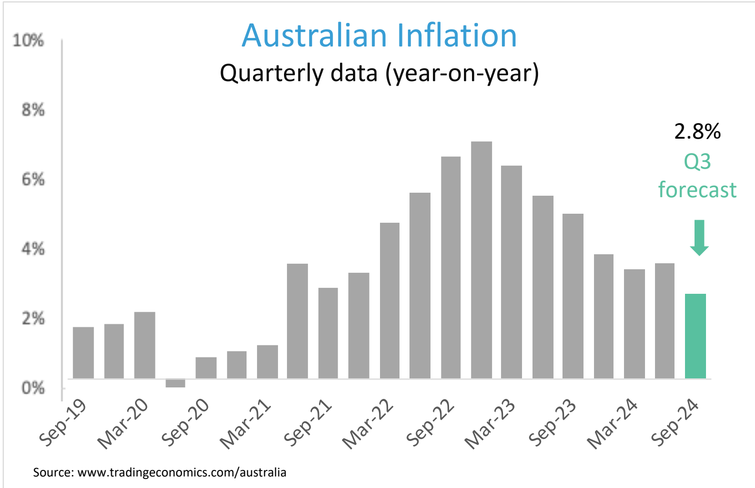
10-year government bond yields in Australia and the US have been coming down over the quarter as inflation continues to decline. The divergence in the yields in the last weeks of the quarter represents the contrast in interest rate expectations, as the RBA is expected to keep rates on hold until next year.



Economic Review and Forecasts

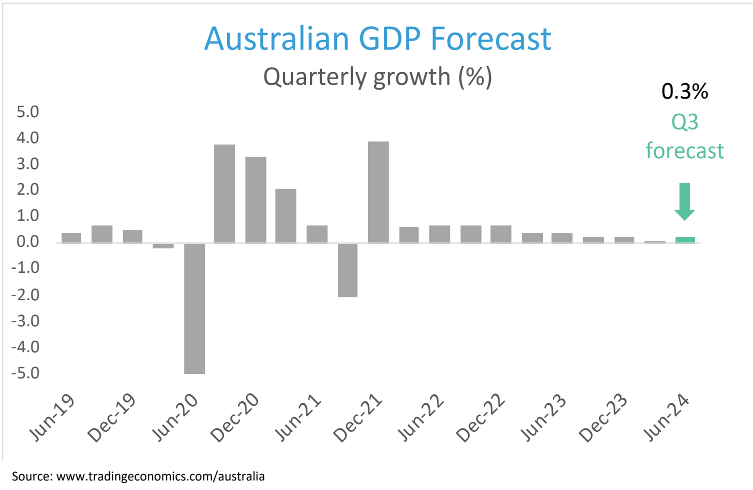
INFLATION CONTINUES TO FALL BUT REMAINS ABOVE TARGET.

Inflation has been falling since the end of 2022, and the inflation rate in Australia is expected be under 3% for the September quarter. The RBA have noted that while headline inflation will decline for a time, underlying inflation remains too high. Economists have warned that a rise in government spending is a factor in elevated inflation.



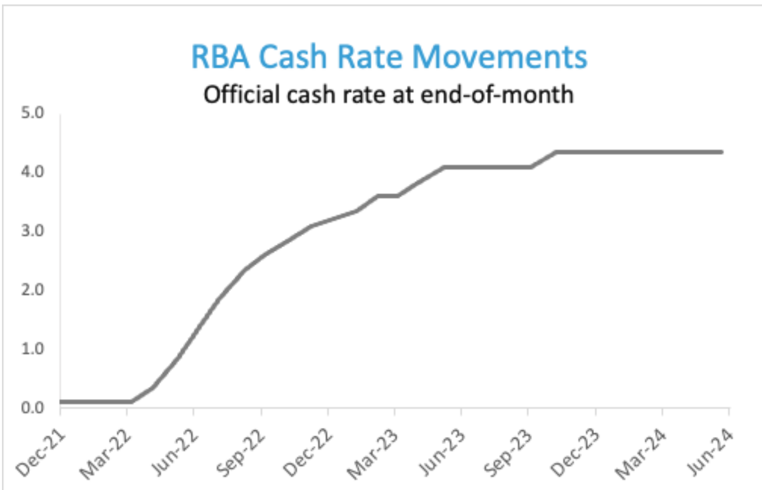
AUSTRALIA REMAINS ON TRACK FOR A SOFT LANDING.

The national economy grew by 0.2% in the three months to June as interest rates forced consumers to slash spending on discretionary goods. Discretionary spending by households fell by 1.1%, particularly on transport services and hotels, cafes and restaurants. This accounts for more than half of all economic activity.



INTEREST RATES ON HOLD, BUT HIGHER RATES A POSSIBILITY

The RBA remains in a wait and see mode and have reiterated that the path of interest rates will depend upon the data and the evolving assessment of risks, At the most recent meeting they continued to rule out a near-term interest rate cut, even as major central banks overseas start to loosen monetary policy to stimulate economic growth.



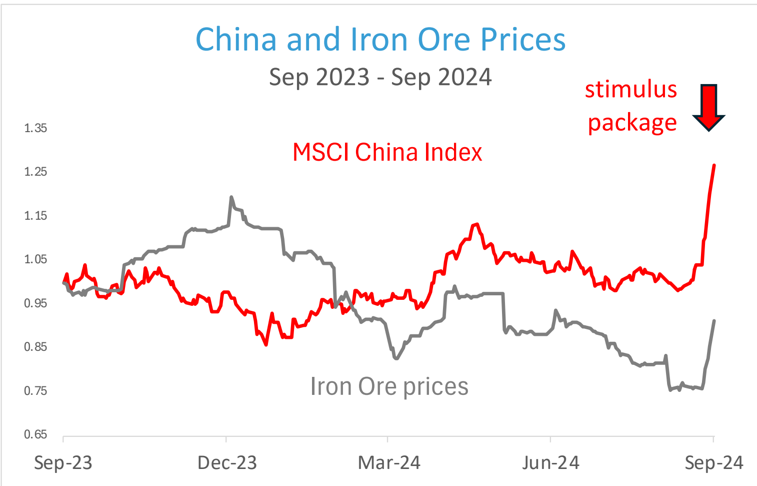
Market Returns to 30 September 2024

Asset Class	3 Months	1 Year	3 Year	5 Year	10 Year
Cash	1.1%	4.4%	2.8%	1.8%	1.9%
Australian Bonds	3.0%	7.1%	-1.2%	-0.4%	2.4%
Global Bonds	4.0%	9.1%	-1.5%	-0.4%	2.3%
Australian Equity	7.8%	21.8%	8.4%	8.4%	8.9%
Developed Markets	2.3%	23.2%	10.6%	12.5%	12.8%
Developed Markets (hedged)	4.4%	29.3%	8.4%	11.7%	10.5%
Emerging Markets	4.7%	17.3%	1.8%	5.2%	6.5%
Australian REITS	14.5%	47.0%	9.1%	7.0%	10.3%
Global REITs	11.7%	21.3%	3.3%	2.0%	7.4%

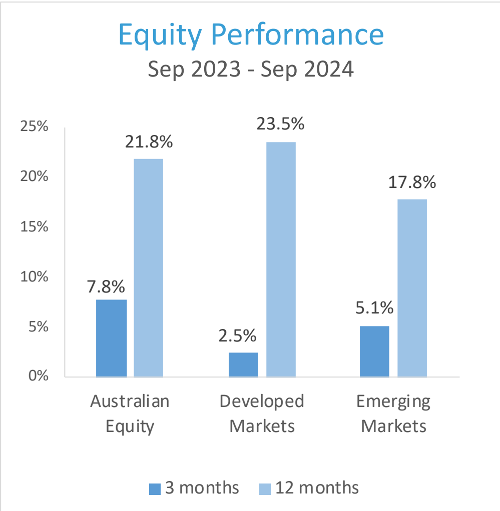
- Earlier in the quarter bond yields fell on expectations of worsening global economic conditions, but the narrative has now changed to expectations of a controlled reduction in rates and a soft landing for the US economy.
- Global bonds have had a better performance than Australian bonds as the Federal Reserve has started their rate cutting cycle, while the RBA is not expected to move interest rates lower until 2025.
- The Australian share market is up by more than 20% for the previous 12 months, mainly driven by the strong performance of the big banks.
- The Australian dollar has been bolstered in recent weeks by the narrowing interest gap between Australia and the US, and the Chinese stimulus package which pushed up iron ore prices. As the AUD/USD exchange rate has climbed during the quarter the hedged MSCI World index has outperformed the unhedged index.
- Emerging Markets continue to lag developed markets, mainly due to the poor performance of the Chinese stock market which accounts for 30% of the EM index.
- Global REITs are also benefitting from the expectation of lower interest rates and are one of the best performing asset classes over the quarter.

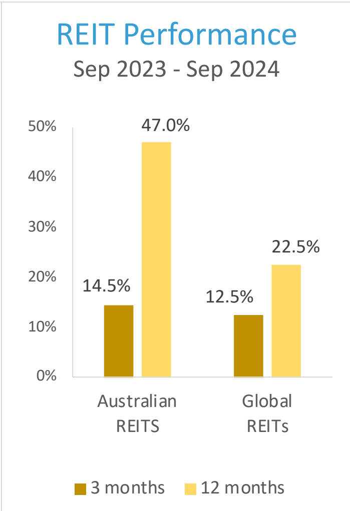
CHINA's STIMULUS PACKAGE BOOSTS IRON ORE

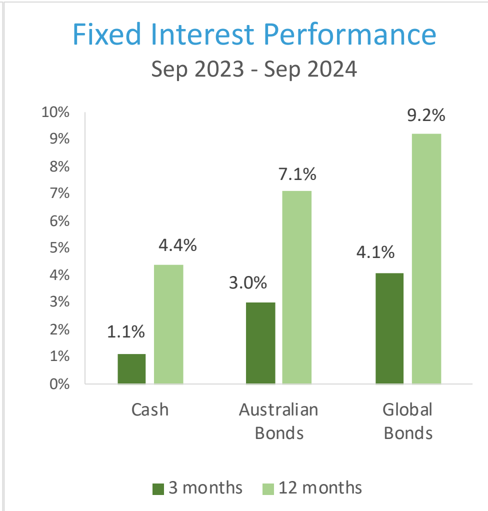
At the end of September the People's Bank of China implemented a range of stimulus measures in response to the county's economic slowdown. Global equities reacted positively, particularly stocks in Hong Kong and China. Australia's big mining stocks jumped as iron ore prices lifted by more than 10% on the news.



Market Returns (Chart)



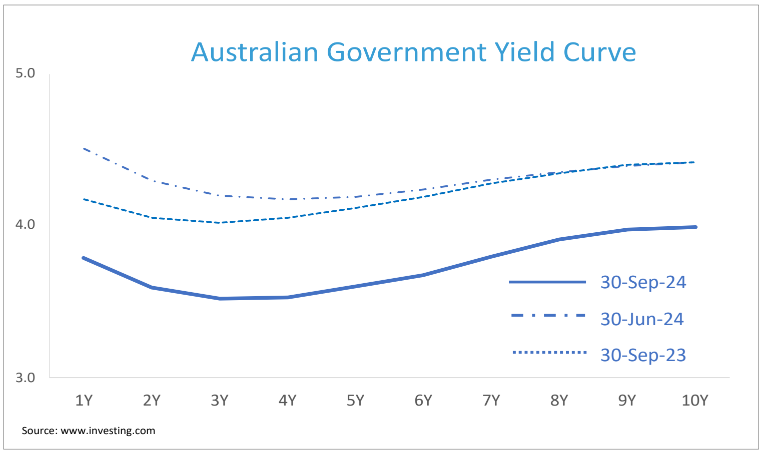




Yield Curves

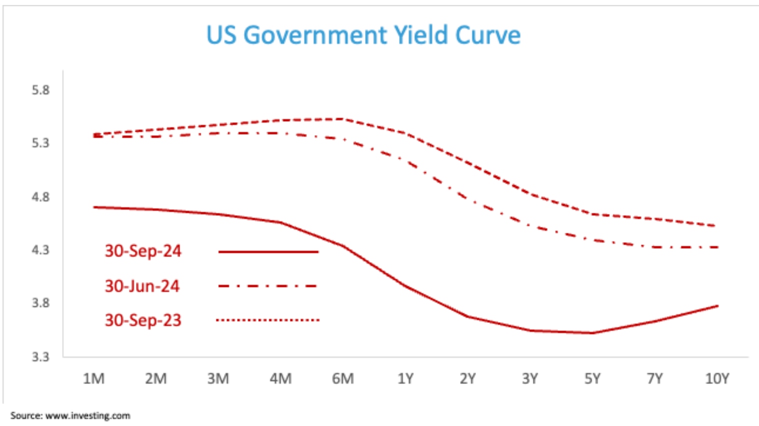
AUSTRALIA

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. The Australian economy is growing is at its slowest pace in decades although inflation is falling only gradually.



UNITED STATES

The US yield curve is dramatically lower since the start of the quarter, as traders price in expectations of where interest rates will end up longer term. The yield curve is no longer strictly “inverted”, as 2 year yields are now lower than 10 year yields, the usual definition of a “normal” yield curve.



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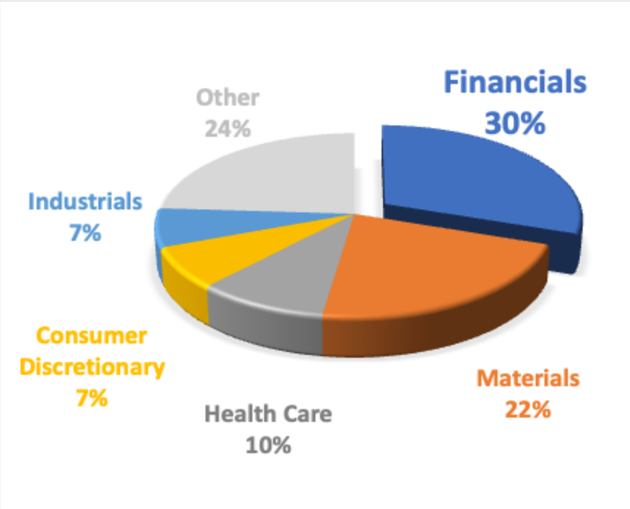
Sector Performance

AUSTRALIA

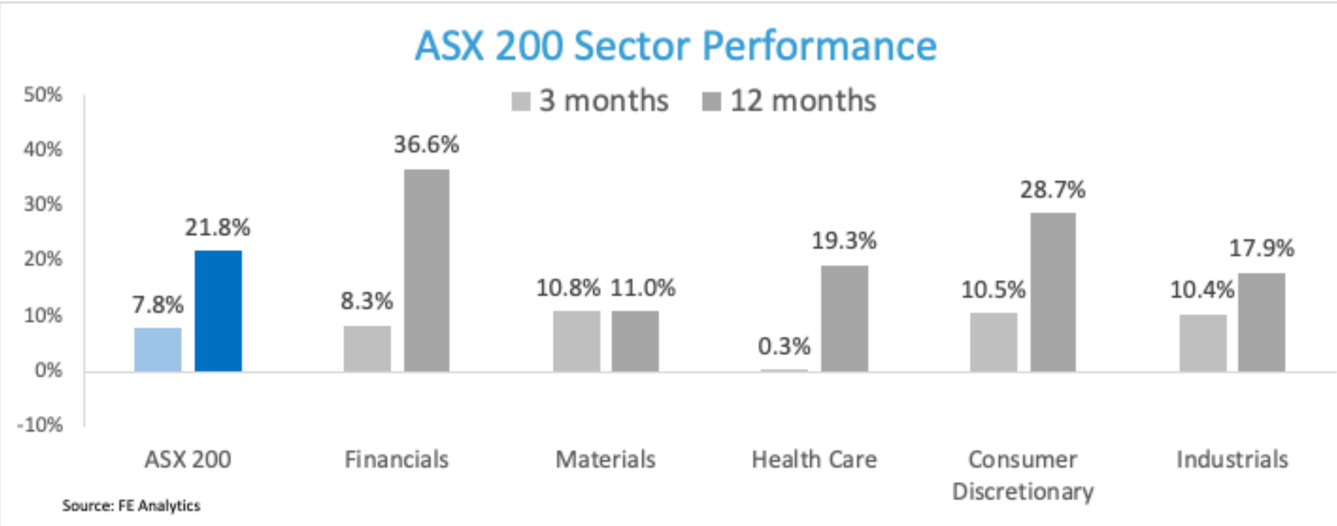
Of the largest sectors Financials and Consumer Discretionary stocks have performed strongly over the last 12 months, while the Materials sector – dominated by the big miners – has performed poorly amidst falling iron ore prices. However the recent policy measures by the Chinese government have boosted commodity prices which has seen the Materials sector increase by 10% in the last week of the quarter.

Sector	3 months	12 months
ASX 200	7.8%	21.8%
Communication Services	7.9%	10.8%
Consumer Discretionary	10.5%	28.7%
Consumer Staple	2.3%	4.7%
Energy	-6.2%	-17.2%
Financials	8.3%	36.6%
Health Care	0.3%	19.3%
Industrials	10.4%	17.9%
Information Technology	16.1%	58.3%
Materials	10.8%	11.0%
Real Estate	14.2%	42.1%
Utilities	-1.2%	13.3%

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%



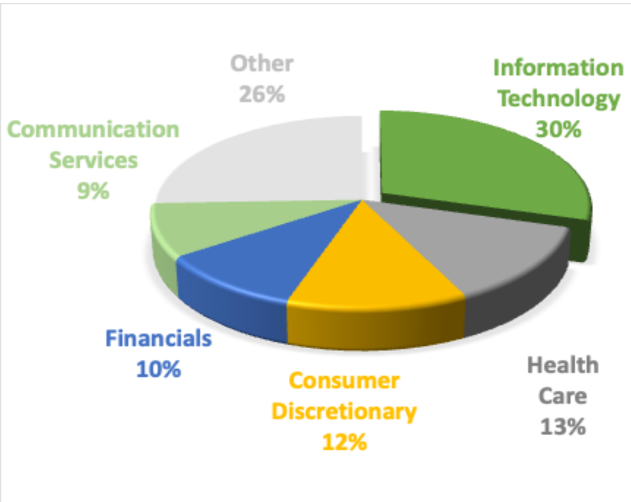
Sector Performance

UNITED STATES

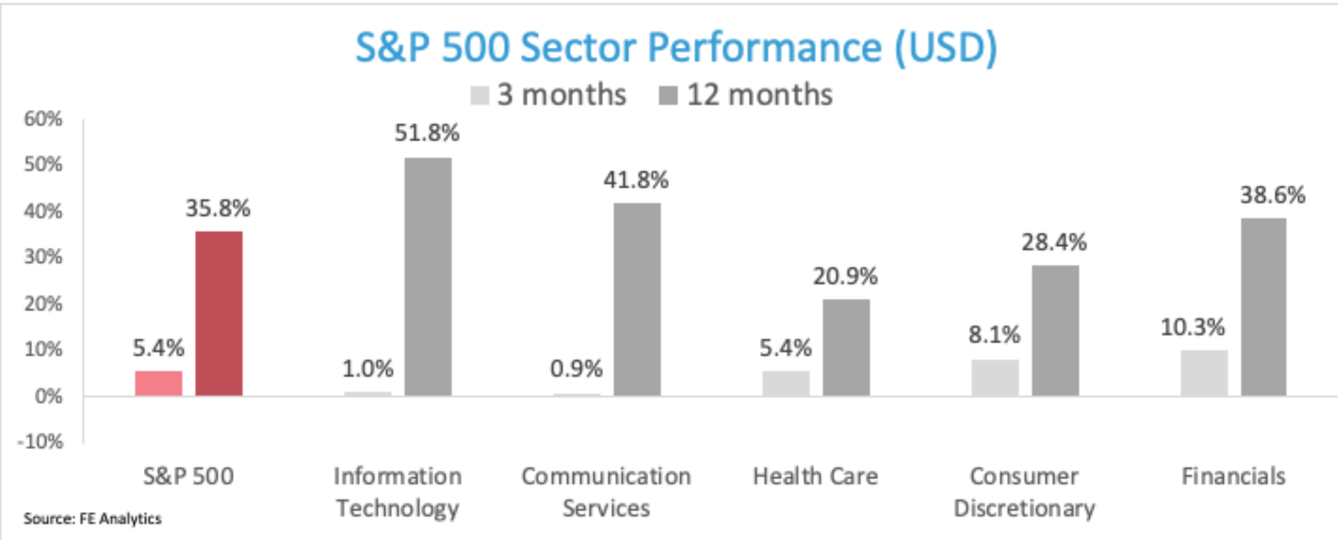
The US Tech sector (Information Technology and Communications stocks) have had exceptional 12 month returns as the large Nasdaq stocks continue to benefit from enthusiasm for AI. However the market volatility in early August which saw the tech stocks pull back by more than 10% may indicate the inflated prices are not sustainable, and the promised benefits of AI may not be fully realized.

Sector	3 months	12 months
S&P 500	5.4%	35.8%
Communication Services	0.9%	41.8%
Consumer Discretionary	8.1%	28.4%
Consumer Staple	8.8%	25.2%
Energy	-3.1%	0.0%
Financials	10.3%	38.6%
Health Care	5.4%	20.9%
Industrials	11.0%	35.2%
Information Technology	1.0%	51.8%
Materials	10.4%	25.9%
Real Estate	16.2%	34.7%
Utilities	18.9%	41.2%

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%



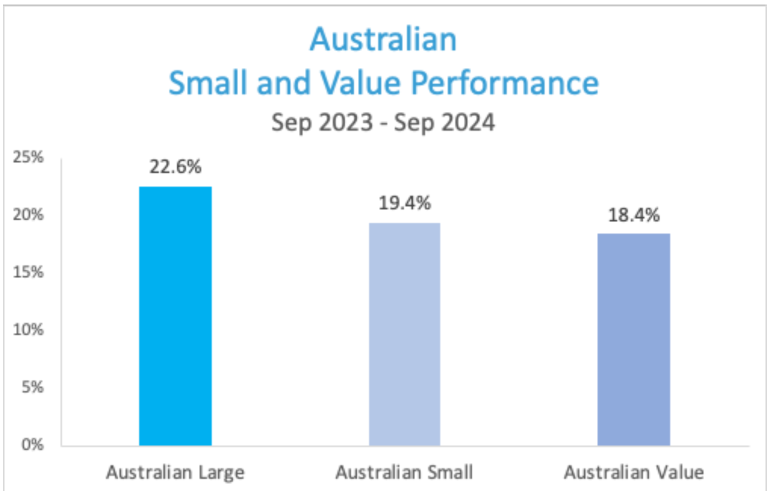
Equity Factors - Small and Value Premiums

Asset Class	3 Months	1 Year	3 Year	5 Year	10 Year
Australian Large	7.4%	22.6%	9.9%	8.6%	9.0%
Australian Growth	7.3%	26.7%	7.9%	7.2%	9.8%
Australian Small	8.9%	19.4%	3.6%	8.1%	9.2%
Australian Value	7.4%	18.4%	11.5%	9.2%	7.8%
Global Large	2.6%	24.1%	11.2%	13.1%	13.4%
Global Growth	-0.3%	28.4%	10.2%	15.8%	15.8%
Global Small	5.8%	17.2%	4.3%	9.0%	11.1%
Global Value	5.9%	19.5%	11.6%	9.7%	10.5%

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.

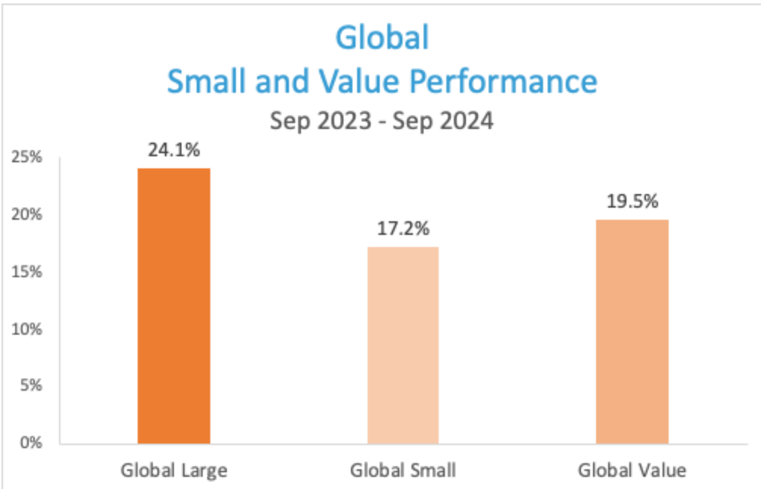
AUSTRALIAN FACTORS

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

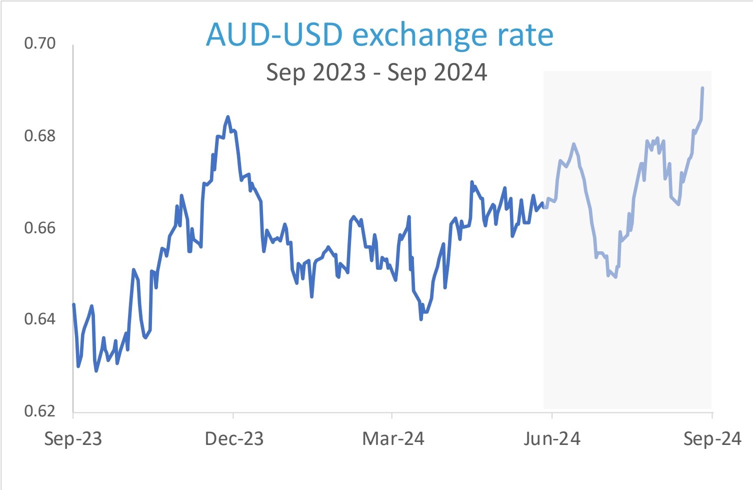
MSCI World ex Australia Index (ATR, AUD)
MSCI World ex Australia Small Cap Index (ATR., AUD)
MSCI World ex Australia Value Index (ATR, AUD)
MSCI World ex Australia Growth Index (ATR, AUD)

Currency and Commodities

EXCHANGE RATE

The Australian dollar is trading at a 2024 high as a weakening USD Dollar and renewed stimulus in China around the property sector has pushed up iron ore prices.

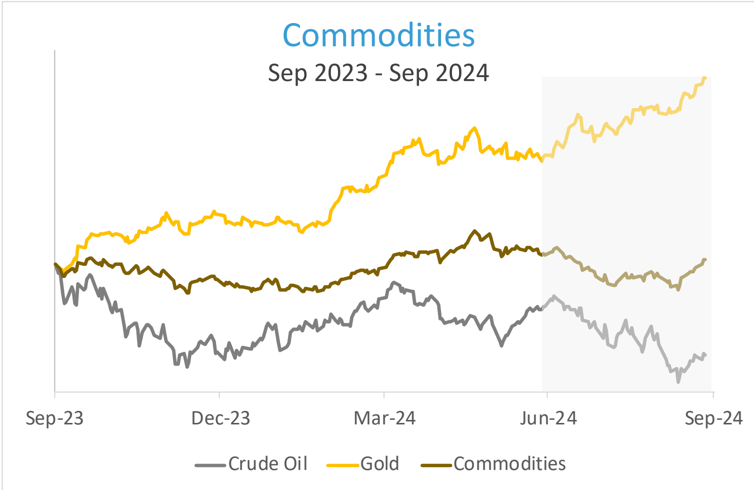
The Aussie has gained 3.9% over the quarter and is up 7.7% for the previous 12 months.



COMMODITIES, OIL AND GOLD

The Commodity index is flat for the year, pulled lower by oil, which is down over 21% but buoyed by gold which is up over 43%. 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.



Source: www.investing.com

Dr Steve Garth
Principia Investment Consultants
October 2024

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