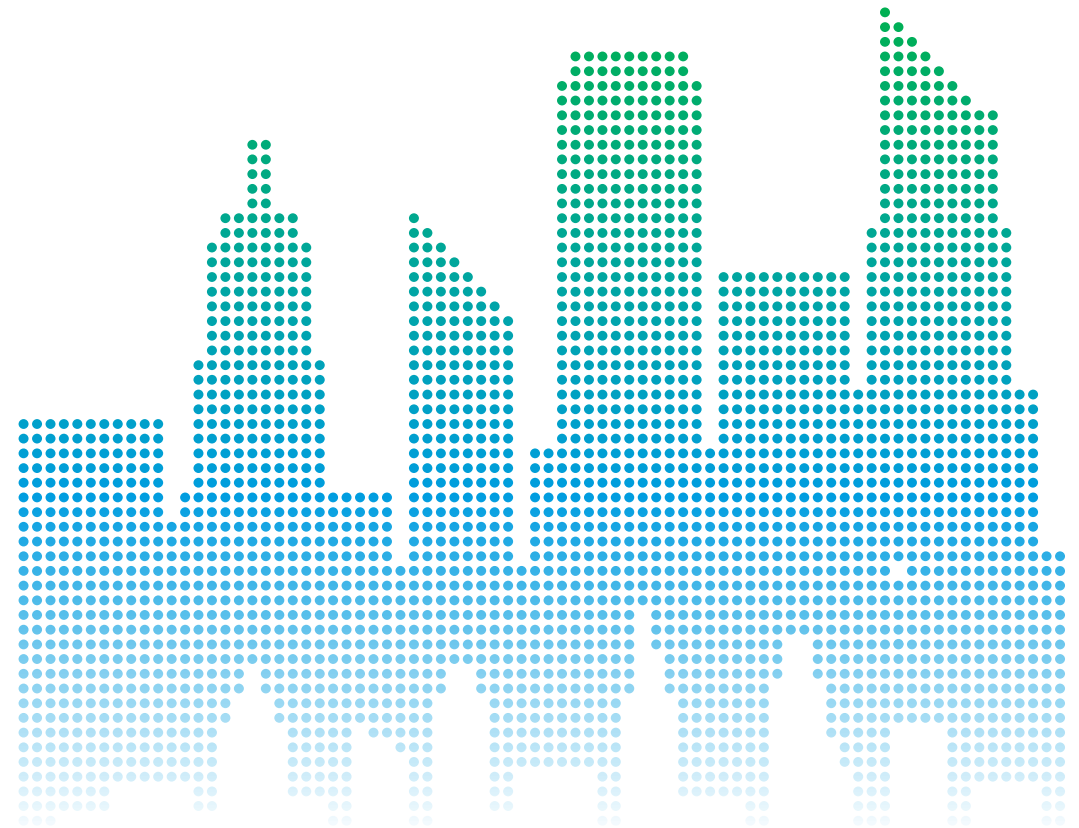


Market Review Monthly

January 2025



Key takeaways

- President Trump imposed tariffs on the US's 3 largest trading partners: Canada, Mexico and China.
- Chinese AI company Deep Seek shocked markets, stating its AI had been developed on lower cost hardware and with lower energy use than comparable US-based AIs.
- Australian inflation in Q4'24 was in line with market expectations, but lower than RBA forecasts. Given the recent RBA focus on inflation, the expectation is they should begin cutting interest rates from February.
- Central Banks continued to cut rates, with the European Central Bank (ECB) and the Bank of Canada cutting rates in January. The Bank of Japan is the exception, increasing rates in response to rising growth and inflation.
- We favour International Listed Property where we believe fundamentals are broadly healthy, and valuations are attractive. We also favour Japanese shares due to the economic growth rebound and solid earnings growth.
- Locally, we favour Australian Sovereign Bonds over cash, with interest rates likely to have peaked this cycle.



Upcoming

1. RBA Interest Rate announcement (18th Feb) with the market currently predicting a 90% chance of an interest rate cut.

2. Australian Labour Market announcement (20th Feb) –The Australian labour market remains stronger than the RBA would be comfortable with.

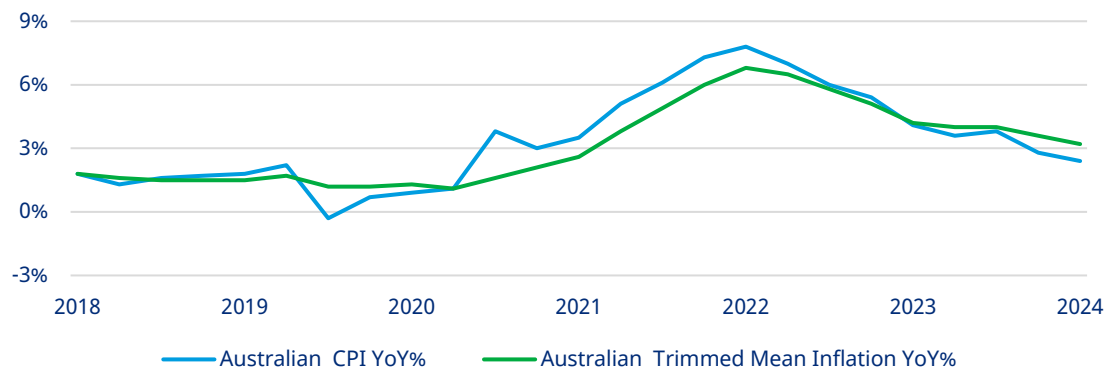
3. US Q4'24 earnings season – Earnings growth is forecast to be 11.9% in 2024 and 14.8% in 2025, leaving investors optimistic.

Economic review

Australian inflation continues to soften likely allowing the RBA to begin cutting interest rates

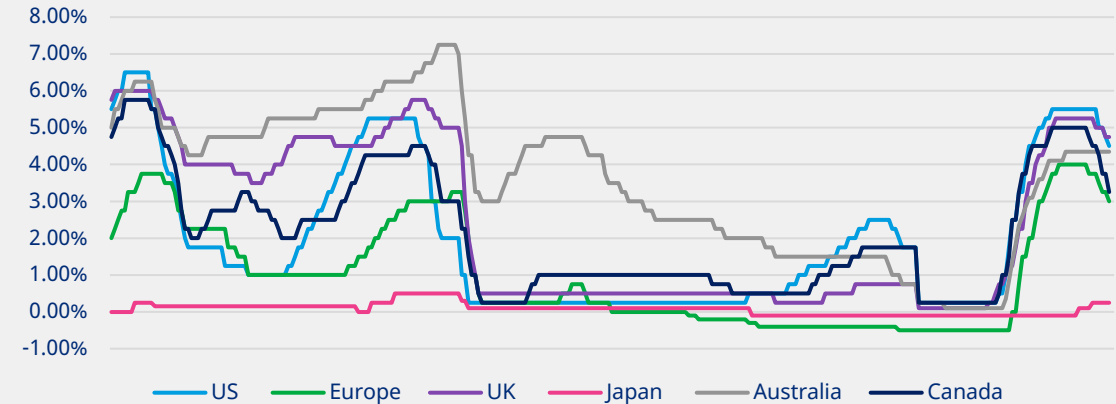
- Australian Q4 CPI increased 2.4% Year on Year (YoY), broadly in line with market expectations and within the RBA's inflation target of 2-3%. With the RBA's recent focus on inflation, this could lead to an interest rate cut in February.
- Australian employment data remained strong with 56,300 jobs added in December. However, most were part-time jobs (80,000), with full time employment falling by 23,700, making this the largest fall in full time employment since December 2023. The unemployment rate rose by 0.1% to 4.0% in December.
- Australian house prices continued to decline with the CoreLogic 5 capital city aggregate falling by -0.2% Month on Month. Sydney and Melbourne extended their decline from the previous month, dropping -0.6% and -0.7% respectively. Other capital cities remained positive, but their growth is slowing.
- Australian consumer confidence slightly weakened in January. This decline was minor compared to the improvement from the extremely pessimistic levels seen in Q4'24.

Australian Inflation



Source: Bloomberg, Mercer

International Cash Rates



Source: Bloomberg, Mercer

US President Trump imposes tariffs on major trading partners

- President Trump imposed tariffs on the US's 3 largest trading partners. The tariffs are 25% on Canada and Mexico and 10% on China. Canadian energy exports will only be subject to a 10% tariff.
- US GDP slowed to 2.3% Quarter on Quarter annualised, down from 3.1% in Q3'24. This aligns with our view that US growth will slow but is unlikely to enter a recession. However, risks to growth remain, particularly concerning tariff implications.
- US labour market data continued to be strong, with 256,000 jobs added in December. The unemployment rate fell to 4.1% from 4.2%, reversing the previous month's change. This indicates a resilient job market in the US and aligns with our view of continued US economic growth.
- The US Federal Reserve (FED) held interest rates at 4.25%-4.5%. noting the labour market conditions have stabilised and inflation remains elevated. The ECB cut rates by 0.25%. It noted growth was balanced and remain confident that inflation will continue to progress towards the target.

Market review

Share markets had mixed performance over the month

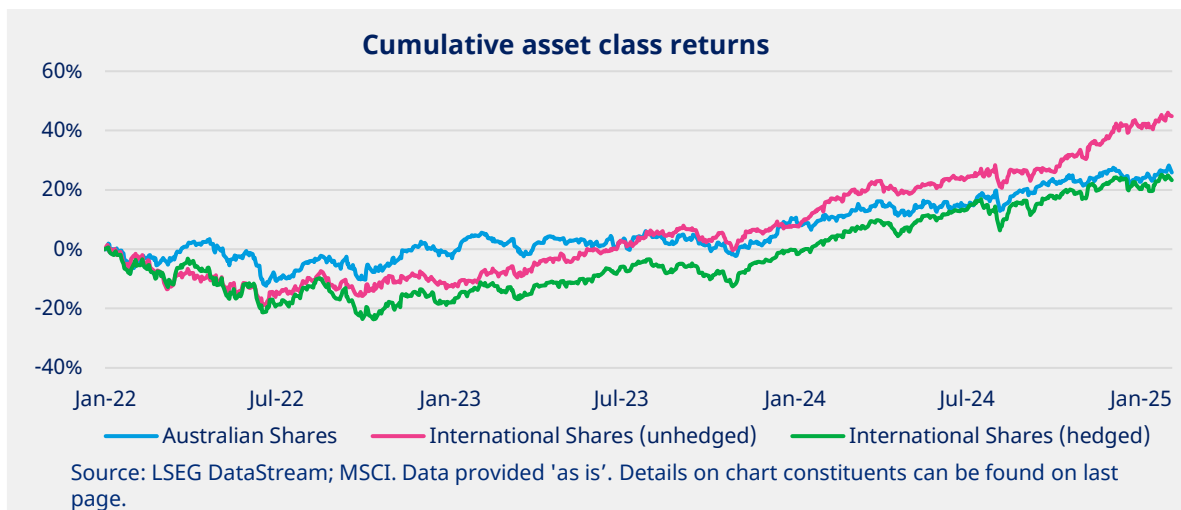
- International Shares (Hedged) had positive returns in January, up 3.5%, driven by softer than expected inflation in the US which reduced expectations for rate hikes. REITs and Small Cap Shares also performed well, assisted by falling bond yields.
- Some US Tech shares saw losses after Chinese AI company Deep Seek shocked markets after announcing its AI had been trained on lower cost hardware and used less energy than the higher cost Nvidia hardware used by comparable US-based AIs. This led to a -10.6% drop in Nvidia's share price over the month.
- Australian Shares were up 4.5% in January, outperforming International Shares, while Emerging Market Shares saw a small gain up 1.0%, underperforming International Shares for the month.

International fixed income markets performance negative

- International Sovereign Bonds returned 0.3%, as bond yields fell over January driven by the weaker than expected inflation data in the US. However Australian Bonds returned only 0.1%, as Australia Sovereign Bond yields rose slightly in January.
- The Australian Dollar (AUD) rose 0.5% against the US Dollar in January reversing some of the decline seen in Q4'24. This occurred, even as expectations for rate cuts in Australia grew while US rate cut expectations were reduced.
- Credit spreads continued to narrow in January, and this saw International Credit gain 0.7% over the month.

Commodity markets produce mixed results

- Tariff threats continued to impact commodity markets. Gold and silver prices increased as pre-emptive buying ahead of possible tariffs pulled supply away from international markets.

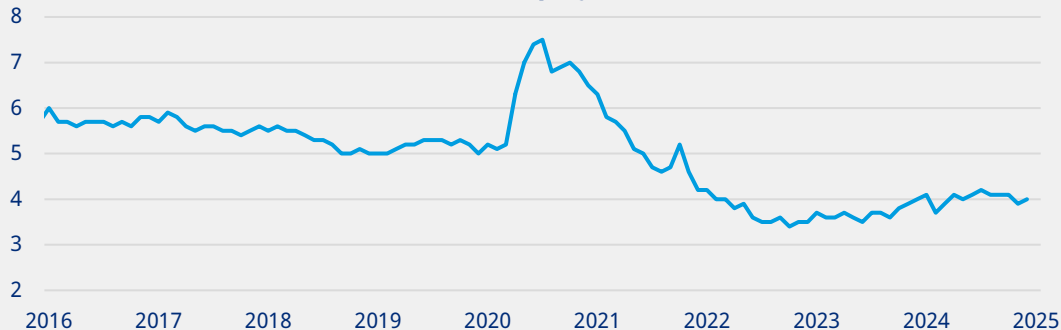


Market Insights

Australia: Increased probability of an interest rate cut

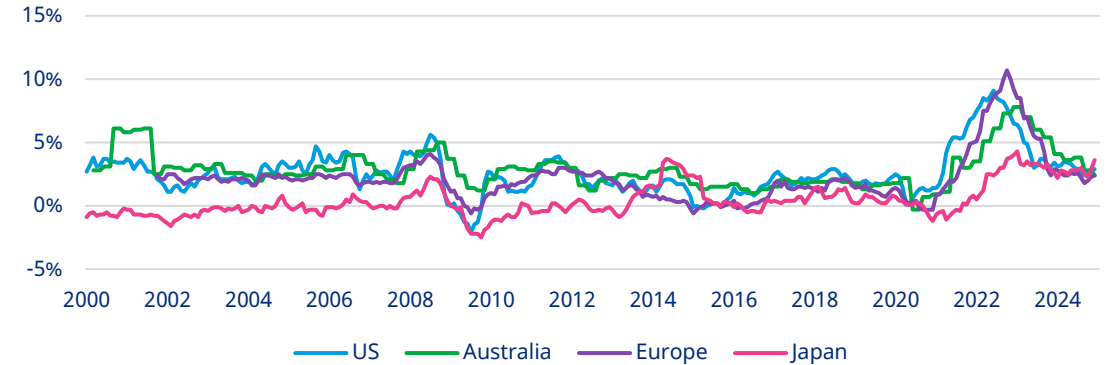
- Weaker inflation data in Australia has increased the likelihood of a rate cut in February as the RBA mentioned requiring 2 quarters of weaker inflation before considering a rate cut.
- However, despite weaker inflation and December's slower economic growth, the labour market remains strong. Even though the market expects a February rate cut, the RBA may not continue cutting rates in consecutive meetings.
- While unemployment remains low, both wage growth and job vacancies have decreased which suggests a softening in the labour market and a modest rise in unemployment in 2025.
- We continue to expect growth to remain weak as higher interest rates and cost-of-living pressures are likely to keep consumption suppressed.
- Locally, we favour Australian Sovereign Bonds over Cash with interest rates likely to have peaked this cycle.

Australia Unemployment Rate



Source: Bloomberg, Mercer

International Inflation



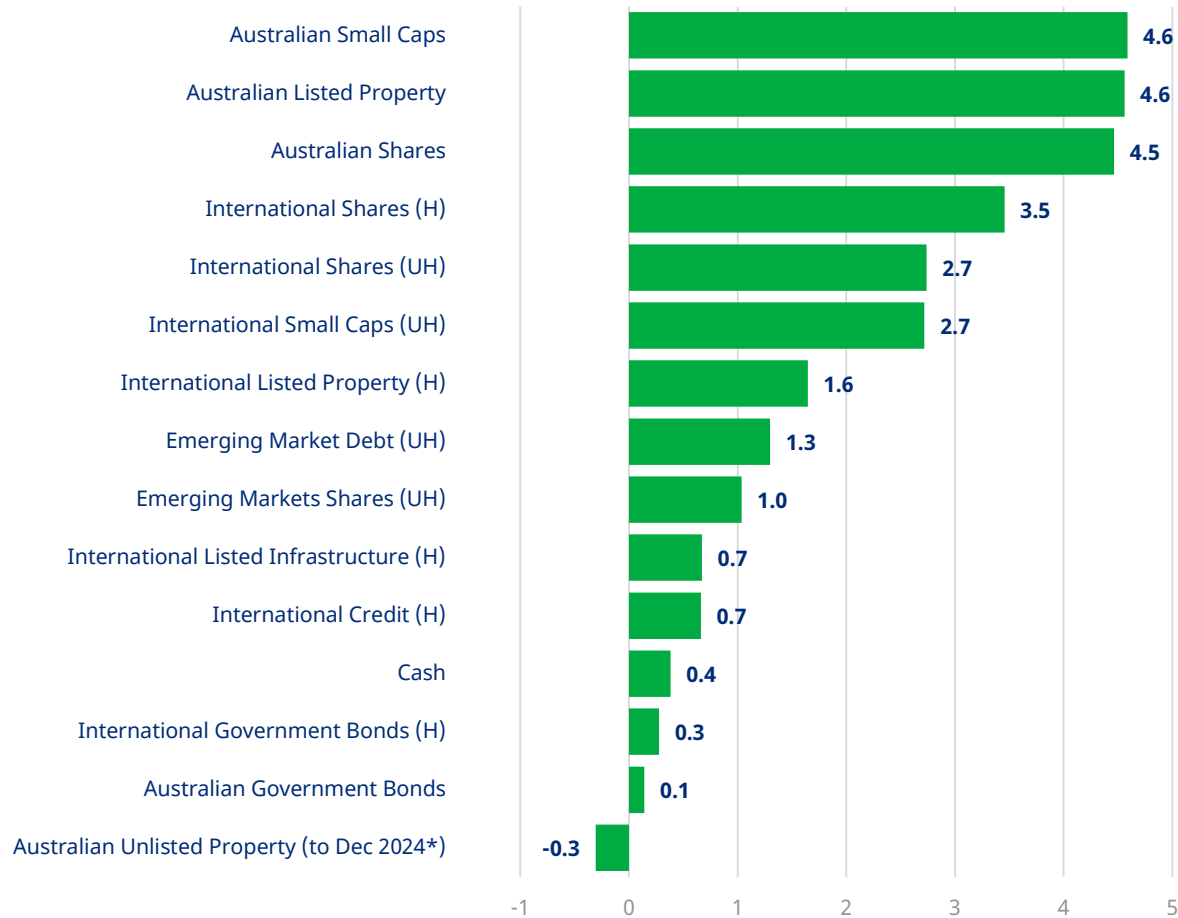
Source: Bloomberg, Mercer

International: US imposes tariffs on its 3 largest trading partners

- The impact of tariffs is likely to have a one-off effect on inflation and Central Banks are expected to treat it as such. We believe President Trump ultimately aims to strike a deal with economic partners, however the longer the trade war continues the greater the implications for economic growth.
- Central Banks are likely to continue to cut rates as inflation moderates but at a slower pace. The exception is Japan where we expect interest rates to rise as it emerges from a multi-decade deflation period.
- Japan is likely to continue to do well economically, driven by income growth and continued investment in capital expenditure. We continue to favour Japanese shares relative to other developed country share markets.
- We favour International Listed Property as fundamentals are broadly healthy, and valuations are attractive. We also favour Japanese shares due to the potential growth rebound and solid earnings growth.

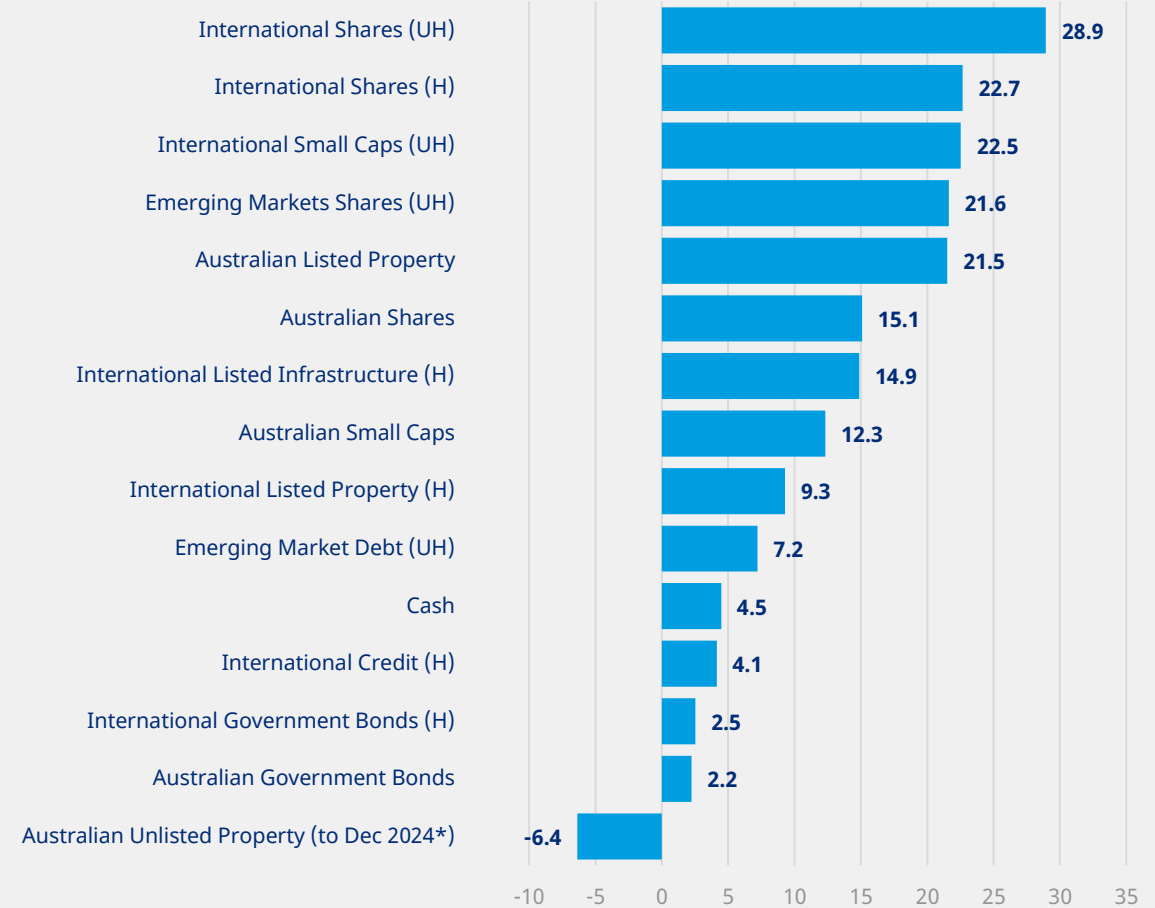
Performance

Market performance January 2025



Data source: LSEG Datastream. Data provided 'as is'. Details on chart constituents can be found on last page

Market performance 12 Months to January 2025



Data source: LSEG Datastream. Data provided 'as is'. Details on chart constituents can be found on last page

Asset class

▲ Australian Shares

- Australian Shares saw positive performance in January also, up 4.5%, outperforming International Shares.
- The Consumer Discretionary sector was the best performer in January rising by 7.1%, likely due to benefiting from lower international bond yields given its sensitivity to borrowing costs. The Financial sector followed closely increasing by 6.1%.
- The only sector in the Australian share market that declined over the month was the Utilities sector, down -2.4% largely driven by a fall in Origin Energy.

▲ International Shares

- International Shares (Hedged) ended January higher up 3.5%, as softer than expected inflation in the US dampened rate hike expectations. Small Cap Shares outperformed Large Cap Shares assisted by falling international bond yields. International Shares (Unhedged) underperformed International Shares (Hedged), up only 2.7% driven by the small rise in the AUD over the month.
- Emerging Market Shares also saw a small gain up 1.0% in January, underperforming International Shares.



▲ Fixed Interest

- International Sovereign Bonds had a positive return of 0.3% in January as bond yields fell. The weaker than expected US core inflation data was a key factor as it gives the FED more flexibility to cut interest rates if the US economy weakens more than anticipated.
- Australian Bonds returned 0.1% for the month, this underperformance relative to their international counterparts was due to Australia Bond yields rising slightly in January reflecting that they fell more the previous month.

▲ Real Assets

- Interest rate sensitive assets such as Australian Listed Property, International Listed Property and International Listed Infrastructure performed well as international Sovereign Bond yields fell over January.

▲ Currency

- The AUD rose slightly against the USD, up 0.5% to close the month at 0.6218. This was a welcome pause in a downtrend that has been ongoing since October 2024, as the economic divergence with the US continues to widen. The US has continued to see reasonable economic growth while Australia's growth has been significantly slower.

Chart Constituents

Asset class	Benchmark	Data type
Australian Shares	S&P/ASX 300	Total Return
Australian Small Caps	S&P/ASX Small Ordinaries	Total Return
International Shares (UH)	MSCI World ex Australia	Net Index
International Shares (H)	MSCI World ex Australia 100% Hedged	Net Index
International Small Caps (UH)	MSCI World Small Cap	Net Return
Emerging Markets Shares (UH)	MSCI Emerging Markets	Net Index
Australian Unlisted Property (one month lag)	MSCI/Mercer Australia Core Wholesale Monthly PFI	NAV Post Fee
Australian Listed Property	S&P/ASX 300 A-REIT	Total Return
International Listed Property (H)	FTSE EPRA/NAREIT Developed Hedged	Net Return
International Listed Infrastructure (H)	FTSE Global Core Infrastructure 50/50 Hedged	Net Return
International Credit (H)	Bloomberg Global Credit	Hedged Return
Emerging Market Debt (UH)	JP Morgan GBI EM Global Diversified Composite	Total Return
Australian Government Bonds	Bloomberg AusBond Treasury 0+ year	Total Return
International Government Bonds (H)	Bloomberg Global Treasury Hedged	Hedged Return
Cash	Bloomberg AusBond Bank Bill	Total Return

Notes

- *Currency: AUD.*
- *UH: Unhedged.*
- *H: Hedged.*
- *Where a lag exists, the performance start and end dates shift accordingly.*
- *Total Return: Total Return Index with Gross Dividends.*
- *Net Index: Total Return (Net Dividends Reinvested).*

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