



# Quarterly Investment Report February 2025

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Crossroads



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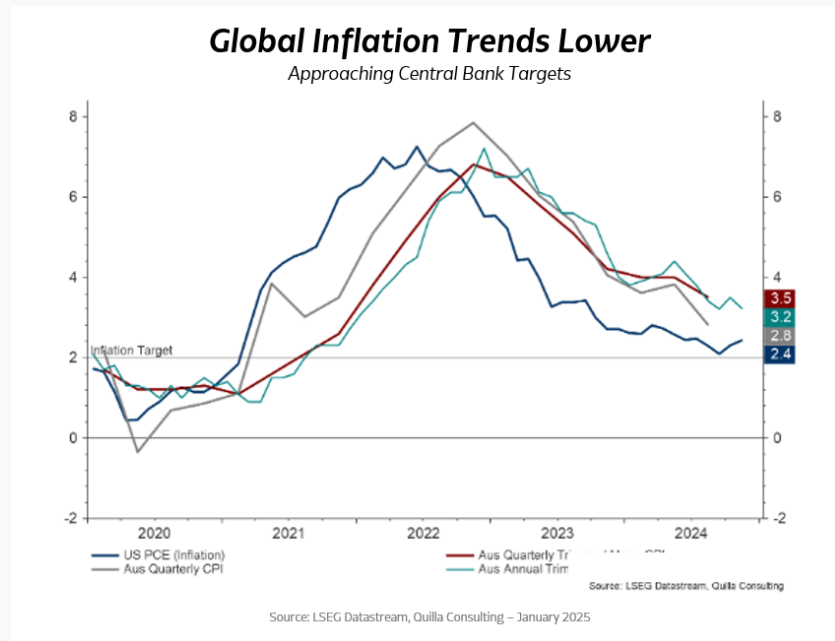
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# Summary

As we enter the first quarter of 2025, markets remain finely balanced between a resilient economic backdrop and a range of risks that could challenge the prevailing optimism.

On the positive side, the global economy, led by the US, continues to show signs of steady growth. Inflation is moderating, and corporate earnings remain strong while broadening out across sectors, reflecting a more resilient economic backdrop.



Corporate earnings remain strong while broadening out across sectors.

Central banks are gradually easing monetary policy, providing liquidity and support to financial markets.

Tariffs as a foreign policy tool pose inflationary risks and potential headwinds to global growth.

At the same time, central banks are gradually easing monetary policy through interest rate cuts, providing liquidity and support to financial markets. These factors create a foundation that could sustain market momentum in the short to medium term.

However, several risks could temper this optimism. Equity markets, both domestically and internationally, are testing all-time highs, with valuations reaching levels that may not be sustainable. If growth expectations fall short or unexpected economic disruptions arise - such as a resurgence of inflation reminiscent of the 1970s - markets could face corrections.

Policy uncertainty in the US adds another layer of complexity. While fiscal stimulus and deregulation could support markets, trade policies - particularly the use of tariffs as a foreign policy tool - pose inflationary risks and potential headwinds to global growth.

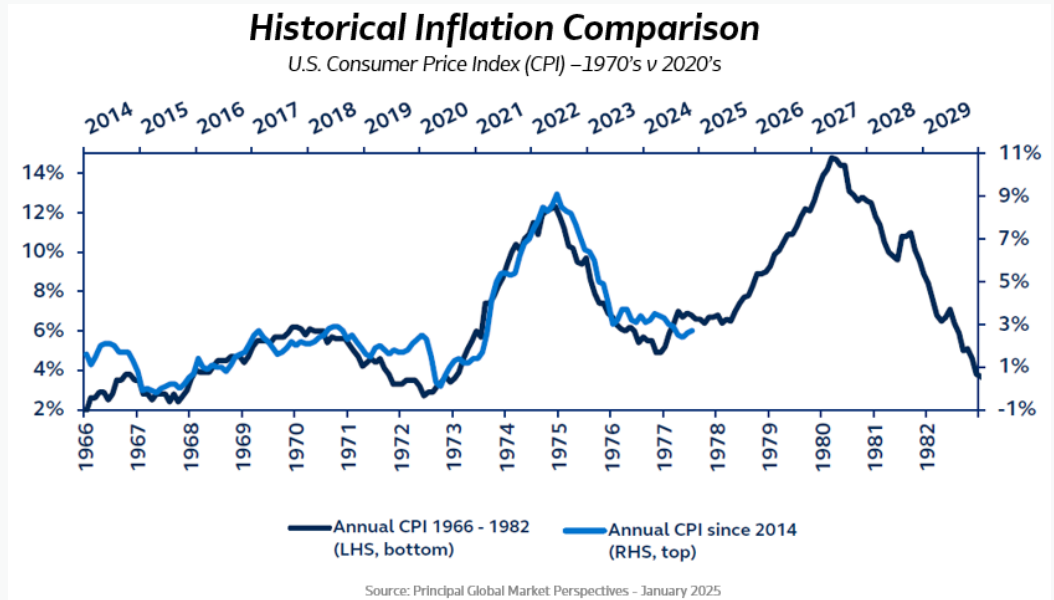


The Federal Reserve, is cautious about repeating past policy missteps.

We expect volatility to increase as investors respond to economic and policy developments.

In an uncertain landscape, a balanced, diversified portfolio is essential.

Against this backdrop, expectations for interest rate cuts remain shallow (<0.5% for 2025) as central banks remain wary of reigniting inflation. The Federal Reserve, in particular, is cautious about repeating past policy missteps, where premature rate cuts led to inflationary surges and forced further tightening.



A defining characteristic of Trump's presidency is his unpredictability, but also his flexibility. Many policy-driven risks can be reversed if markets react negatively, as seen in the early weeks of his administration. However, markets tend to dislike uncertainty, and we expect volatility to increase as investors respond to economic and policy developments.

For context, during the last trade war, the S&P 500 still delivered a 31% total return over three years despite periods of heightened volatility and multiple corrections exceeding 10%. This underscores the importance of a strategic, long-term investment approach rather than a reactive one.

In an uncertain landscape, a balanced, diversified portfolio is essential. Investors should seek growth while mitigating risks through asset class, regional, and sector diversification. Alternative assets remain key in navigating these challenges.

This quarter, we are increasing global currency hedging levels amid AUD devaluation and introducing a new position within listed global property, which we expect to benefit from the rate cycle shift. Given strong economic fundamentals and attractive yields, we remain overweight private credit.

An active yet cautious approach is crucial for optimising returns while managing risks. We remain vigilant and adaptable as market conditions evolve.



# Positioning

As of January 2025	Positioning (DAA)		
Asset Class	Underweight	Neutral	Overweight
Cash			
Fixed Interest			
Australian Fixed Interest			
Global Fixed Interest			
Australian Equities			
Global Equities			
Developed Market Equities			
Emerging Market Equities			
Property			
Australian Property			
Global Property			
Alternatives (Inc. Infrastructure)			
Infrastructure			
Other Strategies (Private Markets, Hedge Funds)			

## Positioning Definitions

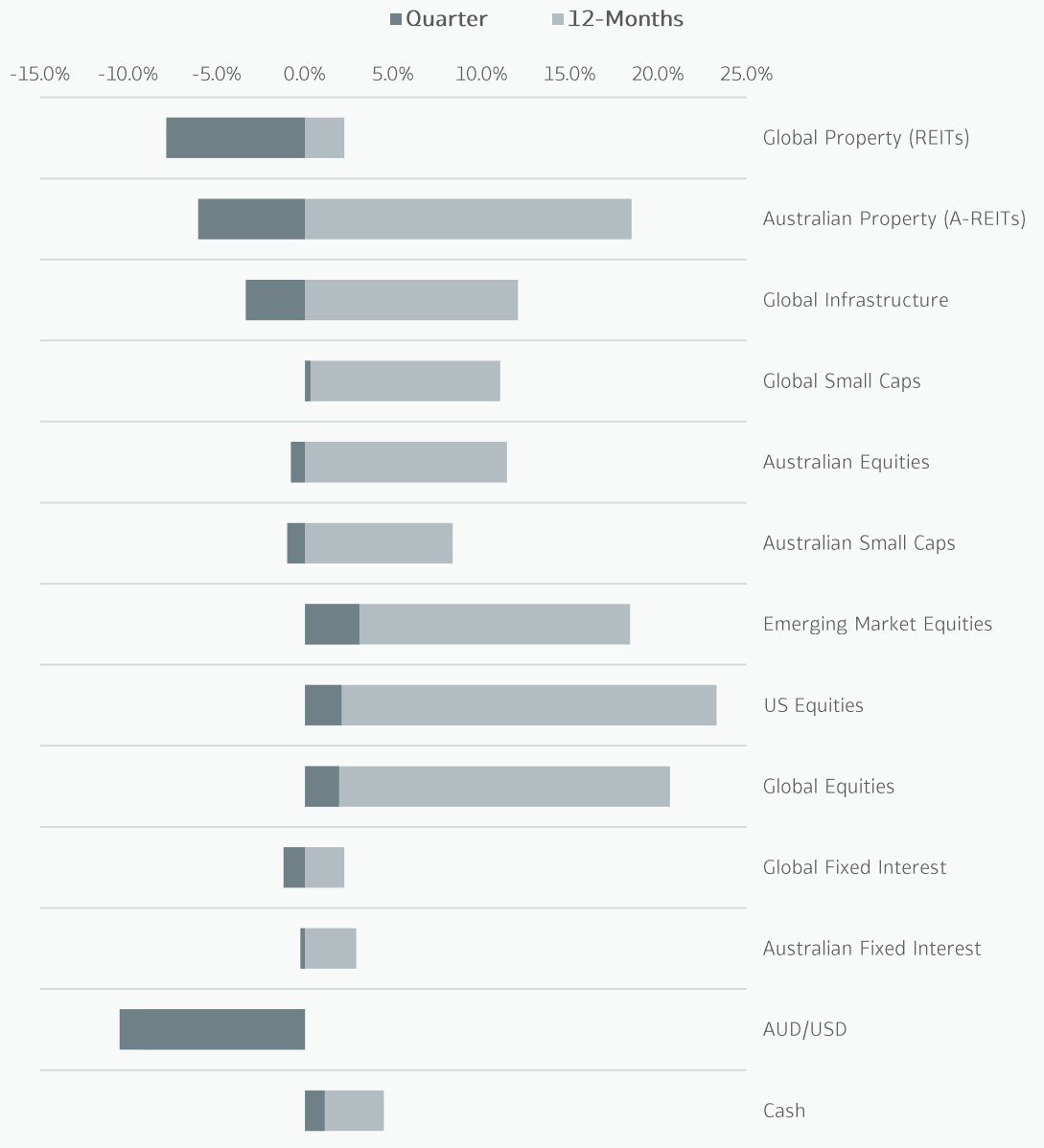
**Overweight**  $\geq 2.0\%$  above benchmark strategic asset allocation weight

**Neutral**  $\leq 2.0\%$  versus benchmark strategic asset allocation weight

**Underweight**  $\geq 2.0\%$  below benchmark strategic asset allocation weight



# Asset Class Returns (31<sup>st</sup> December 2024)





# Cash

## Themes

- The Reserve Bank of Australia kept the cash rate at 4.35% at its December meeting, adopting a dovish tone and expressing confidence that inflation risks were abating.
- This decision came despite a significant rate cut in the US, with other central banks continuing their easing cycles.
- The AUD/USD depreciated by -10% over the quarter, with a stronger US dollar driven by policy initiatives from the Trump administration, impacting local currency returns.

## Strategy

- Term deposits and high-interest cash accounts in Australia continue to offer attractive returns. Unless economic data deteriorates, Australia's cash rates will likely remain higher than in the rest of the developed world.
- However, with the global rate-cutting cycle now underway, the attractiveness of cash is diminishing.

## Neutral

- **Neutral** - We maintain a neutral allocation with a preference for high-interest cash accounts for liquidity.

Overweight

Neutral

Underweight



# Fixed Interest

## Themes

- Global bond yields rose modestly despite central banks cutting rates, driven by concerns over fiscal deficits, stronger-than-expected US data, and policy uncertainty.
- US 10-year Treasury bond yields rose, finishing at 4.57%, contributing to the Bloomberg Global Aggregate Index falling -5% for the quarter.
- Australian 10-year yields increased alongside US yields. The Bloomberg AusBond Composite Index fell -0.3% over the quarter.
- Credit markets remain resilient as stable economic growth and easier monetary policy support a tight-spread environment both in the US and domestically.
- Interest rate cut expectations remain shallow (<0.5% for 2025) in Australia and the US, as central banks are cautious about reigniting inflation.

## Strategy

- The recent rise in bond yields reflects concerns about fiscal deficits and resilient growth, reducing the likelihood of significant rate cuts in the short term.
- Government bonds offer fixed yields with safeguards against growth risks. Australian credit provides a notable spread over high government yields, with a preference for high-quality credit despite anticipated cyclical progress.
- Private credit has shown impressive performance, albeit due to prudent manager selection, offering high single-digit returns with low default rates.
- We expect bond markets to remain volatile as interest rates and inflation expectations evolve.
- Our strategy remains diversified across key bonds and top-tier credit, including senior secured, floating rate, and private credit.

## Positioning

- **Overweight** – We maintain our overweight position to fixed interest, favouring domestic private credit. We are underweight duration relative to the benchmark, mitigating the risk of a steepening yield curve.

Overweight

Neutral

Underweight





# Australian Equities

## Themes

- The ASX200 fell 1% over the quarter, with the materials sector underperforming due to disappointment around China's lack of stimulus follow-up.
- The major banks drove two-thirds of the ASX200 return over 2024.
- High valuations, especially in major banks, have led to concerns about sustainability, given modest earnings growth estimates and external challenges like US tariffs and a weakening Australian dollar.
- Defensive sectors, such as Healthcare, listed property and utilities, faced headwinds over the quarter due to higher bond yields.
- Earnings within the Australian share market are expected to broaden into other sectors as interest rates decrease, enhancing operational leverage.
- The dividend yield on Australian equities is among the highest globally, with the added benefit of franking credits.

## Strategy

- The Australian equity market is expected to continue aligning closely with global, particularly US equities.
- In the short to medium term, Australian banks' return prospects are expected to be lower due to elevated valuations and a lack of earnings growth potential. However, a positive global economic outlook and the stabilisation of China's economy are expected to support sectors exposed to cyclical growth improvements, such as building materials.
- The resources and energy sector is increasingly important for diversified portfolios, serving as a hedge against inflation risks.
- Smaller stocks are starting to show better value, offering opportunities for investors despite large caps performing well.

## Positioning

- **Neutral** – We maintain a neutral position on Australian shares and expect easing monetary conditions to support a more stable earnings backdrop.

Overweight

Neutral

Underweight



# Global Equities

## Themes

- Global equity markets were flat this quarter, with the S&P 500 (+2.4%) offsetting losses in Emerging Markets (-7%) and Europe (-2%).
- The weaker AUD boosted unhedged exposures by around +10%.
- The "Magnificent 7" drove global equity market returns over the last two years, increasing risk for passive investors.
- Earnings growth in global equity markets is expected to broaden, particularly in the US, Europe, and Japan.
- Valuation differences are significant between US and non-US equities, especially in Emerging Markets, Japan, and parts of Europe.
- Record-high equity valuations and US policy uncertainty, particularly around trade and fiscal measures, could introduce volatility.

## Strategy

- US equities are promising due to strong earnings growth and a solid economic base supported by fiscal and monetary stimulus. Valuations outside US large caps appear more favourable.
- AI and tech innovation drive growth, but high valuations (~20% above the 20-year average, MSCI World at 19.5x) and elevated bond yields pose near-term pullback risks.
- We remain positive on US small caps, combining earnings growth and improved investor sentiment.
- We gradually increase global equities exposure during market dips, focusing on potential in lagging sectors such as small-mid caps.

## Positioning

- **Neutral** - We maintain our neutral allocation to Global Equities, with various indicators pointing towards a supportive environment.

Overweight

Neutral

Underweight



# Property

Overweight

Neutral

Underweight

## Themes

- Higher bond yields drove declines in listed property assets during the quarter, as central banks signalled that markets had overestimated the likelihood of near-term rate cuts.
- Australian listed property declined 6%, while global listed property fell 7.5%, reflecting pressure from rising borrowing costs.
- Retail and office transaction activity improved over 2024, suggesting a rebalancing of supply and demand in physical property markets.
- Residential housing continues to be supported by low supply.
- The A-REIT sector faces concentration risk, with Goodman Group comprising nearly one-third of the benchmark index. Globally, performance diverged, with the US outpacing the UK and Europe.

## Strategy

- We notice attractive valuations in specific subsectors of global listed property, which justifies an active investment approach.
- The domestic and global indices increasingly resemble an AI index due to the substantial capital invested in AI and data centre development. We are wary of active managers following this trend and seeking unique opportunities to deliver alpha, potentially from mid-to-small-cap names.
- We are cautious about the concentration risk in the Australian listed property index, where Goodman Group constitutes approximately 40% of the index.
- The domestic and global indices are quickly becoming proxy AI indexes due to the amount of capital being spent on AI and data centre development. We are wary of active managers following the trend and are looking for points of difference to deliver alpha, which may come from mid-small cap names.

## Positioning

- **Neutral** – We have upgraded our view to neutral by introducing a new manager for global listed property, who can capitalise on value opportunities outside the index. The weaker AUD offers an opportunity to hedge our currency exposure.



# Alternatives

Overweight

Neutral

Underweight

## Themes

- Listed global infrastructure rose +3% in the last quarter, supported by gas utilities and energy assets, as demand for energy increases with the rise of AI-driven data centres.
- Hedge fund exposure delivered 21% over the last quarter of 2024, benefiting from increased market volatility and a stronger US dollar.
- Private market strategies ended the year on a strong note, with Private Equity exposures returning 3-6% over the quarter, driven by a resurgence in M&A activity. A major headwind for the sector has eased, with key policy rates now lower than a year ago. Valuations remain attractive compared to long-term averages.
- Unlisted infrastructure and global transport returned 2% over the quarter, closing the year up 10%, providing defensive earnings and stable income.

## Strategy

- We favour real assets such as unlisted infrastructure and transport for their defensive characteristics, long-term income potential, and growth profile.
- Private equity investments - particularly those managed by established firms - are becoming increasingly attractive due to rising capital market activity and the potential for deregulation in the US.
- Investment selection is critical, as risks vary significantly and require specialist expertise.
- We maintain a diversified allocation in alternative strategies (private equity, debt, infrastructure) with proven specialists to enhance returns and mitigate risk.

## Positioning

- **Neutral** - We maintain a neutral allocation, directing capital toward proven market leaders with long-term track records. This quarter, we are reducing USD exposure through our hedge fund allocation, which uses leveraged currency futures.



## Independent Advisory Board

The Advisory Board believe a robust governance framework is critical in forming a House View and making effective Asset Allocation decisions. An Advisory Board charter governs the process and comprises experienced investment professionals with diverse areas of expertise, reflecting an industry best practice in decision-making.

The Advisory Board is responsible for setting and reviewing the House View and upholding the fundamental values and investment philosophy of Mackay Private.

The Advisory Board meets quarterly to meet intra-quarter as required. Voting members make all dynamic asset allocation decisions of the Advisory Board. Please visit our webpage, [www.mackayprivate.com](http://www.mackayprivate.com) or contact us directly at [info@mackayprivate.com](mailto:info@mackayprivate.com) or 1300 721 986.

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