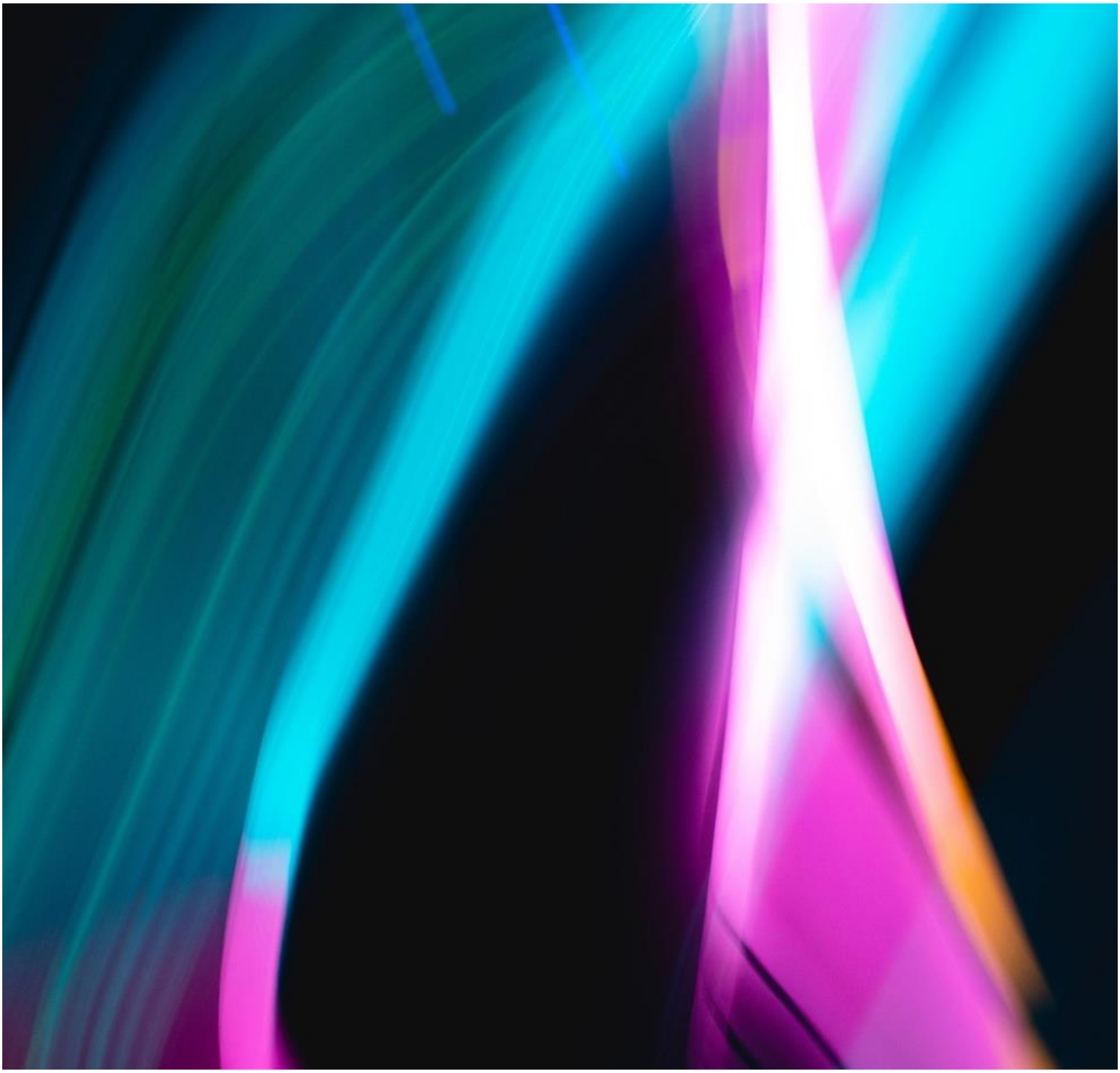
INVESTMENT ENVIRONMENT UPDATE

DECEMBER 2024

PATRIZIA ADVISERS



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Prime Super

Investment Environment Update

After a year of outstanding performance, equity markets faltered at the last hurdle in December to close out 2024 on a slightly dampened note. This was largely in response to the US Federal Reserve's updated December dot plot which showed a median forecast of only two rate cuts in 2025, halved from previous estimates, leading to the second largest daily drop in the US S&P 500 for 2024. Although some of these losses were recovered by the New Year's Eve countdown, overall, the index still fell by -2.5% for December. Nonetheless, the S&P 500 delivered a remarkable 23.3% return for the 2024 calendar year.

As has been the case for much of 2024, the risk of contagion in equity markets proved to be high, as many markets followed suit, recording losses in December. The Australian share market had its worst monthly return of 2024, falling -3.1% and largely erasing its gains from the month prior, whilst the UK FTSE fell -1.4%. European markets had a more positive month, with the German DAX (+1.4%) and French CAC (+2.0%) ending the year on a strong note. Despite a tempestuous 2024, the Japanese Nikkei was the standout performer in December, closing 2024 close to its all-time highest level and delivering a +4.4% return for the month, with markets buoyed by a weaker Yen and a surge of foreign capital inflows.

The performance of fixed income in December was largely influenced by domicile. Given more dovish sentiments from the RBA, accompanied by a stagnant economy, yields moved lower in Australia after a few months of considerable increases. December gains reflected the market's anticipation that the RBA will now deliver its first rate cut at its next meeting in February. Conversely, international fixed income delivered losses for the month following hawkish sentiments from the US Fed and expectations of sustained levels of US fiscal spending and price inflation during a Donald Trump presidency. As such, the most significant market movement for Australian investors in December due to these yield movements was the fall in the Australian dollar, which slid to US$0.62, a depreciation of -5.0% for the month and -9.3% for the calendar year. Given the opposing sentiments from the respective central banks and China's economic woes, it's likely this trajectory will continue into 2025.

Asset Class Returns	December (%)	3 Months (%)	12 Months (%)	3 Years (% p.a.)
Cash	0.38	1.12	4.47	3.19
Australian Fixed Income	0.51	-0.26	2.93	-0.79
International Fixed Income	-0.86	-1.22	2.23	-1.89
Australian Equity *	-3.08	-0.81	11.39	7.06
International Equity - Developed (unhedged) *	2.58	12.12	31.18	12.25
International Equity - Developed (hedged) *	-1.94	1.94	20.66	6.35
International Equity - Emerging (unhedged) *	5.07	3.08	18.48	3.47

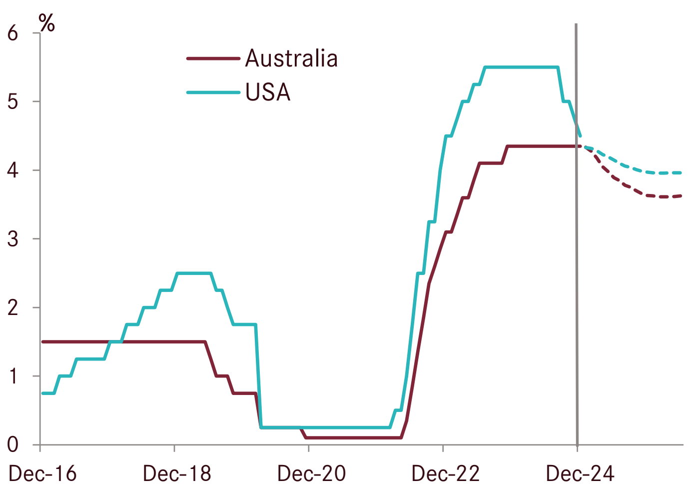
** Returns reflect the relevant accumulation indices.*
Source: Bloomberg, Datastream, PATRIZIA.

As universally anticipated, the RBA held the cash rate at 4.35% at its mid-December meeting. However, the real point of note came at the ensuing press conference where RBA Governor Bullock reinforced the dovish pivot of the updated November Statement of Monetary Policy, emphasizing that the softer messaging in the updated version was indeed deliberate. In response, markets immediately increased the implied odds of a rate cut at the RBA's next meeting in February to over 60%, from 50% prior to the meeting, with this figure ultimately lifting to over 70% by the end of the month. Although most economists (including those from the major banks) continue to keep the RBA's first 25 basis point cut penciled in for the May 2025 meeting, should a low CPI print and/or soft labour market conditions permeate through Australia early in 2025, expectations of an earlier rate cut will rise.

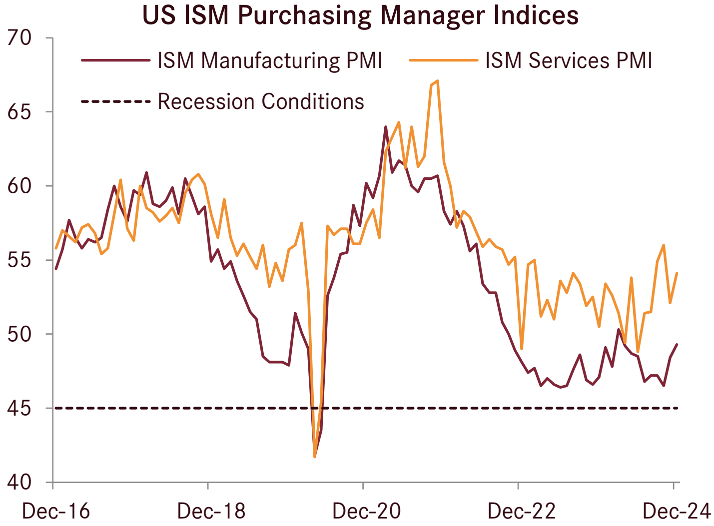
December data revealed the Australia's labour market tightened in November, with almost every labour market metric performing strongly. Employment rose by 35,600 jobs, unemployment fell to 3.9% (its lowest level since March), and hours worked continued its steady rise since COVID-19 lockdowns. Whilst these figures may give the RBA pause for thought on a potential rate cut come February, they are indicative of Australia's recent population growth. In fact, the latest growth data (to September) shows year-to-date GDP per capita declining by -1.5%, suggesting that Australia's ability to stave off recession has been due to strong, rebounding inflows of migration post-COVID-19. National home values in Australia recorded the first quarterly decline in December (-0.1%) in almost two years as reported by CoreLogic's Home Value Index, as high interest rates, cost of living pressures and reduced borrowing capacity unsurprisingly dampened the Australian property market. The loss of momentum heading into the year-end offsets the unexpected resilience of housing in the first half of 2024, whereby home values rose by 4.1%. Whilst rental markets ended the year similarly on a soft note, up just 0.4% for the December quarter, the annual change in national rents remains more than double the pre-pandemic decade average at 2.0% per annum. Business confidence fell 8 points in November to a level of -3 points, reversing a dramatic uptick in October. Business conditions also softened in the month, falling 5 points to 2 points, with declines across all industries except mining and construction. Consumer sentiment weakened as well, with the Westpac Consumer Sentiment indicator dipping -2% to 92.8 in December due to renewed concerns regarding the economic outlook.

The US Federal Reserve followed up on its cut of the cash rate by 0.25% in early November, with another 25 basis point cut at its December meeting. Though seemingly counterintuitive, the December decision to ease monetary conditions was labelled a "hawkish cut", reflecting the updated dot plot and post-meeting press conference. The dot plot indicates just two rate cuts in 2025 (previously four), corresponding with US Fed Chairman Powell's comments that interest rates are "significantly closer to neutral" and that the US Fed needs to see progress on inflation, which came in at 2.7% in November. Yields rose sharply in response to Powell's comments, with the next cut not fully priced until September 2025. However, just days later data revealed that the personal consumption expenditures (PCE) index rose a less-than-expected 0.1% in November, supporting markets disappointed with the Fed's hawkish cut and Powell's comments. US business indicators were more positive in December with the ISM Manufacturing Index up 0.9 points to 49.3, beating consensus forecasts of a step back to 48.2 and close to exiting contractionary territory. Similarly, the ISM Services Index was up 1.9 points to 52.1 in December, marking the tenth straight month of expansion in the sector.

Australia and US Cash Rates



US ISM Purchasing Manager Indices



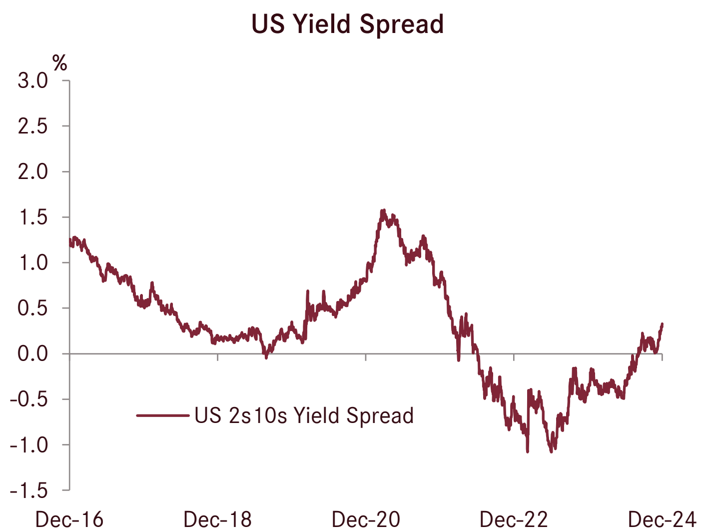
Source: Bloomberg

The ECB cut its cash rate for a third consecutive meeting, bringing the deposit rate down another 25 basis points to 3.00% in December. Markets continue to see the ECB cutting rates by at least another 125 basis points in 2025, as worsening fiscal and political instability in France and Germany, alongside the threat of targeted tariffs on Germany's automotive and industrial machinery sectors from the impending Trump administration, are likely to be significant headwinds for the European economy. European monthly CPI flash estimates climbed slightly from the month prior to 4.1% in December, delivering an estimated inflation rate of 3.3% for 2024. This is notably higher than the ECB's 2% target and may interfere with the central bank's ability to continue cutting rates. While manufacturing remains in deep recession in Europe, there are positive signs for the much larger services industry. The Flash HCOB Eurozone Manufacturing Index decreased slightly to 45.1 in December, marking two years of continuous contraction in the sector. By contrast, the Flash HCOB Eurozone Services Index rose from 49.5 to 51.6 in December, following a fall in November.

December data indicated a marginal increase in UK private sector output, as rising activity in the services industry offset an accelerated downturn in manufacturing production. The Flash S&P Global UK Services PMI Survey increased to 51.1 in December, up from 50.8 in November. The S&P Global UK Manufacturing PMI Survey fell in December, down to 47.0 from 48.0 in November, marking an 11-month low. The Bank of England (BoE) left the cash rate unchanged at 4.75% at its meeting in December. This decision came to no surprise as earlier in the month data revealed stubborn levels of inflation in the UK, rising to 2.6% in November from 2.3% the month prior, as well as rising real wage growth. The UK GfK Consumer Confidence Index increased by 1 point to -17 in December 2024, emulating the resilience seen in other parts of the economy.

In December, President Xi Jinping delivered his annual address stating China's economy was on track to achieve its 5% GDP growth target for 2024. Whilst the finalised 2024 GDP figures are predicted by economists to fall only marginally short of 5%, there are some significant headwinds to China's economic expansion in 2025, namely US President Trump's promised tariffs increases on Chinese goods. With low certainty as to whether fiscal and monetary stimulus measures announced to date will be sufficient to combat Trump's deglobalisation tactics, we anticipate further fiscal and monetary stimulus announcements to come from China over coming months to help China's economy achieve a similar growth outcome in 2025. China's official NBS Manufacturing PMI decreased to 50.1 in December from 50.3 in November, which was inline with market expectations, whilst official NBS Non-Manufacturing PMI soared to 52.2 in December from 50.0 the month prior, greatly exceeding expectations. The latter result was driven by a stabilisation of new export orders, as well as improvements in new orders and employment.

In Japan, CPI climbed to 2.9% year-on-year in November, remaining well-above the BoJ's 2% target. Despite this, the BoJ held interest rates steady at 0.25% at its December meeting, although meeting minutes reveal growing sentiment for a rate hike in the near future. The Japanese yen returned some if its previous gains versus the US dollar in December, as the BoJ's decision to hold rates was relatively dovish compared to the Fed's updated dot plot and commentary.



Source: Bloomberg

Index Returns to 31 December 2024

	MONTH (%)	3 MONTHS (%)	FYTD (%)	12 MONTHS (%)
Australian Equities				
S&P/ASX 300 Accumulation Index	-3.1	-0.8	6.9	11.4
S&P/ASX Small Ordinaries Accumulation Index	-3.1	-1.0	5.5	8.4
International Equities				
MSCI World (ex Australia) Index (hedged AUD)	-1.9	1.9	6.5	20.7
MSCI World (ex Australia) Index (unhedged AUD)	2.6	12.1	14.7	31.2
MSCI Emerging Markets Index (unhedged AUD)	5.1	3.1	7.9	18.5
Property				
S&P/ASX 200 A-REIT Accumulation Index	-6.0	-6.0	7.6	18.5
FTSE EPRA Nareit Developed ex Aus Rental hedged AUD	-6.9	-7.9	5.3	2.2
FTSE EPRA Nareit Developed ex Aus Rental unhedged AUD	-2.3	1.8	14.0	11.9
Infrastructure				
FTSE Developed Core Infrastructure hedged AUD	-6.7	-3.5	9.3	11.7
Australian Fixed Interest				
Bloomberg AusBond Composite Index	0.5	-0.3	2.7	2.9
Global Fixed Interest				
Barclay's Global Capital Aggregate Bond Index (hedged AUD)	-0.9	-1.2	2.7	2.2
FTSE WGBI ex-Aust (hedged AUD)	-1.0	-1.4	2.4	1.2
Cash				
Bloomberg AusBond Bank Bill Index	0.4	1.1	2.2	4.5
Commodities				
Gold (USD per ounce)	-1.6	-0.8	11.9	25.5
Copper (USD per metric tonne)	-2.7	-10.8	-8.7	2.4
WTI Crude Oil (USD per barrel)	4.4	5.2	-12.0	0.1
RBA Index of Commodity Prices (AUD)	3.1	10.1	2.0	-7.4

Australian Dollar versus Foreign Currencies to 31 December 2024

AUSTRALIAN DOLLAR VERSUS	AS AT 31 DECEMBER 2024	MONTH (%)	THREE MONTHS (%)	FYTD (%)	12 MONTHS (%)
US Dollar	0.62	-5.0	-10.8	-7.3	-9.3
British Pound Sterling	0.49	-3.5	-4.4	-6.4	-7.6
Euro	0.60	-3.1	-3.8	-4.0	-3.2
Japanese Yen	97.31	-0.5	-1.9	-9.4	1.2

Source: Bloomberg

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