May 2025

Market Outlook.

"The stock market is a device for transferring money from the impatient to the patient."

Warren Buffett

Foreword

April was a seismic month in the global macroeconomic landscape as the US Government's Liberation Day tariff policy sent shockwaves across the equity, bond, currency and credit markets, leaving even the most seasoned investors on edge. At the heart of this volatility was the announcement of President Trump's larger-than-expected reciprocal tariff plan. The US treasury market acted as a circuit breaker, as yields moved sharply higher in the second week of April, resulting in a pause in some tariffs and exemptions. The ensuing negotiating process together with the accompanying uncertainty has resulted in the International Monetary Fund (IMF) cutting its global growth forecast for the remainder of 2025.

At the heart of these tariffs is President Trump's aim to revitalise the US manufacturing sector, which peaked at 32% of total jobs in 1953 to less than 10% today according to the US Bureau of Labour Stats. It's unlikely we will see these peak levels return, given both the time and cost required to ramp up production capabilities. In addition, the productivity enhancing impact of automation won't be reversed. The end game is more likely to be that some more technically sophisticated manufacturing is bought back to the US. Even so, that too will take time.

Looking ahead, re-shoring, tariff and immigration policies have the potential to be inflationary in the short-term, which has been reflected in survey data. Importantly though, longer-term inflation expectations remain well-anchored. US inflation-linked bond break-even rates for the next 10 years remain around 2.3%, suggesting that US bond markets are not expecting inflation to become entrenched. This matters for Australian investors given the flow on impact for US Federal Reserve (Fed) policy, which also has relevance to our currency.

When uncertainty and volatility levels become extreme, investor anxiety is a natural response. During such periods, investors can gain reassurance through maintaining portfolios with strong foundations. Diversification and quality can help provide this foundation and bolster resilience in portfolios.

Maintaining a well-thought-out, well-diversified portfolio by country, sector and asset class is essential at all points in the market cycle but is vital during periods of market stress and economic uncertainty.

Asset quality in portfolios and investments matters, given it provides the robustness that's necessary in periods of economic turbulence. Volatile markets also underscore the benefits of active management – given the need to be nimble and flexible when opportunity presents.

These recent events reinforce the importance of calmness amid market upheaval. Equities are a long-term asset, but history shows that short-termism is common during extreme uncertainty, as seen in early-2020. Our opinion is that successful investing often involves looking beyond current circumstances and headlines as the best opportunities typically present during periods of maximum uncertainty, simply because that is usually when prices have fallen the most. Asset prices have often adjusted by the time "certainty" arrives, meaning that waiting for certainty can also be highly fraught.

James Foot, Chief Investment Officer
Commonwealth Private

Global Economics:

Uncertainty rising, but labour markets remain the key

- Global growth projections revised downward on falling business and consumer confidence.
- Policy divergence continues with interest rate cuts being made by the European Central Bank.

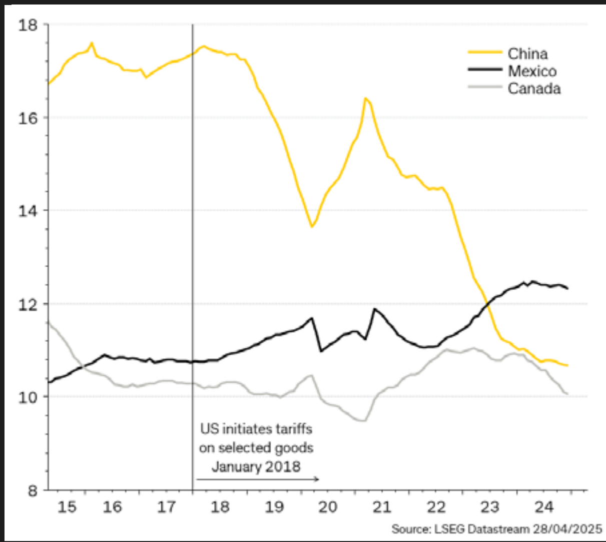
President Trump's tariff moves announced on "Liberation Day" have upended decades of US trade policy, sparking a rapid reassessment of the economic outlook in the US and beyond as tariff-induced recession fears have increased dramatically in just a few short weeks. Fluctuating tariff policy announcements have done little to settle uncertainty as 10% universal tariffs and 145% on China resulting in the outlook for 2025 economic scenarios continuing to be revised downward.

Confidence matters in consumption and investment. There has been a significant drop in consumer sentiment which has now deteriorated to levels associated with the COVID era. Business and investor confidence levels have also fallen, leading to lower GDP forecasts, with rising inflation expectations and stagflation potential clouding the outlook. Weakness in confidence is spilling into intentions to make major purchases and sapping enthusiasm regarding job prospects. Quit rates are even falling to cycle lows and layoffs are surging.

Labour markets are still key, and while the April nonfarm payroll report was decent in terms of job creation, signs of a slowing job market are showing. Notably, decelerating wage growth and pending job cuts related to Department of Government Efficiency.

US trade partners

Change since tariffs first announced



Inflation readings, while below expectations in March and helped by falling global energy prices, are still at levels likely to keep the Fed on the sidelines barring a major pickup in unemployment. Even with delays and reprieves, the 10% universal tariff is still expected to add 50 to 100 basis points to inflation by mid-year, potentially taking readings back towards 4%.

In Europe, the policy divergence has continued with the European Central Bank (ECB) cutting policy rates by 25bp, with the accompanying statement largely unchanged. GDP growth expectations have also been revised lower for the Eurozone in 2025, with the ECB expected to keep cutting sequentially until the deposit rate reaches 1.5%. However, growth expectations improve further out as Europe increases defence spending, Germany increases infrastructure investment, and the negative effects of trade uncertainty subside.

Strong Q1 GDP was released in China, coming in higher than consensus expectations at 5.4%. Given reciprocal tariffs and potential export front-loading ahead of it, we expect Q2 GDP growth to slow sharply and to offset the tariff impact, we expect Chinese policymakers to intensify policy easing measures.

Australia Economics:

Fundamentals take a back seat to volatility, but lower growth is likely

- Focus now turns to the size of the negative impact on growth from the trade war.
- Despite a 90-day pause, the baseline 10% tariff rate remains, as does the 25% rate on steel and aluminium.
- Australia will be impacted by the trade storm, but our lower direct US trade exposure see us better placed. A protracted trade war will, however, harm China/Asia with key flow on effects felt domestically.
- Weaker global growth will likely spur further Reserve Bank of Australia (RBA) easing this year. These factors point to medium-term downward pressure on very short-term AUD interest rates.

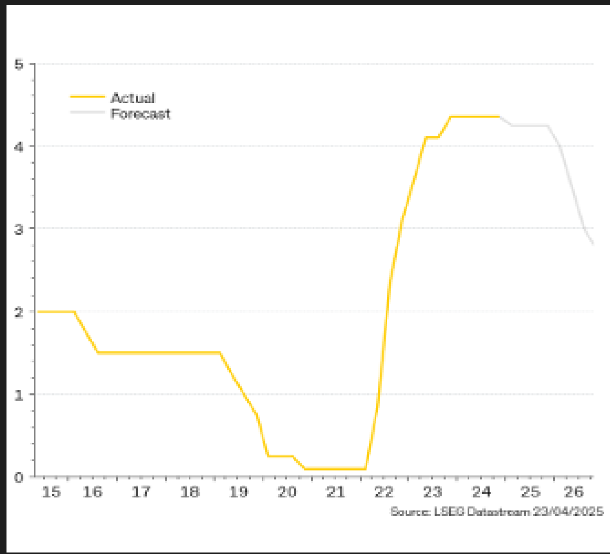
Domestic economic fundamentals have been overshadowed recently by the extreme volatility from President Trump's tariff announcements in early-April. While equity markets have settled, attention will turn to the extent of the negative impact of the tariffs on global growth, including Australia. The initial risk aversion in equity and bond markets from the April 2 tariff announcements saw the US Government pause the reciprocal tariff rates on most countries for 90 days.

Notwithstanding, the baseline 10% tariff rate remains, as does the 25% tariff on steel and aluminium and the China tariff rate of 145%. Given this, and with tighter financial conditions and weakening US soft data, US and global growth will almost certainly weaken, it's just a case of to what extent. There is also major uncertainty on the end outcomes of these tariffs, notably with China. While Australia will still be impacted, we're better placed to weather this trade storm given current resilient economic fundamentals and our modest direct trade exposure to the US.

However, a protracted trade war will harm China and Asia, and key flow on effects will be felt domestically. Therefore, a lot rests on Chinese Government's policy response. For example, a large infrastructure-based stimulus could provide more of a buffer to Australia.

RBA cash rate

Current and consensus forecast



Weaker growth and a tighter Federal election result should spur continued easing from the RBA over this year, starting with the Board meeting in mid-May. CBA expects a total of circa 0.75% of rate cuts by the end of 2025 which would take the cash rate to 3.35%. Downside risks to this forecast exist if the China and US trade war persists for an extended time and/or global growth weakens significantly.

While the US tariff and immigration policies have the potential to be inflationary shorter-term, the above factors point to further medium-term downward pressure on very short-dated AUD interest rates (including term deposit rates) and thus, consideration of alternative fixed income investments.

Amid the above backdrop, the recent data highlighted an economy that is resilient but growing at a subpar rate. This included the March jobs report (which showed an uptick in the unemployment rate to a still low 4.1%), and subdued business conditions surveys.

Equities:

The great rebalancing

- Volatility has reigned supreme recently as investors digested the US Government's change in trade policy and the expected slowdown in global economic growth.
- Previously unloved sectors and investment styles have started outperforming on a relative basis.
- The period since President Trump's election has also underscored the importance of assessing market concentration and taking an active approach to equity market investing.

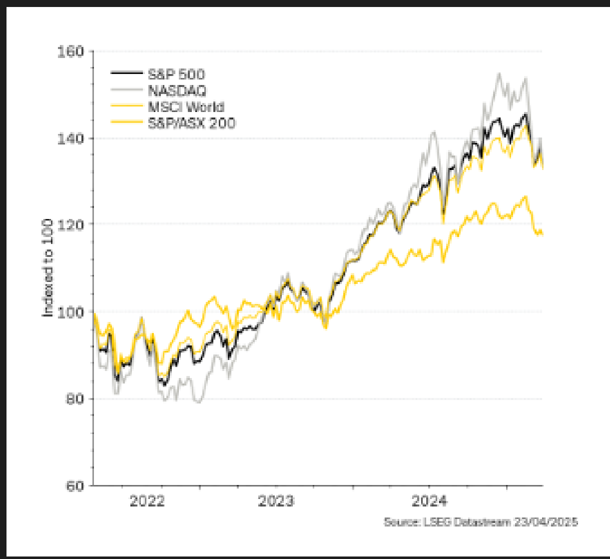
Coming into 2025, equity markets were richly valued, typified by high price/earnings multiples across key growth sectors including Information Technology, Consumer Discretionary and Industrials. In addition, relative to value stocks – notably those in the Materials, Energy and Utilities sectors-growth stocks had reached extreme levels of valuation dispersion.

As of 24 April, markets have adjusted considerably and become more reasonably valued. There's also been a significant rotation by country and region from the US to the rest of the world. This rotation has also occurred by sector (away from cyclical sectors toward defensive sectors).

Since November 2024, coinciding with President Trump's election, the importance of an active approach to equity market investing has been underscored. A passive investment approach doesn't take into account any concentration or valuation risk, nor does it provide the ability to implement downside mitigation strategies. Concentration became particularly apparent as the weight of the 10 largest stocks in the S&P 500 index reached close to 40% at the end of 2024, the highest level since the early 1960s (Source: J.P. Morgan).

Equities Indices below peak levels

With rising volatilities



The US, a magnet for global capital, also reached its highest ever weighting as a percentage of global equity indices at the end of last year, at 74% of the MSCI World (a developed market index) – compared to about 50% in 2010.

The largest declines this year have been felt in US equity sectors. For example, US Information Technology fell by over 20% from the start of 2025 to the second week in April, before recovering slightly. The broad US equity market also underperformed relative to other regions and countries, such as Europe and China over the course of 2025. It has been these declines among US large-caps which have seen the relative-valuation dynamic shift significantly from the start of the year.

There will be times when having a large-cap bias is appropriate. However, there will be other times where the return prospects are greater in other market pockets. The key is to make the assessment fundamentally, rather than simply follow the market's allocations. It's this dynamic which underscores our belief in active management.

Fixed Income:

Core absolute return funds show defensive qualities

- The early-April market stress was a litmus test for our absolute return funds that have dual return and capital objectives, but these funds broadly delivered on the latter in this period.
- Weaker global growth and tighter financial conditions suggest medium-term downward pressure on very short-term AUD rates.
- Credit spreads have bounced off their recent lows but can still move wider if recessionary type conditions are foreseen. Hence, our continued preference for diversified, quality, actively managed fixed income portfolios.

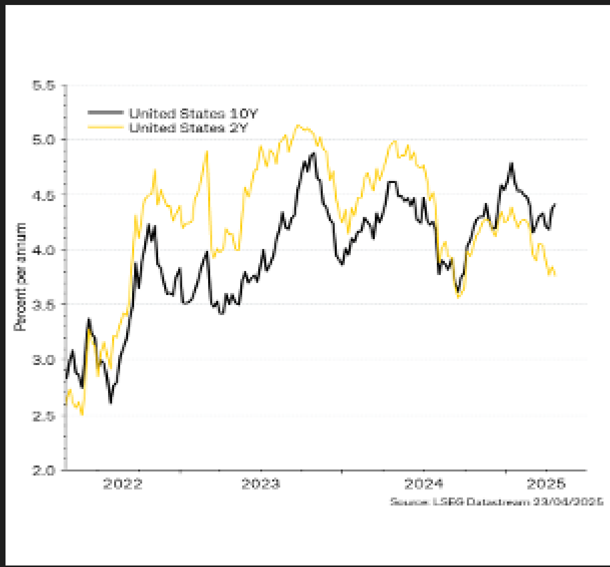
Early April ushered in significant volatility in global bond and credit markets as a result of President Trump's tariff imposts. Despite the risk aversion, uncharacteristically, longer-dated US Treasury (UST) yields initially rose sharply. However, the ensuing statements from key Fed members, confirming they had tools on hand to support the UST market liquidity and confidence if required, indicates to us that the "Fed put" is still available in true market dislocation periods.

This volatility was a key test for those absolute return-based fixed income funds that seek to deliver both relative capital preservation during risk aversion, as well as their medium-term return targets. Pleasingly, our absolute return fixed income strategies broadly delivered on their capital-related objective in this period.

Looking ahead, the focus will progressively turn to the extent of the negative impact of the trade war on global economic growth. As we argued above, weaker global growth and tighter financial conditions all point to downward pressure on local term deposit rates and consideration of alternative fixed income investments, including the funds in our core fixed income model.

Long UST yields rose sharply in early April

US 2-year and 10-year Government Bond Yields



Global credit spreads have bounced off their historically tight levels of late-2024, with AUD investment-grade (IG) financial credit spreads now modestly above long-term averages. However, IG credit spreads are not historically wide and remain well below the levels seen in the risk aversion periods in 2022 and COVID. Therefore, even though current credit fundamentals in Australia and the US are solid, depending on the relative hit to global growth and the outcome of key tariff negotiations, credit spreads can still move wider from here.

This underscores our continued preference for defensive, higher quality, shorter-dated IG exposures, as well as flexible, diversified fixed income credit portfolios where credit and rate positions are actively managed. These actively managed strategies, which includes funds in our core fixed income managed account, have key defence mechanisms and tools to mitigate the portfolio impact of any future credit weakness.

Focus will progressively turn to the extent of the negative impact of the trade war on global economic growth.

Real Assets:

Volatility spills over to listed Real Assets

- Real Assets such as Property and Infrastructure can provide long-term investment stability.
- It can also provide a hedge against the inflationary-based erosion of asset value.
- Equity market volatility in early-April included listed real asset markets, while underlying fundamentals continue to be supportive over the medium-term.

Global listed property securities weren't immune from the US tariff-policy-led market volatility. As markets considered the potential significant economic down-side scenarios: the FTSE EPRE Nareit Developed Index (GREIT Index) declined -10.5%, while the MSCI World equity index declined -10.3%. Thankfully, as at 24 April, much of the market concern and positioning for significant down-side scenarios has passed, and the GREIT Index has recovered almost two-thirds of this decline.

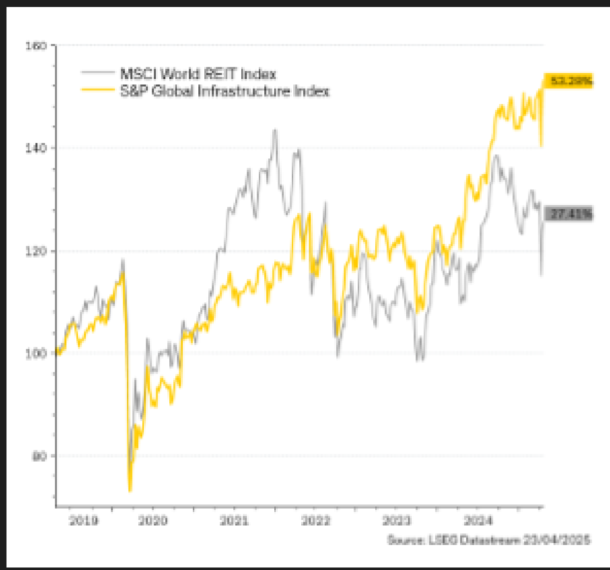
While, in general, real estate investments should be less impacted by tariffs than corporates, real estate values can be negatively impacted during economic downturns (due to lower tenant demand, higher vacancy rates, and lower property income), and during periods of rising interest rates (as higher interest costs reduce prospective returns and cause investor capital to seek higher returns elsewhere). Over the long-term, real estate can provide positive returns, even during inflationary environments.

Factors which contribute to this include the enduring nature and limited supply of real assets, the capacity to generate inflation-linked rental income, and the reduction of supply of new assets as construction costs escalate.

As we noted in our April Market Outlook, the prospects for commercial property have improved compared to the past few years, which saw widespread declines in property values as rising interest rates subdued investor

Real Asset investment returns

USD Total Return



demand. We maintain our positive outlook for direct commercial property over the medium term. Regarding listed property securities, many GREITs had been trading below their assessed net asset value prior to the April selloff. In combination of both underlying property fundamentals and listed market valuations, we maintain our generally positive outlook for both listed and unlisted real estate investments.

While there are few places to hide when listed markets are hit by severe volatility, listed infrastructure proved resilient in April. This sector, represented by the FTSE Developed Core Infrastructure 50/50 Index (Infrastructure Index), declined by -6.5% in early-April, but recovered almost all that fall by mid-April to be up +5.4% for the year-to-date.

Contributing to this resilience is the essential nature of infrastructure assets (which are typically resilient to economic cycles), and their underlying regulated or long-term contracted cash flows with a measure of inflation indexation. We maintain our positive outlook for infrastructure investments and their investment resilience over the medium term.

Alternatives:

Lower volatility with long-term return drivers

- Hedge Funds aim to provide absolute returns with low correlation to traditional asset classes.
- Alternative Credit offers enhanced yields.
- Private Equity offers access to value-added opportunities and participation in developing businesses and technologies.

The re-emergence of market volatility in equity and bond markets discussed earlier in this report has also impacted recent prices of alternative credit assets. As a broad indicator, the credit spread of the Bloomberg US Corporate US High Yield Index increased from 347 basis points as at 31 March 2025 to 453 on 8 April 2025, as negative market sentiment peaked. This translated to a decline in the value of that index of -2.8%. Valuations of other alternative credit assets, such as US BBB-rated Collateralised Loan Obligations (CLOs) and US Liquid Leveraged Loans declined by circa -2.0% over the same period.

These movements were significantly less than the decline in the MSCI World Index of -10% over the same period. (Data source: Bloomberg).

Overall, current credit spreads don't indicate consensus expectations of a (significant) US economic downturn. However, concerns regarding near-term US trade and fiscal policies remain, and economic survey data has weakened. While these concerns have not yet been realised in hard data, we continue to be watchful for developments in this regard.

These factors have been broadly reflected in wider credit spreads and higher yields across alternative credit assets, compared to the end of 2024, thereby increasing prospective returns from this asset class. However, given the current fast-moving nature of markets we believe that such investments are best accessed via active managers which can: (a) select sound credits which are not directly exposed to policy risks (tariffs), or which may be impacted as a secondary effect of such measures (consumer discretionary), and (b) actively reposition the portfolio according to credit fundamentals, relative value between issuers and credit segments, as well as capitalise on opportunities created by broad market movements.

Alternative investment returns

USD Total Return

Less can be said regarding the consequence of April's market volatility on valuation changes in Private Equity (PE) valuations, due to the less frequent valuation cycle (anchored by transaction activity), and delayed reporting cycle of PE investments. In this regard, PE valuations will no doubt be impacted to some extent, reflecting an overall heightened level of risk awareness. However, these valuations should be largely shielded from the non-fundamental volatility seen in listed equity markets.

While liquid equity and bond market volatility provide alarming news headlines, alternative assets continue to provide long-term drivers of investment return with relatively low volatility. As such, the market activity in the first half of April provides a sharp reminder of the need for diversification of both risk and return drivers in investment portfolios.