Firstlinks
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Contents

Editorial

New figures from UBS show that household wealth in Australia has reached a record-high $17.2 trillion this year, up 6% or $950 billion over the past year. Household wealth per person is now $623,000, among the highest in the world.

However, the growth in wealth has slowed in recent quarters, principally due to stagnating property prices and lower returns from share markets.

Household assets, liabilities, and wealth

Household	Assets		Liabilities		Wealth						Assets-to-income	Liabilites-to-income	Wealth-to-income
	% q/q	% y/y	% q/q	% y/y	% q/q	% y/y	$tn	Per person ($000)	$bn q/q	$bn y/y	% ratio	% ratio	% ratio
Q1-24	2.3	9.5	1.6	5.5	2.4	10.2	16.3	600	386	1,513	1,247	194	1,047
Q2-24	1.3	8.5	2.0	5.9	1.2	9.0	16.5	604	198	1,366	1,246	197	1,046
Q3-24	2.2	9.2	0.8	5.7	2.4	9.9	16.9	616	401	1,517	1,255	195	1,056
Q4-24	1.0	7.0	1.9	6.4	0.9	7.1	17.0	618	149	1,134	1,253	197	1,052
Q1-25	1.2	5.9	1.5	6.4	1.2	5.8	17.2	623	199	947	1,254	198	1,053

Source: ABS, Macrobond, UBS * may include UBS estimate for latest quarter(s)

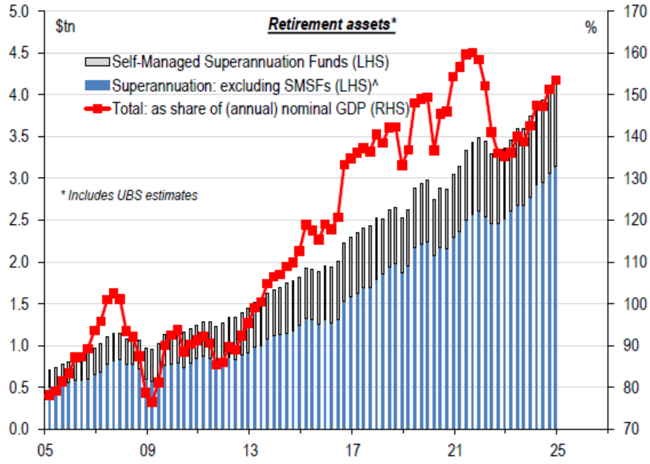
Retirement assets boom

Total retirement assets – including super and SMSFs – increased by 11% Year-on-year (YoY) in the fourth quarter of last year to a record-high $4.2 trillion. If super and SMSFs continue to grow at this rate, it means their total assets will increase by $1 trillion every two years.

The fourth quarter rise in assets was driven by growth in super contributions. Coupled with strong asset returns, it resulted in super inflows again exceeding outflows.

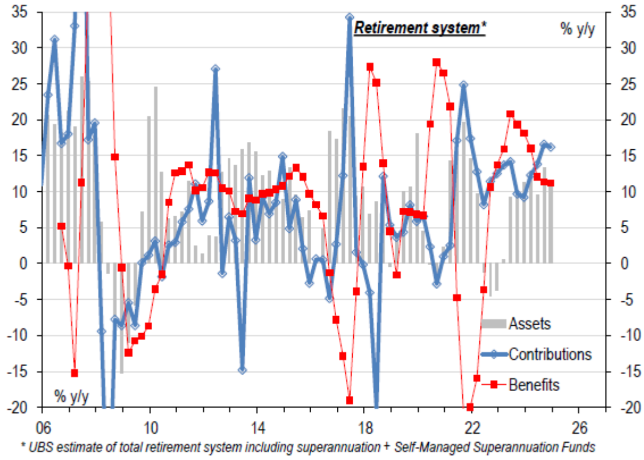
APRA-regulated super funds grew assets to $2.9 trillion in December quarter, up 3.1% on the previous quarter and 14% over the prior year. Industry funds contributed most to this rise, and they continue to dominate the super landscape, accounting for 51% of total APRA-regulated assets, up from 49.7% the year before.

Total retirement system assets



Source: APRA, ATO, Macrobond, UBS estimates

Total retirement system assets, year-on-year growth



Source: APRA, ATO, Macrobond, UBS estimates

Superannuation assets

	Assets ($ billion)				
	Dec 2023	Mar 2024	Jun 2024	Sep 2024	Dec 2024
APRA-regulated					
Corporate	47.3	46.7	46.3	47.6	46.5
Industry	1,271.5	1,349.0	1,366.2	1,426.0	1,488.3
Public sector	524.8	542.1	551.3	565.3	573.7
Retail	713.0	752.7	756.0	789.3	806.5
Entities with more than six members	2,556.6	2,690.5	2,719.7	2,828.1	2,915.0
of which: Eligible rollover funds					
Single-member ADFs	0.0	0.0	0.0	0.0	0.0
Small APRA funds	1.7	1.6	1.6	1.6	1.6
Total APRA-regulated	2,558.3	2,692.1	2,721.4	2,829.7	2,916.6
of which: Pooled superannuation trusts	237.2	226.3	228.3	236.6	248.0
ATO-regulated					
Self-managed super funds	958.9	984.3	990.7	1,022.0	1,017.8
Other					
Exempt public sector superannuation schemes	163.8	169.6	167.3	171.6	175.2
Balance of life office statutory funds	56.6	57.0	57.2	57.3	57.3
Total	3,737.6	3,903.0	3,936.6	4,080.6	4,166.9

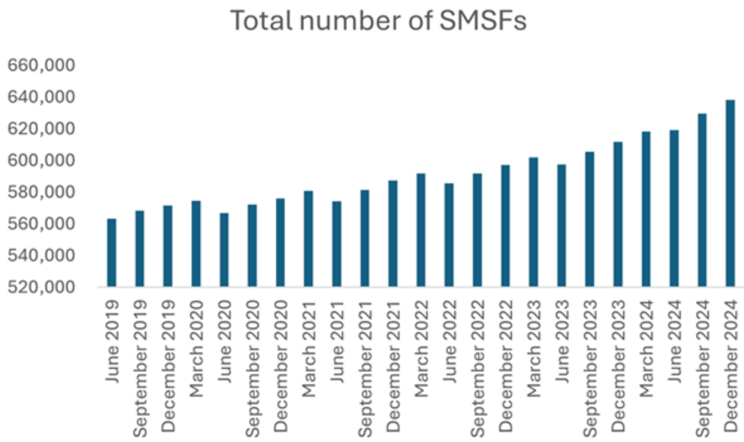
Source: APRA

SMSF assets slide marginally

As the chart above shows, SMSF assets dipped to $1.018 trillion in the fourth quarter, though they were still well up over the year.

While assets slid, SMSF member numbers still grew. ATO figures show there are now 638,411 SMSFs, a net rise of 8,727 in the December quarter and almost 27,000 over the previous year.

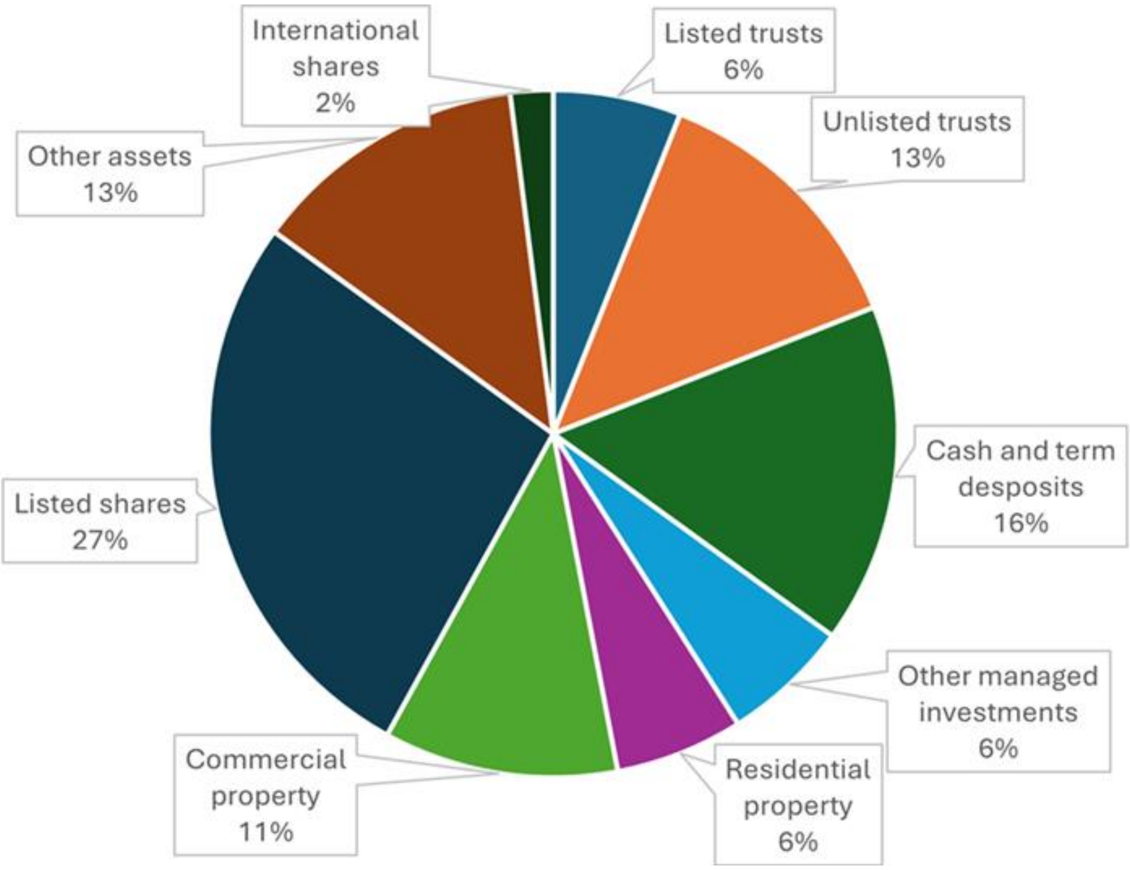
The figures reveal the majority of SMSFs have assets between $500,000 to $5 million (64%), with 23% holding between $200,000 to $500,000. And while SMSFs are attracting younger members, 85% are still 45 years or older.



Source: ATO, Firstlinks

As for where SMSFs are investing their money, listed shares still dominate at 27% of total assets, followed by cash and deposits at 16%, unlisted trusts at 13% and commercial property at 11%.

SMSF asset breakdown



Source: ATO, Firstlinks

The two things that stand out in the above chart are the large cash holdings and the small allocation to international shares. On the former, that may change given the lower fixed term deposit rates now on offer. Regarding the latter, it's hard to tell if this is an accurate figure or not.

However, it does correlate with a recent University of Adelaide study which found that a lack of exposure to overshares shares, especially US tech, had cost SMSFs in recent years:

"Home market bias, limited international diversification, and the drag of small SMSFs were the key drivers of SMSF underperformance compared to APRA-regulated funds in the 2022-23 fiscal year," the report said.

The data showed that the median rate of return for SMSFs in the year ended June 30, 2023, was 6.8% compared with 8.4% for retail and industry funds.

House pricing: turning back up?

Though super is important, residential property remains the key driver of wealth in Australia. The residential property market is valued at $11.1 trillion, accounting for about 64% of total household wealth.

And though it's been a drag on wealth in recent months, that could be about to change as the latest data indicates that the housing market may be bottoming. Average home prices rose 0.3% in February, after a brief three-month downturn of just 0.4%. The upswing came in anticipation of, and then confirmation of, an RBA rate cut which boosted buyer confidence. Most cities saw gains with the recent losers of Melbourne, Hobart, Canberra and Sydney picking up as the booming cities of the last two years – Brisbane, Adelaide and Perth – continue to slow as poor affordability impacts them.

Australian dwelling price growth

	February, % change	Annual % change	% change from peak	Median value
Sydney	0.3	1.1	-1.6	$1,186,459
Melbourne	0.4	-3.2	-6.4	$772,561
Brisbane	0.2	9.7	New high	$894,425
Adelaide	0.3	11.9	New high	$822,201
Perth	0.3	14.3	New high	$807,933
Hobart	0.4	-0.3	-11.9	$661,544
Darwin	-0.1	1.5	-5.9	$506,591
Canberra	0.2	-0.9	-7.1	$846,955
Capital avg	**0.3**	**3.2**	**-0.6**	**$896,613**
Regional avg	**0.4**	**5.5**	**New high**	**$661,966**
National avg	**0.3**	**3.8**	**-0.1**	**$815,912**

Source: CoreLogic

Whether the housing upturn continues will depend on the next RBA moves, whether population growth continues to slow, and which party wins the Federal Election and their economic priorities.

The soft spot in the wealth boom

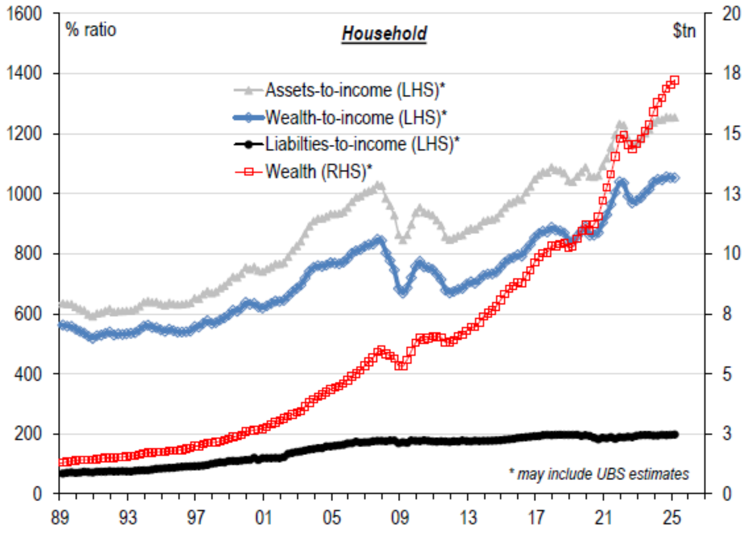
If there's a soft spot in Australia's growing wealth, it's debt. The household liabilities-to-income ratio has ticked up to a near-record of 198%, according to UBS. That's among the highest in the world, albeit the ratio has remained relatively flat over the past seven years.

However, the household wealth-to-income ratio is higher still at 1053%.

What this shows is how a multi-decade asset and debt boom has underpinned our wealth boom. And how we're dependent on more rises in asset prices to spur further gains in wealth.

The issue is that asset prices have detached themselves from incomes to such a degree that it's led to the current 'cost-of-living crisis'. And it's likely a big reason why the growth in Australia's wealth has slowed over the past year.

Household liabilities-to-income ratio hit near record levels



Source: ABS, Macrobond, UBS

In sum, Australia remains a fabulously wealthy country, though the foundations of that wealth have started to fray in recent years.

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In my article this week, I revisit one of my most popular articles from last year, *16 ASX stocks to buy and hold forever*, and answer the many questions I've got from readers since that time, including what stocks on the list may be worth buying now and [whether I'd make any changes to the list](#).

James Gruber

Also in this week's edition...

Julie Steed outlines the key superannuation rates and thresholds that will apply from 1 July 2025, following the recent release of earnings and CPI data. She'll also detail the primary considerations and opportunities leading up the end of the financial year.

Reporting season saw some volatility in the share prices of the Big Four banks, after their barnstorming performance in 2024. What lies ahead for the banks? **Hugh Dive** takes a closer look.

Understanding investment risk in superannuation is crucial for your retirement account. **UniSuper's Annika Bradley** has a guide on how to define, take, and manage risk to select the right investment mix for you.

Mid-last year, **Warren Bird** wrote of how money supply growth was the 'forgotten' indicator of inflation, and that it signalled moderating inflation for the following 6-12 months. That proved correct, and Warren gives us an update on where we sit now.

Emerging markets get a bad rap even though they've delivered strong long-term returns. **Siddharth Jain** thinks their underperformance over the past 5-10 years is set to turn around thanks to an inflection point in earnings.

Has Australian commercial property bottomed? **Charter Hall's Steven Bennett** says a sharp fall in supply and renewed demand points to a better 2025.

Lastly, in this week's whitepaper, **Allianz Retire+** explores the unique challenges and opportunities with retirement planning and the need to adjust to the demands of today's environment.

16 ASX stocks to buy and hold forever, updated

James Gruber

One of my most popular articles from last year was one entitled 16 ASX stocks to buy and hold forever. I think it sparked interest for a few reasons. First, owning stocks that can compound returns at a high rate is an attractive proposition. Second, a number of investors have very long timeframes and there isn’t much in the financial press that caters to these investors.

One year on, I thought it’d be worth revisiting the article to answer the many questions I’ve got from readers since that time, including what stocks on the list may be worth buying now and whether I’d make any changes to the list.

The 16 stocks I chose

Let’s quickly recap the premise of the original article. I got the idea from Warren Buffett, who had famously named several stocks that he’d like his company, Berkshire Hathway, to own forever, including Coca-Cola, American Express, Occidental Petroleum, and the Japanese trading companies.

I thought I could take that and apply it to the local share market. It wasn’t an easy task because I had to be confident that the companies could last indefinitely, and that they had enough growth opportunities to allow them to achieve shareholder returns that beat the ASX 300 index (otherwise, why own them?).

To help with the task, I created seven criteria to identify the ASX stocks that could be held indefinitely:

1. Part of the ASX 300
2. Long runway of growth opportunities
3. Economic moats
4. Good returns on capital
5. Sound balance sheets
6. Don’t rely on exceptional managers to succeed
7. Unlikely to be disrupted

From these criteria, I chose 16 stocks that you could hold forever:

Company	Code	Market cap (bn)	Industry
Argo Investments	ARG	6.9	Financial services
ASX Ltd	ASX	13.0	Financial services
Auckland International Airport	AIA	12.5	Airports
Aurizon	AZJ	5.7	Railroads
Australian Foundation Investment	AFI	9.2	Financial services
Cochlear	COH	17.1	Medical devices
EQT Holdings	EQT	0.87	Asset management
James Hardie	JHX	22.0	Building materials
Medibank Private	MPL	12.1	Insurance
Propel Funeral Partners	PFP	0.73	Personal services
REA Group	REA	32.7	Internet
Skycity Entertainment	SKC	0.91	Resort and casinos
The Lottery Corporation	TLC	10.9	Gambling
Transurban	TCL	41.6	Infrastructure
Washington H Soul Pattinson	SOL	12.5	Capital markets
Wesfarmers	WES	84.8	Home improvements/retail

Source: Morningstar, Firstlinks

To be clear, the list wasn't a case of buying *now* and holding forever. It was a wish list of potential stocks to own *in future* and own indefinitely.

Are there really forever stocks?

One query I got was what I meant by 'forever'. In a follow-up interview I did with Morningstar's Mark LaMonica, I clarified that my timeframe for forever was 50+ years.

I also got scepticism about whether any stocks really could be held indefinitely. After all, studies show the average lifespan of an S&P 500 company is around 15 years. The scepticism has merit, though it doesn't preclude finding special companies that can buck that trend.

One year on, would I change the list?

Yes, I would. In hindsight, there are two weak links in the list. The first is Argo Investments. Put simply, its portfolio returns are continuing to disappoint. I thought it might be a temporary blip, but it has been underperforming for a long period, and there doesn't seem to be any turnaround to that. My error was that I got caught up in its long history, stable management, and decent returns over almost 80 years. However, as a fund manager, it's performance that matters, and on that front, its 'glory days' appear to be behind it. Consequently, I would eliminate this one from the list.

Some investors have also questioned the merits of Australian Foundation Investment given its recent underperformance. I've got more faith that management will turn it around and deliver outperformance in future.

The other stock I have on my watchlist is Aurizon. When I featured it in the list, I said that I love the railroad business. Railroads have cost advantages for bulk transportation that won't go away. And there are long-term contracts with imbedded price increases. And though Aurizon gets 80% of its earnings from coal haulage, I'm more optimistic than most on coal volumes over the next decade, plus I'm buoyed also by the company's gradual transition to non-coal transportation.

One thing I may have underestimated is the competition in the industry. That impacts both rate and volumes.

I'm keeping a close eye on this, but for now, I think Aurizon should remain on the list.

The other company that may raise eyebrows is SkyCity. It's had a horror run, with regulatory crackdowns, a New Zealand economy that's been in recession, and a broader casino industry that's been on the nose.

Yet, I'm still a believer in the long-term future of the company given its long-dated and exclusive licences in Auckland and Adelaide. It remains a keeper.

In saying that, the biggest lesson that I've learned over the past 12 months is that sometimes the biggest competitive advantage for a company can also be its largest risk. That's especially the case for companies that have government licences and contracts.

For SkyCity, its economic moat comes from its exclusive casino licences. But we've seen increased regulatory scrutiny in New Zealand of late. And in Australia, Crown and Star have encountered the wrath of Governments after decades of friendly regulatory oversight.

We've also seen that with another stock on the list: Transurban. Pressure continues for it to renegotiate toll road contracts after a review recommending as such. This is another one to keep a close watch on, though I remain confident that any change to contracts will be adequately compensated and that there are still ample growth opportunities ahead for the company.

What other stocks could be considered for the list?

There are four stocks that were unlucky not to make the original list:

1. **Brambles (ASX: BXB)**. Wooden pallets are an old technology but it doesn't look like being replaced any time soon. Brambles is a leader in the industry, operating in 60 countries. Demand for its products should continue to grow given most of its business comes from fast-moving consumer goods.

2. **ARB (ASX: ARB)**. This company has grown from a local bull bar manufacturer to become a global automotive accessory leader. It's accelerating its push into the US, recently increasing its stake in Off Road Warehouse, the largest 4x4 accessory retailer in America. Lots of growth opportunities, great returns on capital, and a proven management team make ARB a potential keeper for the long-term.

3. **Goodman Group (ASX: GMG)**. Greg Goodman is a smart guy who knows how to scale a business and make a buck (or billions of bucks). His pivot into data centres seems well timed and should pay off given the increasing commoditisation of AI should drive greater demand for AI and data centres. Meanwhile, the industrial property business remains well-placed given the rise and rise of e-commerce.

4. **Aristocrat Leisure (ASX: ALL)**. Aristocrat's gaming machine business operates in a mature industry but with licencing requirements that limit new players coming into the market. In recent years, it's expanded into the fast-growing mobile gaming market. This move should drive growth for the company, which has become one of Australia's biggest overseas success stories.

I mentioned above that I would eliminate Argo from the list of stocks to own forever. In its place, I would choose either Brambles or ARB.

What stocks on the list are worth buying now?

There are six 'forever' stocks that I believe are potentially worth buying now:

ASX Ltd | Aurizon | SkyCity | Medibank Private | The Lottery Corporation | Washington H Soul Pattinson

The top three stocks here have all encountered what I consider temporary setbacks. I wrote of Aurizon and SkyCity above. On ASX, it has proven my point in the original article that you want to own companies that don't rely on exceptional managers to succeed. Because leaders of ASX have failed at a lot of things, and yet the quality of the company is undiminished. Of all the companies, ASX Ltd is my strongest buy idea.

The remaining three companies that I think are potential buys are high quality businesses offering reasonable value. Medibank Private continues to show its strength in an industry that should continue to grow for decades to come. The Lottery Corporation is a great company. Yes, it has regulatory licences, though it seems highly unlikely that Governments will undermine the company's monopolies in markets. Washington H Soul Pattinson is a proven, canny investor. One wonders if Perpetual or parts of it may be in play for Soul Patts at some stage.

Which of the stocks are overvalued now?

Of the 16 stocks on the list, which are the ones to avoid right now? I would name three:

REA | Cochlear | Wesfarmers

All three companies are high quality, and all are priced for perfection, and beyond.

I considered REA incredibly expensive at this time last year, and the stock is up 33% since! It's now trading at 18x sales and 53x earnings. The move by Costar on REA rival, Domain, may be the catalyst for a reality check in the REA share price. CoStar is a proven operator with deep pockets and investors may soon fret about the potential implications for REA.

Cochlear's share price has taken a hit over the past 12 months, yet at 46x earnings, it still seems very overpriced. I think the company can grow profits by high single digits over the next few decades, but there's no way I'd pay a 46x multiple for that.

Wesfarmers is another that seems overpriced. Again, though, I thought the same thing last year, and it's performed ok since.

James Gruber is an assistant editor at Firstlinks and Morningstar.com.au.

2025-26 super thresholds – key changes and implications

Julie Steed

The Australian Bureau of statistics recently released the average weekly ordinary time earnings (AWOTE) and consumer price index (CPI) figures for the quarter ending December 2024. These statistics are used to determine key superannuation rates and thresholds that will apply from 1 July 2025. This article outlines the rates and thresholds that are changing and those that aren't. It also explains some key considerations and opportunities in the lead up to 30 June 2025 and beyond.

Transfer balance cap

The transfer balance cap limits the amount of superannuation that can be used to start a pension, where the investment returns are generally tax free. The transfer balance cap was introduced from 1 July 2017 at $1.6 million and is indexed periodically to the CPI in $100,000 increments.

From 1 July 2025 the transfer balance cap will increase from $1.9 million to $2.0 million.

Contributions

Some key thresholds that impact contribution planning will increase from 1 July 2025, while others will be unchanged.

Total super balance

The value of the general transfer balance cap is used to determine the total super balance threshold which impacts eligibility for making non-concessional contributions and spouse contributions, as well as receiving Government co-contributions. This will increase to $2 million from 1 July 2025.

When determining eligibility for contributions, the total super balance is measured at the previous 30 June, not at the time a contribution is made.

Concessional contributions

The concessional contributions cap is indexed to AWOTE in $2,500 increments. The concessional contributions cap will remain at $30,000 from 1 July 2025.

This also impacts the concessional contributions that can be made under the five-year carry forward rules by individuals who have a total super balance at the previous 30 June of less than $500,000. The five-year carry forward total super balance threshold is not indexed.

Individuals who have a total super balance on 30 June 2025 below $500,000 will have a concessional contribution cap of up to $137,500 in the 2025-26 financial year. This includes a maximum of $25,000 for 2020-21, $27,500 for 2021-22, 2022-23, 2023-24 and $30,000 for 2024-25. They can also use the concessional contributions cap of $30,000 for 2025-26, bringing the total potential concessional contributions cap in 2025-26 to $167,500.

From 1 July 2025, any unused concessional contributions from 2019-20 will no longer be available to use. This means that 2024-25 is the last year that individuals can use any unused concessional contribution cap from 2019-20.

Non-concessional contributions

The non-concessional contributions cap is calculated as four times the concessional contributions cap. From 1 July 2025 the non-concessional contributions cap will remain at $120,000.

The two- and three-year bring forward limits also remain at $240,000 and $360,000 respectively from 1 July 2025.

The total super balance thresholds for determining eligibility to make non-concessional contributions will change, as outlined in the table below:

FY 2024-25			FY 2025-26		
TSB on 30 June 2024	NCC cap	Bring-fwd period	TSB on 30 June 2025	NCC cap	Bring-fwd period
< $1.66m	$360,000	3 years	< $1.76m	$360,000	3 years
$1.66m < $1.78m	$240,000	2 years	$1.76m < $1.88m	$240,000	2 years
$1.78m < $1.9m	$120,000	N/A	$1.88m < $2.0m	$120,000	N/A
$1.9m +	Nil	N/A	$2.0m +	Nil	N/A

Importantly the three-year bring forward maximum contribution is based on the non-concessional contributions cap at the time the three-year bring forward is triggered. There is no benefit from indexation for individuals who have triggered a bring forward in 2023-24.

Example: Shamal triggered the three-year bring forward in 2023-24 by making a $150,000 non-concessional contribution. In 2023-24 the maximum three year bring forward was $330,000. Shamal can contribute a further $180,000 prior to 30 June 2026 (subject to their total super balance). They don't benefit from indexation of the non-concessional contributions cap during this time.

Thresholds not indexed

The $500,000 threshold for accessing the five-year concessional catch-up contributions is not indexed. In addition, the $300,000 total super balance threshold for determining eligibility for the work test exemption is not indexed.

Historic rates and thresholds

The table below summarises the history of the rates and thresholds:

Item	Indexed to	Since 1 July 2017	From 1 July 2021	From 1 July 2023	From 1 July 2024	From 1 July 2025
Transfer balance cap	CPI	$1,600,000	$1,700,000	$1,900,000	$1,900,000	$2,000,000
Total super balance	CPI	$1,600,000	$1,700,000	$1,900,000	$1,900,000	$2,000,000
Concessional contribution cap	AWOTE	$25,000	$27,500	$27,500	$30,000	$30,000
Non-concessional contribution cap	4 x CCC	$100,000	$110,000	$110,000	$120,000	$120,000
Two-year bring forward		$200,000	$220,000	$220,000	$240,000	$240,000
Three-year bring forward		$300,000	$330,000	$330,000	$360,000	$360,000

Superannuation guarantee contributions

Although not subject to indexation, from 1 July 2025 the superannuation guarantee rate is increasing from 11.5% to 12%. Individuals who make personal concessional contributions or have salary sacrifice contributions made by their employer may need to factor the increase into their arrangements.

Summary

The superannuation rules changed dramatically in 2017 and introduced a variety of thresholds that determine eligibility for certain tax concessions and the ability to make contributions. The indexation of the thresholds adds an additional layer of complexity from 1 July 2025. Understanding the additional complexities will assist individuals to maximise the opportunities available within super in both 2024-25 and 2025-26.

Julie Steed is a Senior Technical Services Manager at MLC TechConnect. This article provides general information only and does not consider the circumstances of any individual.

The naysayers may be wrong again on the Big Four banks

Hugh Dive

The last five years have been very eventful for bank shareholders, with each year bringing a new set of worries predicted to bring the banks (and their share prices) to their knees.

2020 brought capital raisings from NAB, and Westpac missing its first dividend since the banking crisis of 1893 as experts forecast a 30% decline in house prices and 12% unemployment. Then 2021 saw the banks grappling with zero interest rates. The Australian Prudential Regulation Authority (APRA) warned management teams about the systems issues they may face from zero or negative market interest rates, an issue that seems quite comical now.

In 2022, the RBA raised the cash rate from 0.10% to 3.10%, its most rapid tightening ever. And in 2023, the concerns switched to the impact of sharply rising interest rates on bad debts and the 'fixed rate cliff'. Ultimately we saw little impact on earnings as borrowers made lifestyle changes to maintain mortgage payments.

As the banks coped with the above issues, the reason touted for selling bank shares switched to valuations in 2024 and 2025, with analysts advocating investors to sell all their banks as they were simply "too expensive". However, this call seemed premature, with the banks rallying +33% throughout 2024. Despite falls this February, their share prices are also mostly ahead of the ASX 200 in 2025.

In this piece, we are going to look at the profit results and quarterlies released by the banks in February 2025 and see if doom for the bank share prices finally occurs in 2025.

Reporting season scorecard Feb 2025

Company	Share Price	Market Cap $B	Cash earnings per share growth (pcp)	Increase in Dividends	Net interest margin	Credit Impairment charge as % of loans	Capital Ratio	Return on Equity	Forward PE Ratio	Forward dividend yield	Grossed Up Yield	12 month total return
Westpac	$31.75	$ 112	-2.0%	6.3%	1.95%	0.07%	12.5%	11.0%	15.3X	5.3%	7.5%	27.6%
ANZ	$29.80	$ 94	-6.5%	2.4%	1.57%	0.07%	12.2%	9.4%	12.6X	5.6%	7.1%	10.6%
NAB	$35.33	$ 119	-7.3%	1.2%	1.70%	0.10%	12.4%	11.6%	15.3X	5.0%	7.1%	9.4%
CBA	$156.08	$ 256	2.3%	4.7%	2.08%	0.07%	12.2%	13.7%	25.1X	3.1%	4.4%	38.8%
Macquarie Half Year	$227.53	$ 88	15.2%	2.0%	1.76%	0.01%	12.8%	9.9%	19.3X	3.4%	3.8%	20.8%
BOQ	$6.66	$ 4	-24.0%	-13.0%	1.56%	0.01%	10.7%	7.1%	11.7X	5.0%	7.1%	19.9%
Bendigo Bank	$10.73	$ 7	-1.1%	0.0%	1.88%	0.15%	11.2%	7.6%	12.8X	5.9%	8.4%	18.7%

Source: Company reports, IRESS, Atlas Funds Management

February 2025 reporting season

Over the last month, Commonwealth Bank and Bendigo Bank reported audited financial results for the six months ended December 2024, with the other banks giving unaudited quarterly updates. Quarterly updates can be misleading both positively and negatively, and generally show a lower level of capital than will be reported at the full half, reflecting a newly paid dividend and only three months of organic capital generation. Further, the quarterlies have offered limited and inconsistent disclosure of key metrics such as bad debts and net interest margins.

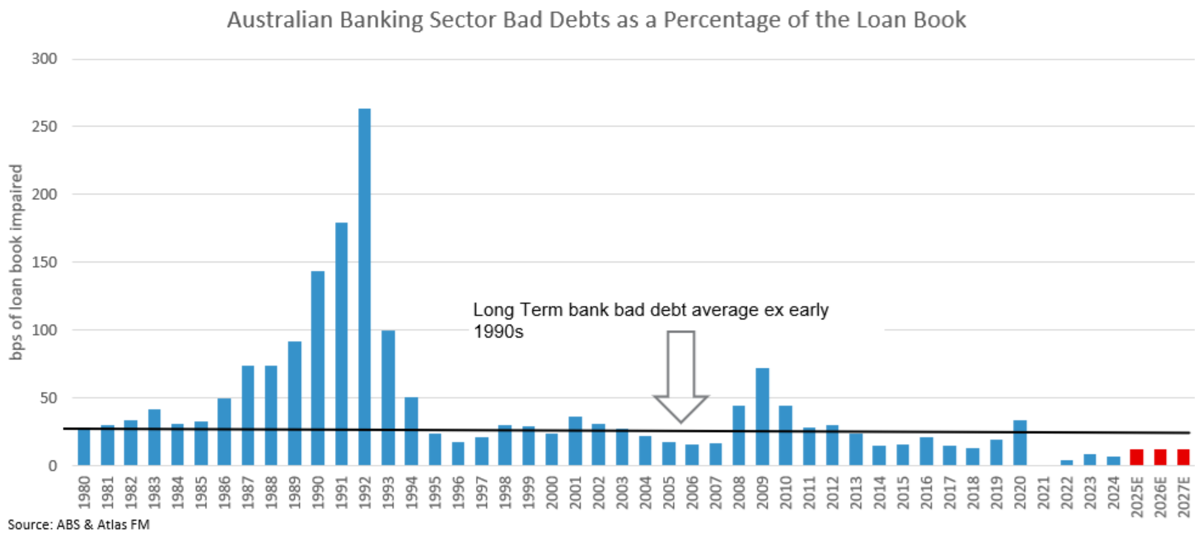
In early February, CBA reported very strong results, with higher profits, dividends, margins, and minuscule bad debts. However, given the company's lofty valuation, there was no room for error. This saw CBA's share price increase to $166 per share.

However, a week later, NAB sent tremors through the banking sector after releasing a quarterly report revealing higher impairments against business loans and a contracting net interest margin. While the large fall in the share price was unpleasant for NAB shareholders, Bendigo Bank had a rougher month, down 19% after revealing a 10% drop in profits due to higher expenses. Atlas tends to avoid owning the regional banks as they have a structural disadvantage compared to the major banks, with higher funding costs, lower IT and risk management resources, lower margins and a lower return on equity.

Bad debts will rise one day

The low level of bad debts from banks has continually surprised the market over the past five years due to a combination of prudent lending, APRA guidelines, house price appreciation, and the fact that residential loans in Australia are 'recourse-based' lending. This means that if the mortgage holder defaults on their home loan and the proceeds from the property sale do not cover the bank's debt, the bank can pursue the borrower for the residual owed.

Since 2021, the major banks have reported bad debt expenses between 0% and 0.2%, the lowest in history and clearly unsustainable. Excluding the property crash of 1991, bad debt charges through the cycle have averaged 0.3% of gross bank loans for the major banks, with NAB and ANZ reporting higher bad debts than Westpac and CBA due to their greater exposure to corporate lending.



In predicting the trajectory of bad debts in 2025, the 1989-93 spike should be excluded, as these were due to a combination of poor lending practices and very high interest rates. Indeed in 1991, the head office of Westpac was unaware of the concentration risk from different arms of the bank simultaneously lending to 1980s entrepreneurs such as Bond and Skase.

During this period, borrowers saw interest rates approaching 20%, a level outside any current forecasts. Today, the composition of Australian bank loan books is considerably different to what they were in the early 1990s or even 2007, with fewer corporate loans (such as to ABC Learning, Allco, and MFS) and a greater focus on mortgage lending, which is secured against assets and historically has very low loan losses. Additionally, the major banks have pulled the plug on their foreign (mis) adventures, with no exposure to northern England and

Asia, which in 2008, saw high bad debts, often due to the making of questionable loans outside of the core market.

While unemployment remains low, Atlas expects banks' loan losses will remain low, particularly when much of the more 'exciting' high-yield lending to developers is not on bank balance sheets but with private credit funds. A new investment class that has emerged seriously in the past five years.

The size of the private credit market has exploded to be around $40 billion. While the prospects for private credit funds invariably attributes their growth due to these funds being more nimble and smarter lenders than the banks, which sees private credit funds winning new borrowers over the staid major banks, the real reason for the emergence of private credit funds is far less exciting.

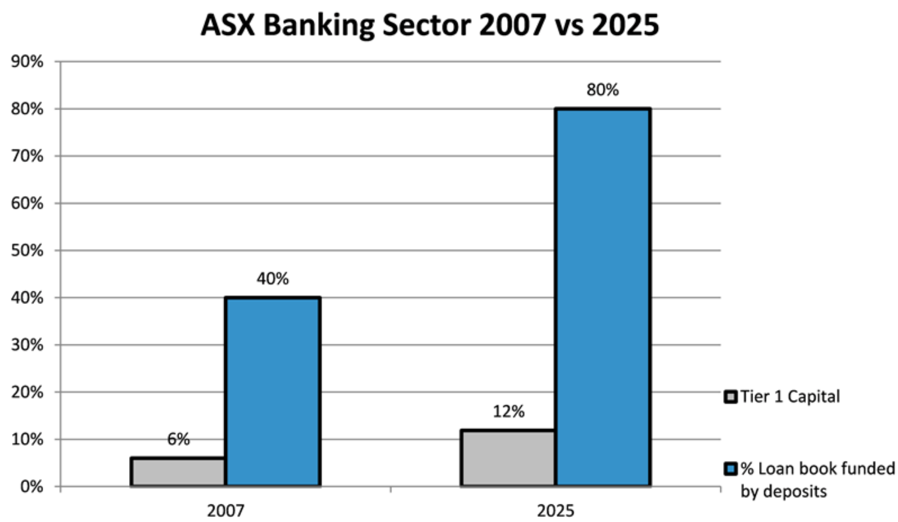
After the Basel III banking accords were designed to improve the stability of global banks, Australian regulators have largely forced banks out of lending to riskier borrowers such as property developers by forcing banks to set aside high levels of capital against poorer credit loans. Consequently, the return on equity (ROE) measures of loans to property developers with limited pre-sales are unattractive for the major banks to make. Conversely, private lenders are not regulated by APRA or the RBA and have happily stepped into this void.

Indeed, over the past year, we have seen some aggressive practices utilised by certain private credit funds to avoid reporting losses on impaired assets, which the author last saw in the final months of Allco and Babcock & Brown fifteen years ago. Pre-GFC, these problematic loans that were made by private credit funds would have been made by major banks. Clearly, the rise of private credit funds has contributed to low bank bad debts over the past few years and likely lower-than-expected bad debts in the near future.

Banks structurally safer in 2025

In 2025, all banks have a core Tier 1 capital ratio above the APRA 'unquestionably strong' benchmark of 10.5%. This allowed Australia's banks to enter the event of COVID-19 in 2020 and then the 2022-24 rising rate cycle with a greater ability to withstand an external shock than was present in 2007 going into the GFC, where their Tier 1 Capital ratios were around 6%.

For investors, this is important as the banks have more capital backing their loans in 2025 than in 2007. It means that the chance of a bank either becoming insolvent or being forced to raise dilutive equity is reduced. Additionally, the quality of the loan books of the major banks is higher in 2025 than in 2007 or 1991, which saw a greater weighting to corporate loans with higher loss levels than mortgages.



Foreign banking adventures that have caused investor heartaches in the past have largely ceased, with NAB pulling out of Europe and CBA and ANZ selling stakes in Asian banks. Further, as discussed above, the more 'exciting' mezzanine loans to property developers, which were on bank loan books in 2007, now substantially reside in the loan books of private credit funds.

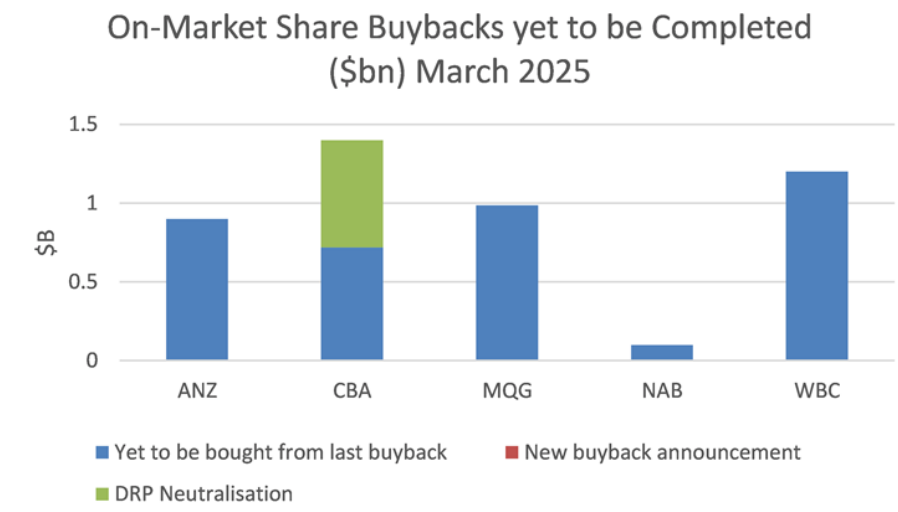
Additionally, the banks' funding source is more stable today than it was 15 years ago, with an average of 80% of loan books funded internally via customer deposits. This means that the banks rely less on raising capital on the wholesale money markets (typically in the USA and Europe) to fund their lending. Pre-GFC, the banks funded around 25% of their lending from the short-term wholesale market, effectively borrowing short and lending long, based on the assumption that this short-term debt can be easily and cheaply refinanced. An assumption that caused RAMS' demise in 2007.

Since the GFC, the banking oligopoly in Australia has only become stronger, with foreign banks such as Citigroup exiting the market and smaller banks such as St George, Bankwest, and now Suncorp being taken over by the major banks.

Politicians occasionally bemoan Australia's concentrated banking market structure, with 75% of lending being done by big four banks plus Macquarie and point to the 4,600 banks in the USA on the assumption that a vast amount of small regional banks would deliver more lending competition. However, a feature of the US system is regular bank collapses, with the Pulaski Savings Bank in Illinois in January being the first bank failure of 2025 and the fifteenth since 2019! Conversely, the last bank collapse in Australia was the State Bank of South Australia in 1991. Indeed, a strong, well-capitalised banking sector looked to be very desirable in 2023 with the collapse of Silicon Valley Bank in the USA and UBS' forced takeover of Credit Suisse.

Buybacks provide a backstop

One of the factors not considered 12 months ago by the experts advising investors to sell all of their bank shares was the impact of on-market share buybacks. All the major banks have capital in excess of regulatory requirements, which have built up since the 2018 Royal Commission as the banks exited non-core businesses such as wealth management and insurance, and provisions for Covid-19 losses went unused. Over the past year, this excess capital has been channelled into on-market share buybacks, where $5.1 billion of bank shares were bought and cancelled, effectively creating a new and consistent buyer.



Source: Company Reports & AFM

Atlas sees that share buybacks are preferable to the sugar hit of a one-off special dividend as they reduce the dividend for future profits and are infinitely preferable to management teams spending shareholder capital on questionable acquisitions. The Australian banks' track record of exporting their domestic banking brilliance to other markets has a very checkered history.

Currently, close to $4 billion of share buybacks are still underway, with all banks, with the exception of Macquarie, actively buying back their own stock on the ASX. The quantum of this buyback is likely to be expanded in May when ANZ, NAB, Macquarie and Westpac report their financial results. Swimming against the tide of on-market share buybacks was a poor investment strategy in 2024.

Our take

Atlas was pleased with the bank results we saw in February 2025, mainly from CBA, and expects the upcoming May reporting season to show that the three banks that gave quarterly reports are also in good shape. We don't expect the banks to perform in 2025 as they did in 2024, but they are likely to hold up well in what we see to be a flat market for Australian shares in 2025, supported by their dividend yield and ongoing buybacks, particularly on share price weakness. With an average grossed-up yield of +6.5% and lower-than-expected bad debts, bank shareholders will be rewarded for their patience and for ignoring the current market noise.

Hugh Dive is Chief Investment Officer of Atlas Funds Management. This article is for general information only and does not consider the circumstances of any investor.

Unpacking investment risk in superannuation

Annika Bradley

In superannuation, the word 'risk' is thrown around more than 'boujee' is on TikTok. It's such a nebulous word, but understanding 'risk' is key to selecting your investment mix in super. And it can really impact the size of your account balance at retirement. Let's unpack how to define investment risk, how to take investment risk, and what to know about it when selecting the right investment mix.

What is investment risk?

Let's start with the word 'risk'. One dictionary definition: "the possibility of financial loss", with synonyms: 'uncertainty' and 'unpredictability'. Investing feels uncertain and unpredictable so, is that 'investment risk'? The truth is, there's no perfect definition – but many agree 'permanent capital loss' is the best fit. For example, when WeWork, the co-working office space company, filed for bankruptcy – investors lost almost all money invested, which is definitely 'investment risk'.

Another common definition is 'volatility' - the 'degree of variation' in share prices or 'market ups and downs'. So, if one share price moves up and down more wildly than another, it is more 'volatile'. Wild share price moves feel uncertain, but they don't necessarily lead to 'permanent capital loss'. Many companies' share prices move up and down yet are solid long-term investments.

However, 'volatility' can become 'investment risk' when you simply lose your nerve and sell out of an investment just because its price has fallen, crystallising a 'permanent capital loss'. This is why advice to 'stay the course' is often offered (meaning - avoid the temptation to sell just because the share price has fallen).

Taking investment risk: the risk vs return trade-off

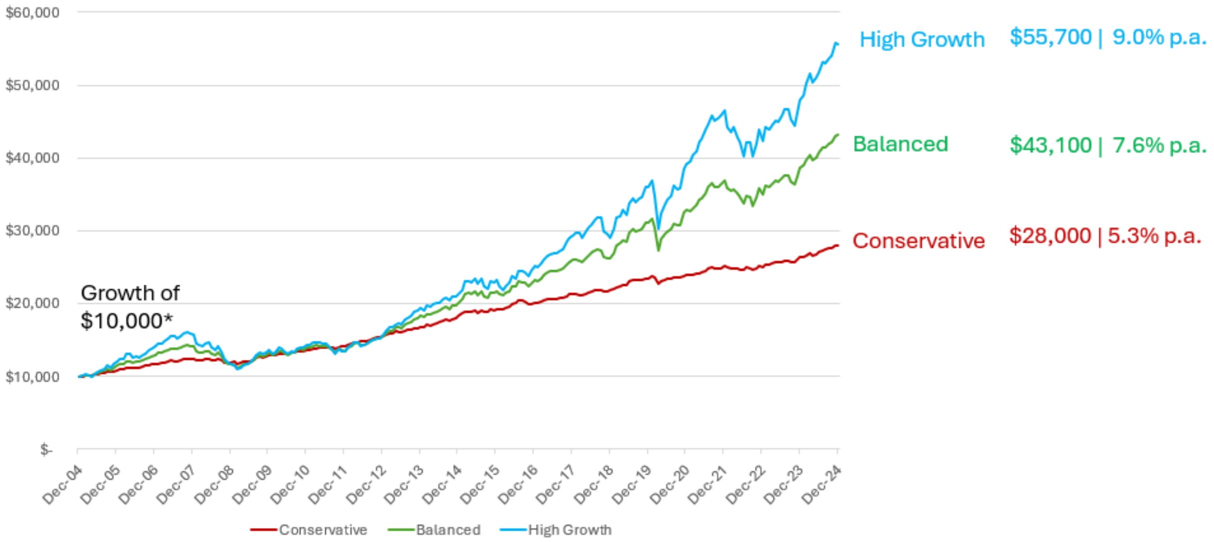
To simplify, assume an investor takes investment risk by only investing in cash or shares. Over time, cash has generated lower returns with lower risk, and shares - higher returns with higher risk. This is the concept of risk and return. An important side note: investing in cash over the long-term comes with another risk – inflation can erode purchasing power, but that's a separate article. Exhibit 1 shows the long-term performance of cash and shares.

Exhibit 1: Investment returns and risk over 20 years: Shares versus Cash

*Source: Bloomberg, UniSuper. Australian Shares is the S&P/ASX 200 Total Return Index[1] and Australian Cash is Bloomberg AusBond Bank Bill Index[2]. Daily return series applied. *Assumes income is reinvested and no fees, costs, taxes are incurred. Dollar figures are rounded to the nearest 100 for simplicity. Past performance is not an indicator of future performance.*

In super, an investment mix is delivered through an 'option' or 'fund'. An option labelled as 'conservative' generally holds more cash and means lower returns - less investment risk; and 'high growth' generally holds more shares and means higher returns - more investment risk. 'Balanced' is a mix in the middle. The graph below shows how these typical options have performed over the long-term.

Exhibit 2: Investment Returns and Risk Over 20 Years: Superannuation Options



*Source: UniSuper. Conservative is the UniSuper Conservative Option - Accumulation; Balanced is the UniSuper Balanced Option - Accumulation; and High Growth is the UniSuper High Growth Option - Accumulation. Monthly return series applied. *Returns are after fund taxes and investment expenses but before account-based fees. Assumes income is reinvested. Dollar figures are rounded to the nearest 100 for simplicity. Past performance is not an indicator of future performance.*

What do you need to know about taking investment risk?

Your investment mix and level of investment risk is unique to you and your circumstances. Here's a few considerations when selecting the right investment mix in super:

Know your timeframe: Superannuation is a long-term game. A 50-year-old female's investment time horizon, on average, is more than 30 years! In Exhibit 1, we saw how shares outperformed cash historically, but they can and do go down at times. Remember, a price fall doesn't necessarily mean 'permanent capital loss' (unless you sell it) and a long timeframe means you can wait for a recovery.

- **Key point**: investing in shares and higher risk assets can make sense if you have a long timeframe.

Know your 'why' and yourself: Human nature means it's hard to see your superannuation balance falling, even if only temporarily. But if you know taking investment risk can be necessary to beat inflation and generate higher returns to enjoy a more comfortable retirement, it can be easier to manage uncomfortable emotions, ride out downturns, and stick to the plan. Of course, if you can't sleep at night worrying about market falls and won't stay the course, you might need to accept lower returns and less risk.

- **Key point**: develop a plan for retirement (it's never too soon!), understand the right investment mix to achieve your goals, and educate yourself about market ups and downs and the emotions they will bring.

Diversify: if all your super was invested in WeWork, watching it file for bankruptcy would have hurt. But many diversified options in super own hundreds of investments. This diversification means that if one company's shares become worthless you will suffer a permanent loss of capital, but it won't wipe you out.

- **Key point**: super offers many 'diversified options': owning shares, property, infrastructure – all sorts of assets from around the world. Focus on selecting a well-diversified option.

Outsource: everyone knows buying a house is time-consuming. Looking online, inspections, contracts, and settlement. Buying any investment takes time. And constructing a portfolio with hundreds of investments takes a lot of time. In superannuation, there are many well-resourced teams who invest for you; understand risk and take time to do thorough research.

- **Key point:** make the very important decision of which 'diversified option' is best for you (e.g. growth or balanced) and outsource the rest.

Know your illiquidity levels: illiquid assets are generally those that can't be readily converted into cash. As super is a long-term game, you probably don't need to access all your money quickly. But in retirement, when cash withdrawals from your super are made, high levels of illiquid assets can be problematic.

- **Key point:** know what level of assets cannot be readily converted to cash. If you need to access a high proportion of your balance in the short to medium term, illiquid levels should be lower.

Know what to expect: unrealistic expectations are an investor's worse enemy. Everyone knows someone's friend who made 100% return investing in Bitcoin or a speculative mining stock. To put it in perspective, over the last 20 years, the Australian market earned, on average, about 8% each year, not 100%. And that was not earned in a straight line. Some years the annual return was down over 20%, other years up over 20%.

- **Key point:** past performance is not an indicator of future performance but know historical return levels and patterns to help set expectations.

Investment risk feels very uncertain at times, but understanding it helps you pick the right investment mix in super. This mix drives investment returns and the size of your account balance in retirement. And prior to retirement, the right investment mix is one of the most important decisions you'll make. So, take time to understand whether your current mix is appropriate and get back to living your best 'boujee' life.

Annika Bradley is an Investment Specialist at UniSuper, a sponsor of Firstlinks. In previous roles Annika worked with Morningstar and QSuper. The information in this article is of a general nature and may include general advice. It doesn't take into account your personal financial situation, needs or objectives. Before making any investment decision, you should consider your circumstances, the PDS and TMD relevant to the financial product, and whether to consult a qualified financial adviser.

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This 'forgotten' inflation indicator signals better times ahead

Warren Bird

In the middle of last year I wrote about the relationship between money supply growth and prices growth (aka inflation) – see this article from Firstlinks. I've been asked for an update on how the story is playing out, so here we go.

In that article, I noted that the annual growth rate of broad money (aka M6) had dipped to 4% in early 2024 but appeared to be trending at around 6%. I proposed that, if this trend rate continued, then that was consistent with inflation heading back into the 2-3% band. On that basis, there would be an emerging case through late 2024 into 2025 for the cash rate to be reduced, though even then I was suggesting that reductions would or should only be modest, into a 'neutral' policy range of 3.75-4.0%.

It's played out that way

That's pretty much what we've seen since. M6 growth did accelerate from 4% back up to 5-6% through the spring of 2024 but has slipped again in the summer (to just over 3% p.a.). It continues to trend at around 6%, though possibly a little on the weaker side of that number. In the 6 months since I wrote the article the annualised growth rate has been only 5.2%.

At the same time, inflation has declined from 4% to less than 3%. The CPI figures – both quarterly and monthly – are posting year-to rates at 2.5%.

Many are quick to point out that these outcomes have been manipulated to the downside to some extent by the Government's energy rebate payments and point to the year-to rate of inflation measured by the trimmed mean of the CPI still being at 3.2% in 2024. I have two responses to that:

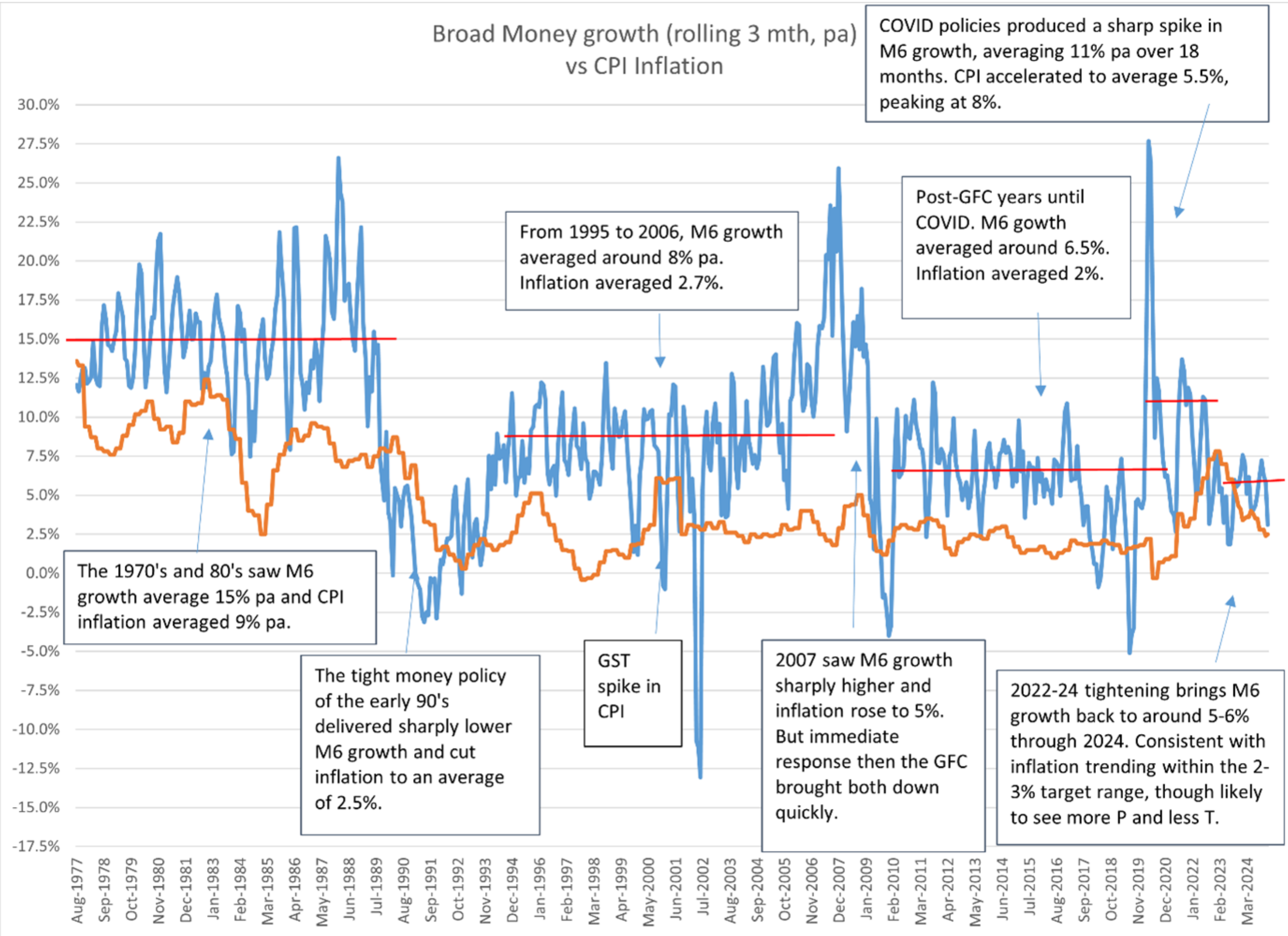
1. I acknowledge that it's mathematically true, but ask "so what?" I argue that lower actual inflation rates, from whatever source they come, can be expected to feed into inflation expectations, creating a self-reinforcing trend in the economy.
2. To also point out that looking only at year-to rates of growth still includes too much of what was happening almost a year ago and doesn't look closely enough at what's going on now. And what's going on now with trimmed mean inflation is that, for the second half of 2024, it was running at an annual rate of only 2.7%.

So I rest my case. Money growth has been 5-6% pa since I wrote my article and core inflation has slowed to 2.5-3.0%. Although the RBA still doesn't mention the money supply data in its statements about policy, this is the undeniable background to the rate cut announced this month.

The cash rate of 4.35% did its job. It got inflation down from 8% to less than 3%. It did that by changing the demand for and supply of credit, which is captured in the money supply data. Hence, M6 growth has also slowed from its double-digit levels in 2020-22 to the recent 5-6%.

In the past, M6 growth at this rate lined up with inflation below 2.5%. Unless there's an over-reaction by borrowers to this month's rate cut, resulting in a rebound in money growth, this means that the macro environment shows some strong evidence that the RBA's new inflation target is well within reach.

Here's an update of the chart that I included in last year's article.



One RBA review error

I can't let what I just had to say pass without comment. Of all the things to come out of the review of the RBA, the change from the target being expressed as inflation of "2-3% on average over the cycle" to targeting the mid-point of that range, 2.5%, is the most disappointing and unnecessary. The rationale for the previous formulation was well argued by successive Governors and Deputy Governors over many years. It is a clear commitment to inflation management at a sensible level but doesn't have the misleading appearance of fine-tuning precision that a spot point target has. Saying that the target is 2.5% simply invites market pedants and the media to quibble if we were to get a reading of 2.4% or 2.6% that policy must be changed to achieve the target.

Money supply is not the whole story for inflation or monetary policy, but it provides an early and good read on whether the cash rate setting is transmitting to accelerating, steady or slowing price pressures. That is, it helps to evaluate if a policy change is working or not. It supports last month's rate cut decision and I will continue to watch these data in the coming months to understand how much of an impact the cut to 4.1% is having.

Warren Bird has over 40 years' experience in public service, business leadership and investment management. He is currently a Director of the WA Government Employees Super Board (GESB) and Chair GESB's Investment Committee. He is also Chair of the independent Audit and Risk Committee of the Illawarra Shoalhaven Local Health District. This article reflects the personal views of the author.

The biggest and most ignored catalyst for emerging market stocks

Siddharth Jain

Contrary to popular perception, the emerging market asset class has delivered strong long-term returns.

Since the MSCI Emerging Market (EM) index was launched in 1988, it has compounded at 9% in US dollar terms annually, compared to 11% for the S&P 500. Analyzing trailing returns at the bottom of a cycle can also understate this reality.

Foreign investment in emerging markets has waned over recent years due to negative sentiment toward the asset class that today resembles what we observed in the US during the financial crisis or in the energy sector during the COVID pandemic.

But while other investors may view these assets as out of favor, we see an opportunity.

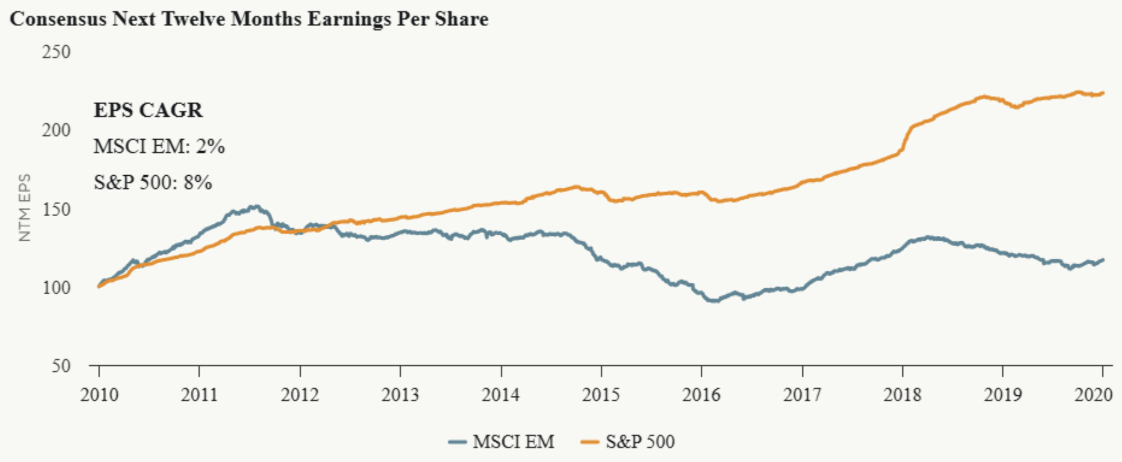
Why consider investing in emerging markets now

Superior GDP growth, favorable demographics, or relative valuations by themselves are not compelling enough reasons. China's mediocre long-term equity returns are a great case study showing that these variables alone are not sufficient to drive performance.

Instead, our North Star is corporate earnings. In our office is a sign that reads, "Earnings are like gravity," because we believe stock prices follow earnings over the long term. Thus, we are turning positive on emerging markets primarily due to the improving earnings outlook.

In our opinion, the single biggest driver behind the S&P 500's massive outperformance over the past decade has been earnings growth. After minimal earnings growth in the 2000s, the S&P 500's earnings accelerated to an 8% CAGR in the 2010s, largely driven by the technology sector. In contrast, the MSCI EM's earnings were basically flat during this time.

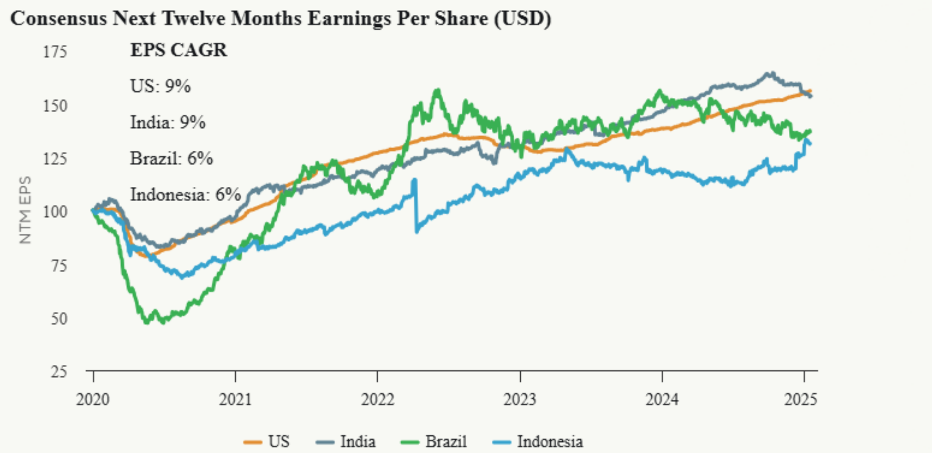
MSCI EM Index vs. S&P 500 Index

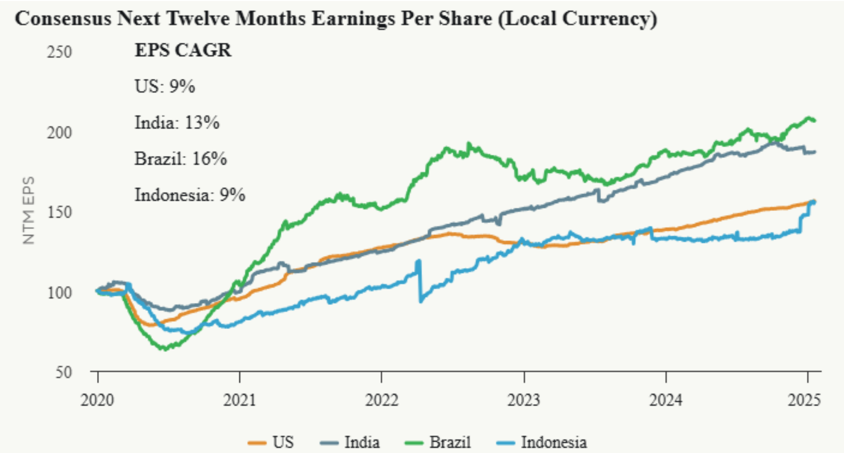


Source: Bloomberg. Data from 31 December 2009 through 31 December 2019. You cannot invest directly in an index. PAST PERFORMANCE MAY NOT BE INDICTATIVE OF FUTURE RESULTS.

However, earnings have started to recover for emerging markets in both local currency and US dollar terms. We will focus on three of our favorites—India, Indonesia, and Brazil—but these are by no means the only markets we are excited about. Since January 2020, these three countries have delivered earnings growth comparable to the S&P 500, despite having minimal technology exposure.

US, Brazil, Indonesia, and India Earnings Per Share (In US Dollars and Local Currency)





Source: Bloomberg. Data from 1 January 2020 through 19 January 2025. You cannot invest directly in an index. PAST PERFORMANCE MAY NOT BE INDICTATIVE OF FUTURE RESULTS.

Drivers of the earnings inflection in emerging markets

1. Improving Economic Policies

Good economic times often lead to bad economic policies, and vice versa. In our opinion, it is only in the darkest times that politicians are willing to make the unpopular but necessary decisions required to stabilize an economy, such as slashing spending. The early 2000s bull market led to poor economic policies, including increased spending, trade deficits, excessive leverage, corruption, and government intervention, to name a few.

However, the sharp slowdown in emerging markets during the 2010s resulted in pro-business leaders taking office: Narendra Modi in India, Michel Temer and Jair Bolsonaro in Brazil, and Joko Widodo in Indonesia. We have discussed their economic policies at length in prior GQG research papers.

One Indian CEO remarked how "the Indian government went from slapping red tape on businesses to rolling out a red carpet for them" under the Modi administration. Unlike in the developed world, trade deficits and inflation in emerging markets have improved dramatically over the past few years.

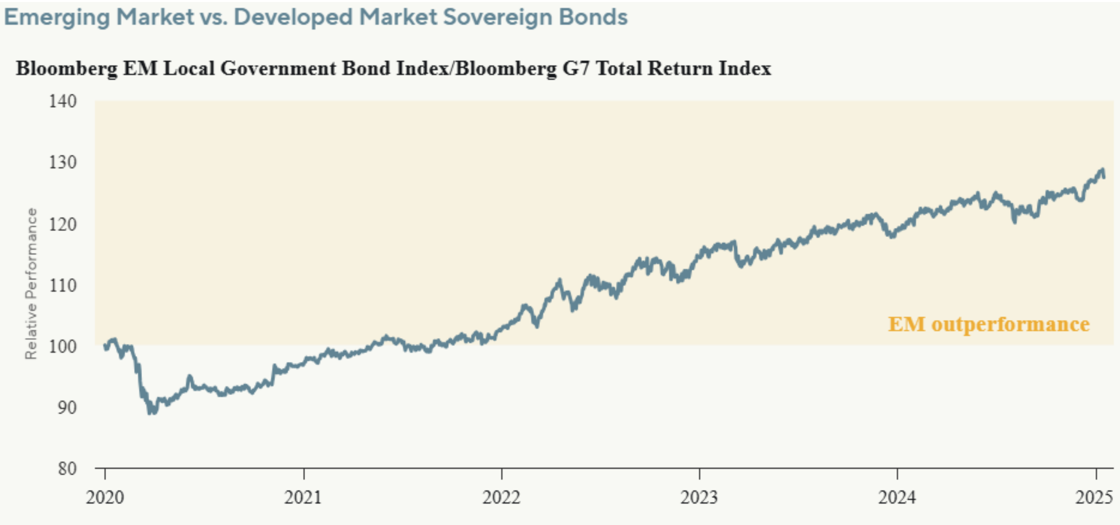
India, Indonesia, and Brazil each reduced their trade deficits from 4% to 5% of GDP to 1% to 2% over the past decade, whereas the US went in the opposite direction. Similarly, inflation improved from roughly 10% at its peak to mid-single digits.

In contrast, the developed world seems to be making the same economic mistakes the emerging world made in the 2000s. As of this writing, the US has a 6% fiscal deficit despite a booming economy, a 4% trade deficit, and a 120% debt-to-GDP ratio.

Europe is in an even tougher situation given its stagnating economy, stifling regulatory environment, and political turmoil. Bond markets have been sending a clear message with emerging market sovereign bonds consistently outperforming developed market bonds in recent years.

2. Stronger Banking Systems

Today, most emerging market banking systems are in solid shape, in our view, as loan growth has improved, and corporate balance sheets have been cleaned up. It is also important to remember that banks have an outsized impact on emerging market equity markets as they are typically the largest public stocks in each country. The financial sector makes up approximately 25% of the MSCI EM benchmark and accounts for three of the five biggest public companies in Indonesia.

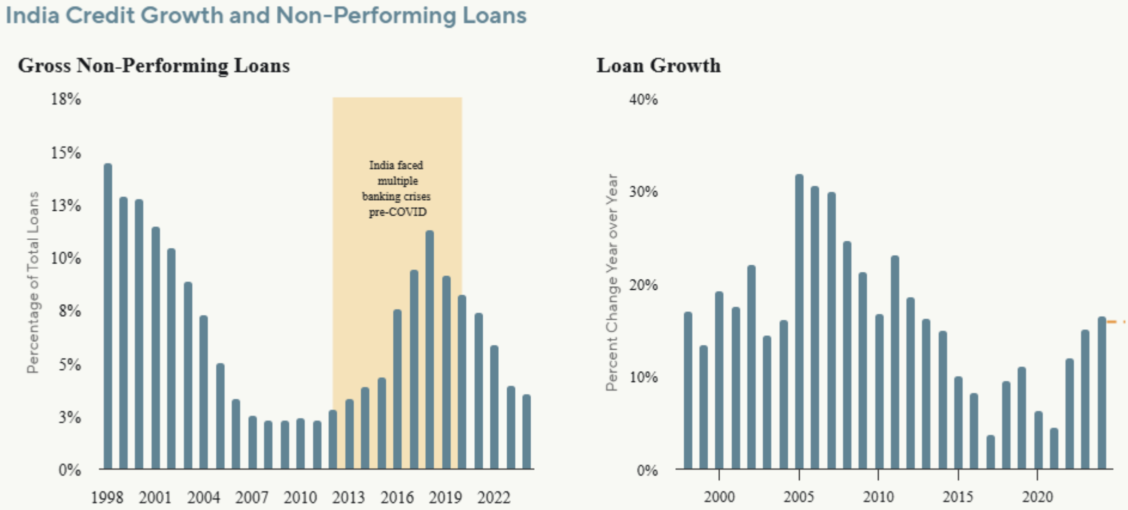


Source: Jefferies. Data from 1 January 2020 through 16 January 2025. You cannot invest directly in an index. PAST PERFORMANCE MAY NOT BE INDICTATIVE OF FUTURE RESULTS.

The developed world faced a banking crisis in 2008, but India, Indonesia, and Brazil experienced one nearly a decade later. Buoyed by the early 2000s bull market, local corporations of these emerging market countries took on excessive debt and paid the price once growth slowed down.

As a result, Brazil's two biggest companies, Petrobras and Vale, nearly went bankrupt in the mid-2010s. This had a cascading impact on these countries' banking systems, particularly the state-owned banks. Non-performing loans surged, liquidity dried up, and banks sharply curtailed lending.

Meanwhile, India's non-performing loans crossed 10% of GDP in 2018. Any economy would struggle in this environment, as credit has a multiplier impact across sectors such as housing, autos, and infrastructure.

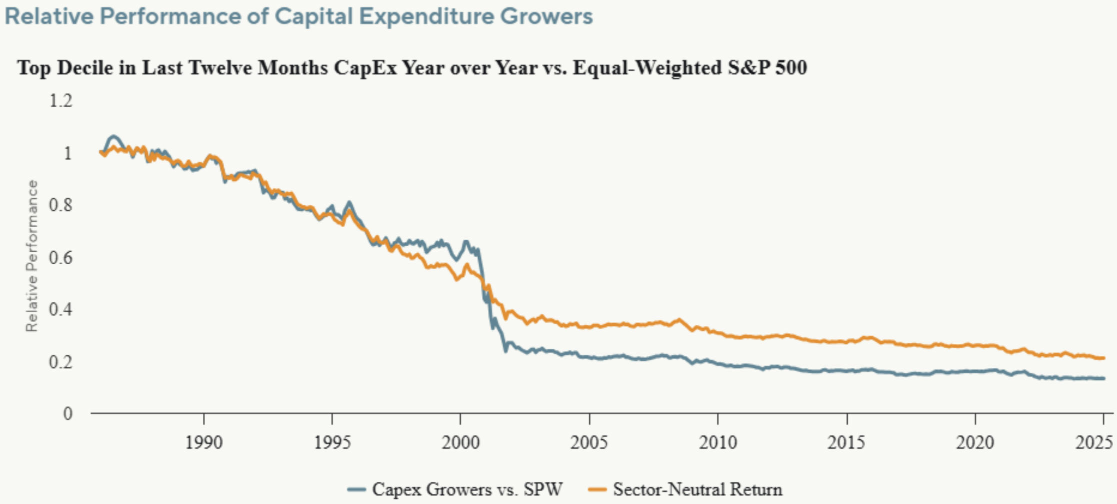


Source: Bloomberg. Data from 1 January 2020 through 19 January 2025. You cannot invest directly in an index. PAST PERFORMANCE MAY NOT BE INDICTATIVE OF FUTURE RESULTS.

Emerging markets provide true diversification

While we remain positive on the US given its plethora of high-quality companies, we are starting to see clouds on the horizon. Most notably, we believe the massive AI-driven capital expenditure surge in the technology sector could soon start weighing on S&P 500 earnings growth.

Prior innovations, such as railroads, electricity, shale, and telecom, also went through similar capital expenditure cycles, and they did not end well. Rising fiscal and trade deficits could also eventually negatively impact the dollar, similar to the early 2000s.



Source: Bank of America. Data from 31 December 1985 through 31 December 2024. You cannot invest directly in an index. PAST PERFORMANCE IS NOT INDICATIVE OF FUTURE RESULTS.

From a diversification perspective, we also believe investors should consider how much of their overall portfolio is likely to behave similarly to US technology. This may be a much larger portion of their portfolio than they realize. Emerging markets offer an idiosyncratic return profile and have historically moved in cycles opposite to those of the S&P 500.

Riding the wave in emerging markets

On a bottom-up basis, we are finding many attractive investment opportunities in emerging markets. Especially in the four following markets.

India

India's Sensex is one of the only major indexes that has matched the S&P 500's earnings growth over the long term. Over the past 20 years, both the US and India have delivered approximately 7% US dollar earnings per share (EPS) growth.[1] Like the US, India offers a large addressable market, a stable democracy with rule of law, and a dynamic private sector. Unlike its Asian peers, India's consumption-driven economy helps insulate the country from global volatility.

Given the country's size and growth outlook, we believe India could be the main driver of emerging market earnings over the next cycle, like Malaysia and China played previously. In particular, we are very excited about the country's infrastructure sector, which has grown earnings by over mid-teens annually.

The main pushback with India is valuation. However, after the recent correction, the Sensex now trades at its pre-COVID multiple of 20 times EPS, despite better earnings growth.

Indonesia

Indonesia offers many of the same characteristics as India (pro-business government and stable democracy) that have resulted in attractive long-term returns. Since the beginning of the 21st century, Indonesia has delivered 9% annualized US dollar returns compared to India's 10% and the US's 8%.[1]

Relative to India, we think Indonesia will likely see slower earnings growth but higher dividends. For example, the country's index currently offers an attractive 5% dividend yield. We are positive on the big banks, which could deliver low-double-digit earnings growth and a 20% return on equity.

Brazil

Brazil faced its equivalent of the Great Depression during the 2010s but is well on the path to recovery, with its economy consistently surprising to the upside post-COVID. Furthermore, Brazil's returns largely come from dividends with the country's Ibovespa index now yielding 7%. We continue to see investment opportunity in Petrobras, Brazil's oil major, which operates some of the highest quality oil reserves in the world and offers a mid-teens dividend yield.

The main downside in Brazil is the Lula administration's fiscal spending, in our opinion. However, we are being paid to wait, given the robust dividends and elections less than two years away. Additionally, we believe a company like Petrobras is relatively immune, given its significant dollar revenue and dividends, which help plug the country's fiscal gap.

United Arab Emirates (UAE)

Similar to Asia in a previous cycle, the Middle East is transforming into a new frontier for investing as the region opens its economy to foreign investment, implements pro-business reforms, and rapidly attracts expatriates. The UAE is copying the Singaporean playbook and transforming into a global financial hub.

Most UAE companies offer a mid-single-digit dividend yield with high-single-digit earnings growth in a stable currency. The property sector is likely to be one of the biggest beneficiaries from the country's transformation, in our view, and could see high-teens earnings growth.

Active management is key

Understanding cycles is a critical component of navigating financial markets over the long run. Both the US and emerging markets have experienced lost decades in the past, and it is a mistake to simply extrapolate recent performance.

Economic policies, corporate earnings, and bond markets have already inflected positively in many emerging markets. While not guaranteed, history suggests that an improving relative earnings outlook could also drive higher multiples and a weaker dollar, which would be a triple tailwind for emerging markets.

There are many potential risks to monitor, such as the implications of Trump 2.0, but we believe investors with a longer-term perspective should consider adding emerging markets as part of a diversified portfolio.

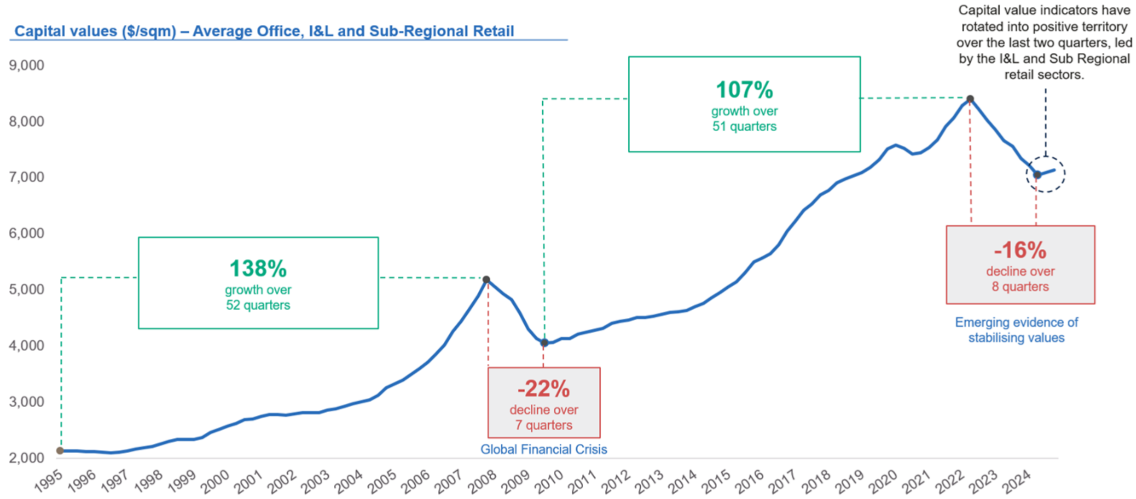
Siddharth Jain is a deputy portfolio manager at [GQG Partners](). This article contains general information only, does not contain any personal advice and does not consider any prospective investor's objectives, financial situation or needs.

Has Australian commercial property bottomed?

Sasanka Liyanage, Steve Bennett

Over the past few years, commercial real estate sector returns have been dominated by the largest interest rate cycle increase in decades. The adjustment to higher rates contributed to the most significant valuation repricing since the Global Financial Crisis (GFC), as you can see in Chart 1 below.

Chart 1: Indicative market capital values and total returns across the Prime Office, Industrial & Logistics (I&L) and Sub Regional Retail sectors



Source: JLL Research, Charter Hall Research. Click to enlarge.

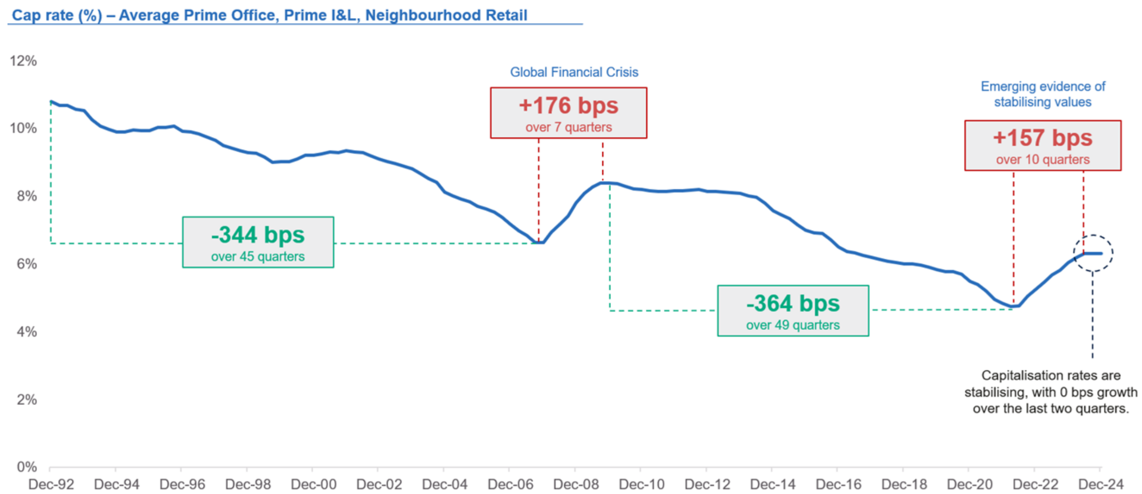
Today, however, the Australian prime property sector offers compelling risk-adjusted returns. Yields are attractive compared to historical levels and offer high-quality cashflow, with forecast equity IRRs now at large premiums to bond yields. Given the gains across the broader listed equity markets over 2024, real estate sector weightings are generally below targets for institutions, increasing the prospects for material redeployment into property.

Promisingly, a recovery was sustained over the second half of 2024. Annual transaction volumes in the physical market ended 2024 at the highest level since mid-2022. Reinforcing this outlook, the spread to net tangible assets (NTA) in the real estate listed equity markets has reduced and, in some instances, has turned into a premium; a notable gain from the average ~30% discount a year ago.

Broker and valuation forecasts, supported by increased transaction evidence, point toward the stabilisation in capitalisation rates across the Prime core real estate sectors (see Chart 2).

Note: Capitalisation rate is calculated by dividing net operating income by a property's current market value. A higher market value implies a lower capitalisation rate.

Chart 2: Indicative market capitalisation rates across the Prime Office, Industrial & Logistics (I&L) and Neighbourhood Retail sectors



Source: JLL Research, Charter Hall Research. Click to enlarge.

2025's office market: perception, reality and the great opportunity

Office had the largest reduction in property values (-21%) in the recent downcyle, given the uncertainty cast by the pandemic lockdowns and the capacity for demand to absorb a surge of lagged new supply completions. However, with return to office mandates now becoming more prevalent, the sector is rebounding with an increase in tenant demand.

The trend back into the office continues to accelerate (see Table 2) as the limitations of non-office attendance become patently clear to companies and government entities look to drive productivity and their corporate culture. Since the end of the lockdowns, the occupied stock across Australia's Prime Office market has increased by 9%; the third strongest growth globally.

Table 2: Return to office mandates (% employers)

Time required in office	2024	2025
5 days	36%	39%
4 days	19%	22%
3 days	19%	20%
2 days	13%	8%
1 day	4%	4%
0 days	9%	7%
Average	**3.43 days**	**3.64 days**

n=500 employers

Table: Financial Review • Source: Robert Half

Ironically, meaningful reductions to office space in flexible arrangements could only be achieved by reducing staff flexibility. The increase in flexible working did not translate to a contraction in office occupied stock. Prime office area increased with a growing workforce; and tenancy areas were mostly maintained or increased.

Desk sharing arrangements proved to be impractical for most firms as this confined talent to fixed or advanced-booking schedules. This was challenged by the dynamic preferences of staff and the ebb and flows of workflow. Contingent desk space was a mechanism for flexibility. Flexible policies also require greater collaborative and communicative space (i.e. more meeting rooms).

A growing chorus of major organisations have expressed the significance of office-centred cultures and intensified efforts to encourage attendance, including more rigorous mandates and bonus-linked attendance. To incentivise the return and office productivity, firms have also focused on the quality of the offering through improved amenities.

Cyclical and secular forces are moving in favour of the office market

Asset pricing looks set to be supported by the downward trajectory of interest rates and borrowing costs. Meanwhile, higher construction costs have endured and existing asset values sit well below their replacement costs. This has led to a significant reduction in forward supply.

Office assets typically have longer lead-times given the asset, planning, and locational complexities. As such, the next decade will likely be affected by a period of undersupply for modern office assets in core CBD locations. Existing assets with superior credentials will benefit from greater pricing power. This trend has already emerged in markets such as Brisbane, where insufficient supply has contributed to effective rent growth of 20%+ over the past two years.

As detailed in Charter Hall's recent 'Why Australia' report, this should unfold against the backdrop of long-term economic fundamentals that continue to strengthen against the other major global economies and contribute demand across the Prime Real Estate sector.

Over the next decade, Australia has the strongest economic, population and employment growth forecasts – between two to four times greater than the G12 nation average growth rates. In a world with rapidly ageing populations, Australia benefits from a younger and more productive population.

Office demand also continues to benefit from a range of enduring mega trends, headlined by the AI transformation. AI jobs are forecast to increase by above 164,000 by 2030 and generate between 800,000 sqm and 1.3 million sqm of additional office space demand. Moreover, technological advances have accelerated white-collar job growth over recent years in industries such as cybersecurity, tax, defence and automation.

Looking ahead, these trends are expected to continue, with leasing volume growth to be supported by the positive economic momentum against the backdrop of declining office supply. We are of the view that the earlier correction in asset values was largely cyclical, as markets adjusted to higher interest rates and slowing economic conditions. As this trend recedes and secular tailwinds strengthen, high-quality offices are providing appealing forward-looking return profiles.

Sources: JLL Research, Morgan Stanley, ABS, Oxford Economics, Tech Council of Australia, Charter Hall Research.

Steven Bennett is Chief Executive of Direct Property and Sasanka Liyanage is Head of Research at Charter Hall Group, a sponsor of Firstlinks. This article is for general information purposes only and does not consider the circumstances of any person, and investors should take professional investment advice before acting.

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