PRINCIPIA

INVESTMENT CONSULTANTS

Quarterly Market Report

March 31, 2025

The Correction We Had to Have

At the start of 2025, global markets had strong momentum but also definitive signs of overexuberance. The uncertainty around the impact of tariffs and soft economic data has weighed on consumer sentiment and US equities – particularly tech stocks - have lagged stocks in international developed and emerging markets.

In a few short months, President Trump has thrown the market for global merchandise trade into chaos with his aggressive and unpredictable escalation of tariffs on allies and enemies alike. A few countries have retaliated with tariffs of their own, although at this time not all measures have actually been implemented. Some governments are negotiating with US officials to avoid a debilitating tariff war.

The biggest impact of tariffs on global equity markets has been in the US, where the S&P 500 has fallen by more than 7% since its peak in February, while the Nasdaq Index has fallen even harder and endured a technical correction as it has plunged more than 10% from its highs.

Furthermore, the emergence of DeepSeek - a Chinese AI startup - has challenged the U.S. Tech industry's dominance, raising concerns about the sustainability of AI-driven market valuations, which has particularly impacted the share price of market leader Nvidia. While broader economic concerns have compounded the downturn in the Nasdaq, the correction may also be a sign of deeper shifts in the valuations of the biggest tech stocks.

At its March meeting the Federal Reserve refrained from adjusting interest rates for a second straight meeting holding the cash rate in the 4.25% to 4.5% range. However, the central bank said that it was still waiting for more progress on inflation, and clarity on President Trump's trade policies, before making another move. The message after the Fed meeting was that "Uncertainty around the economic outlook has increased".

Trump's trade war continues to fuel concern the US economy could stall. While most economists still don't anticipate America will fall into recession in the next year, they do say the chance of a contraction has increased. However, given that markets around the world hit record highs in 2024, it is worth remembering that - like the laws of gravity - what goes up must come down. The first quarter of 2025 may well have been the correction we had to have.

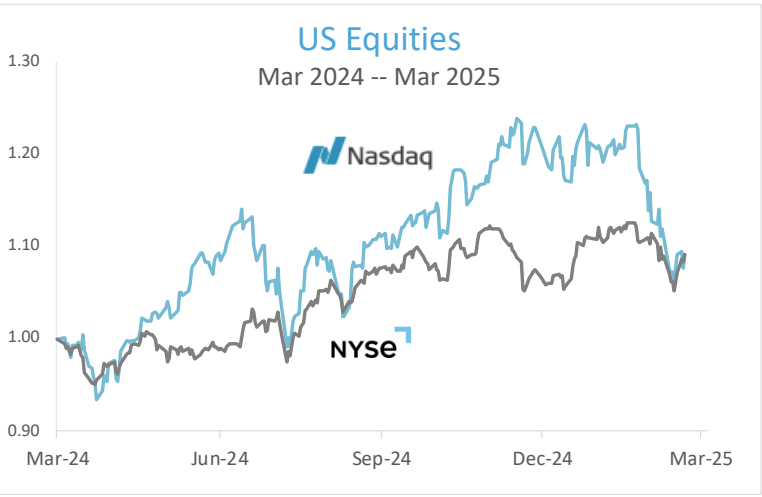
Equity and Bond Market Overview

WEAK DOMESTIC ECONOMY AND TARIFFS WEIGH ON ASX.

The Australian market is down -2.8% for the quarter and has returned 2.8% over the previous 12 months. Concern around tariffs, geo-politics and a generally weak domestic economy are all factors weighing on the market. In a concentrated market a handful of large stocks – NAB, CSL and Fortescue all had negative returns greater than -10%.

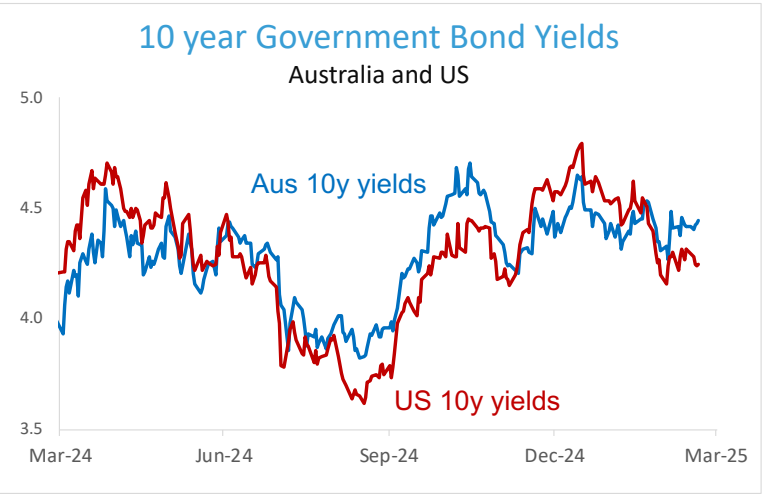
US MARKETS EXPERIENCE A CORRECTION ON US POLICY.

The S&P 500 Index returned -4.3% for the quarter on concerns around the impact of tariffs, even though recent data indicates the US economy remains resilient. The S&P 500 consists of stocks listed on the NYSE, which returned 2.1%, and stocks listed on the Nasdaq – home of the biggest tech companies - which returned -10.3%.



BOND YIELDS FALL ON WEAK ECONOMIC DATA.

10-year government bond yields in Australia and the US have performed a balancing act between potentially higher inflation brought on by US policy, and data that suggests that economic growth will remain soft. The Federal Reserve and the RBA both kept rates on hold, waiting for the effect of tariffs to play out.

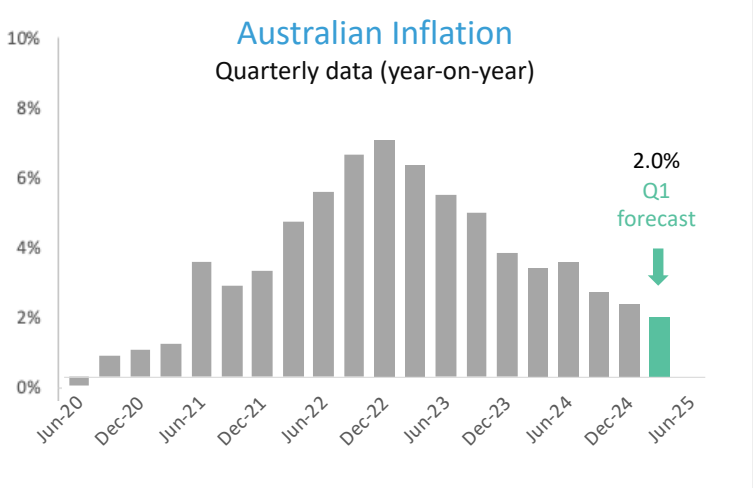


Source: investing.com

Economic Review and Forecasts

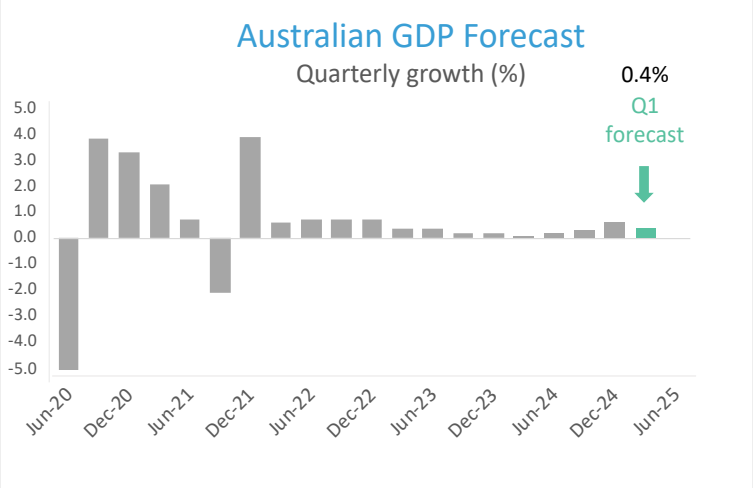
INFLATION CONTINUES TO FALL BUT REMAINS ABOVE TARGET.

Australia's annual inflation rate fell to 2.4% in Q4 2024 and is forecast to come down further to 2% in Q1 2025. Goods inflation has been easing, mainly due to steep declines in prices of electricity and fuel. The RBA's Trimmed Mean CPI rose 3.2% YoY, below forecasts but still greater than the central bank's 2-3% target.



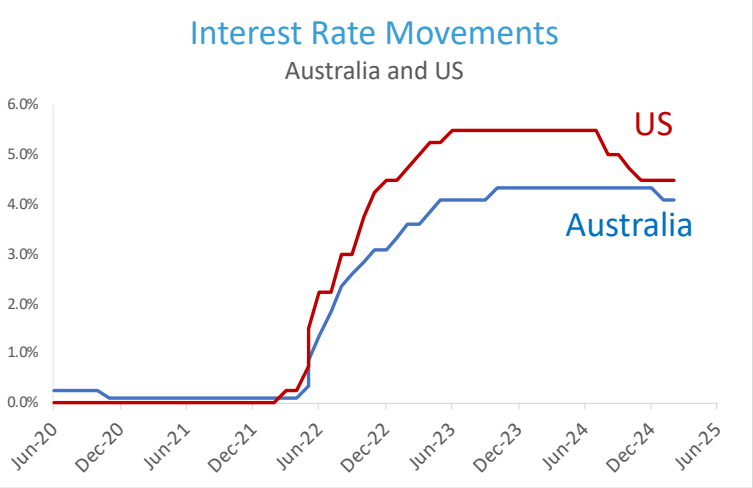
AUSTRALIAN GROWTH SLOW BUT CONTINUES TO IMPROVE.

The Australian economy grew by 0.6% QoQ in Q4 of 2024 and is forecast to grow by 0.4% in the March quarter. The Q4 result was driven by a rebound in household spending as expenditures on essentials like rent and healthcare continued to rise. The GDP Growth Rate is projected to trend around 0.5% in 2026.



CENTRAL BANKS REMAIN CAUTIOUS ABOUT RATE CUTS.

The Reserve Bank of Australia (RBA) cut the cash rate by 25bps to 4.1% at its February meeting. The Fed Reserve kept the federal funds rate unchanged at 4.5% during its March meeting in line with expectations. Policymakers noted that uncertainty around the economic outlook has increased but expressed confidence that inflation is moving downward.



Source: tradingeconomics.com

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Market Returns to 31 March 2025 (net returns, AUD)

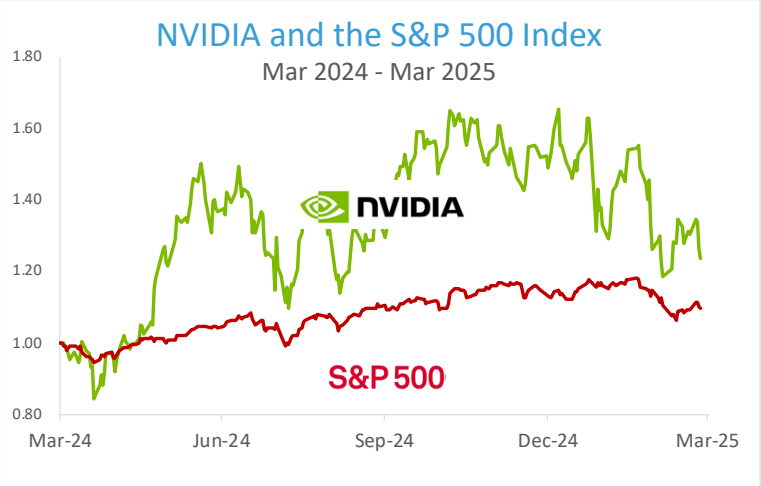
Asset Class	3 Months	1 Year	3 Year	5 Year	10 Year
Cash	1.1%	4.5%	3.6%	2.1%	2.0%
Australian Bonds	1.3%	3.2%	1.7%	-0.5%	1.8%
Global Bonds	1.0%	3.6%	0.1%	-0.5%	1.7%
Australian Equity	-2.8%	2.8%	5.6%	13.2%	7.1%
Developed Markets	-2.4%	12.2%	14.6%	15.8%	11.9%
Developed Markets (hedged)	-2.6%	6.7%	7.2%	15.2%	9.4%
Emerging Markets	2.3%	13.2%	8.0%	7.6%	5.8%
Australian REITS	-6.8%	-5.4%	3.6%	13.6%	6.7%
Global REITs	0.7%	10.4%	2.9%	7.5%	4.9%

Source: MSCI, Bloomberg, S&P Global

- The Federal Reserve and the RBA have kept rates on hold as they assess the impact of tariffs and sluggish economic growth. Longer bond yields have fallen over the quarter, boosting the returns from Australian and global bonds.
- The Australian market recorded a negative quarter on concerns around tariffs and a weak domestic economy. Major stock detractors were NAB, Fortescue and CSL.
- The Developed Markets have had a negative quarter as uncertainty around the impact of tariffs and soft economic data has led to a selldown in US equities – particularly in tech stocks. **The US accounts for around 70% of the Developed index**.
- The Australian dollar was down by more than 10% in the final quarter of 2024 but has been relatively flat since the start of the year. Consequently, hedging has not played a major role in the performance of international equities this quarter.
- Emerging Markets are positive for the quarter as China - **which accounts for 30% of the EM index** – has returned 14% (in AUD) despite the weak local economy.
- Global REITs outperformed global equities, but Australian REITs underperformed the local market due to Goodman Group, which is 40% of the A-REIT sector.

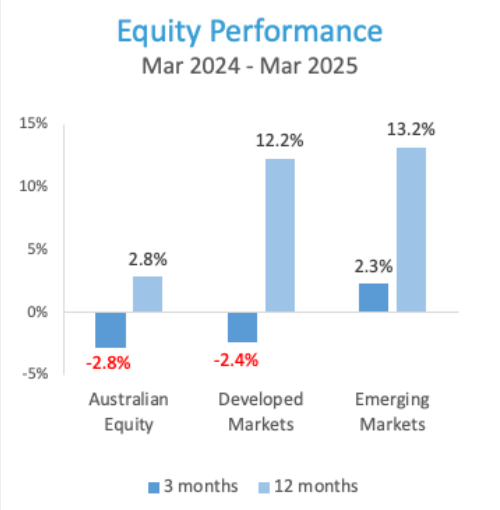
U.S. AI LEADERSHIP SHAKEN BY CHINESE START-UP DEEPSEEK.

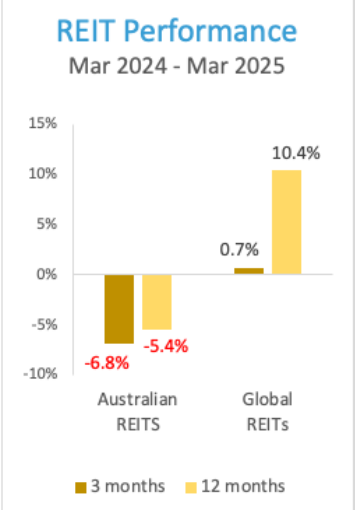
The emergence of DeepSeek has challenged the U.S. AI industry's dominance, raising concerns about the sustainability of AI-driven market valuations, particularly impacting Nvidia. While broader economic concerns have compounded the downturn in Nvidia's share price, the correction may also be a sign of deeper shifts in AI valuations.

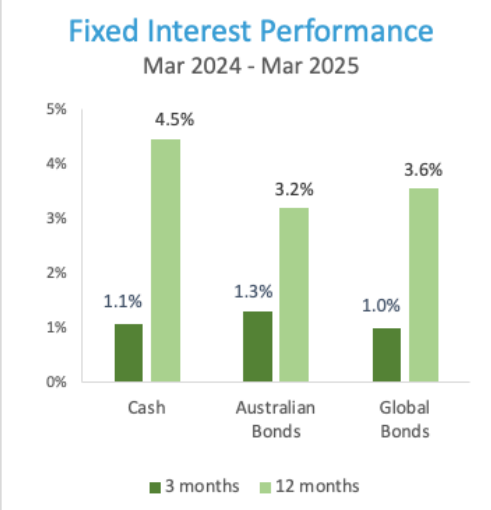


Source: investing.com

Market Returns (Chart)



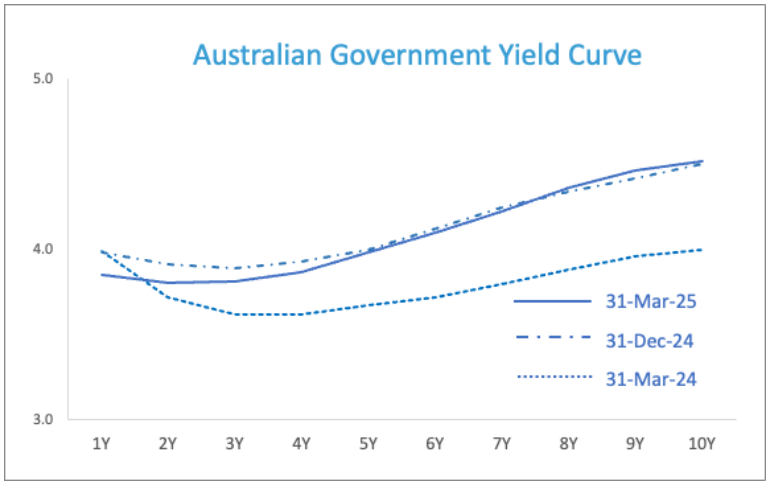




Yield Curves

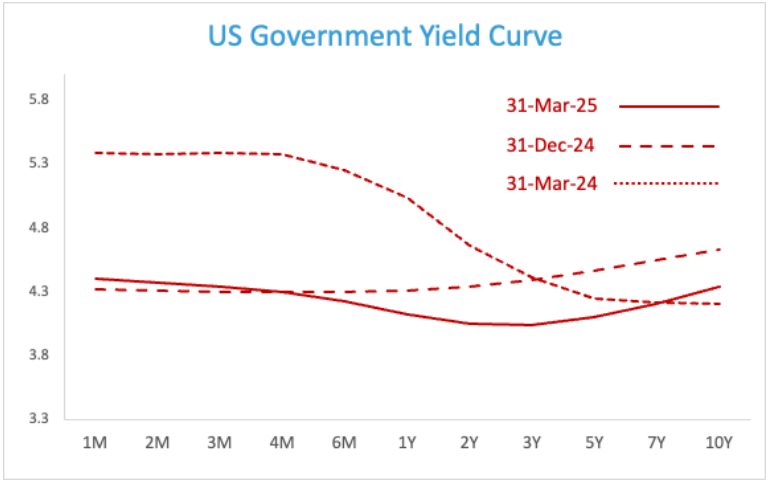
AUSTRALIA

While the RBA lowered its cash rate to 4.1%, the Australian yield curve is now reflecting an expectation that interest rates will remain around this level for the next year, although economists have different views on the direction of any interest rate change. The Australian economy is growing at its slowest pace in decades, but inflation remains stubborn and is falling only gradually.



UNITED STATES

The US yield curve is no longer "inverted", as 2 year yields are now lower than 10 year yields, the usual definition of a "normal" yield curve. Short term yields are reflecting an expectation that the Federal Reserve will make further rate cuts, while longer term yields indicate the market is ignoring inflationary effects from the Presidents economic policies.



Source: tradingeconomics.com

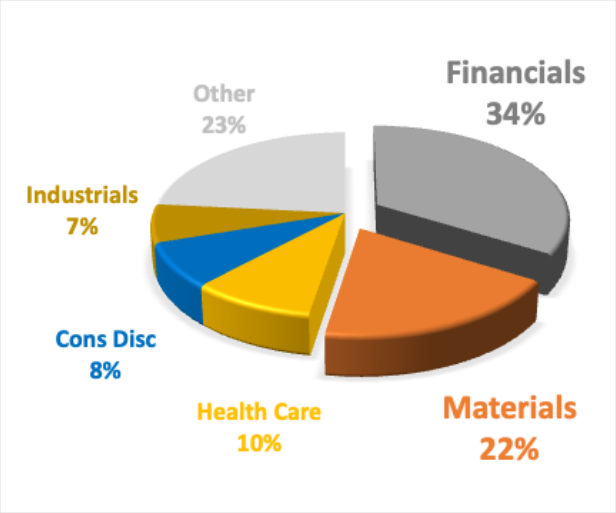
Sector Performance

AUSTRALIA

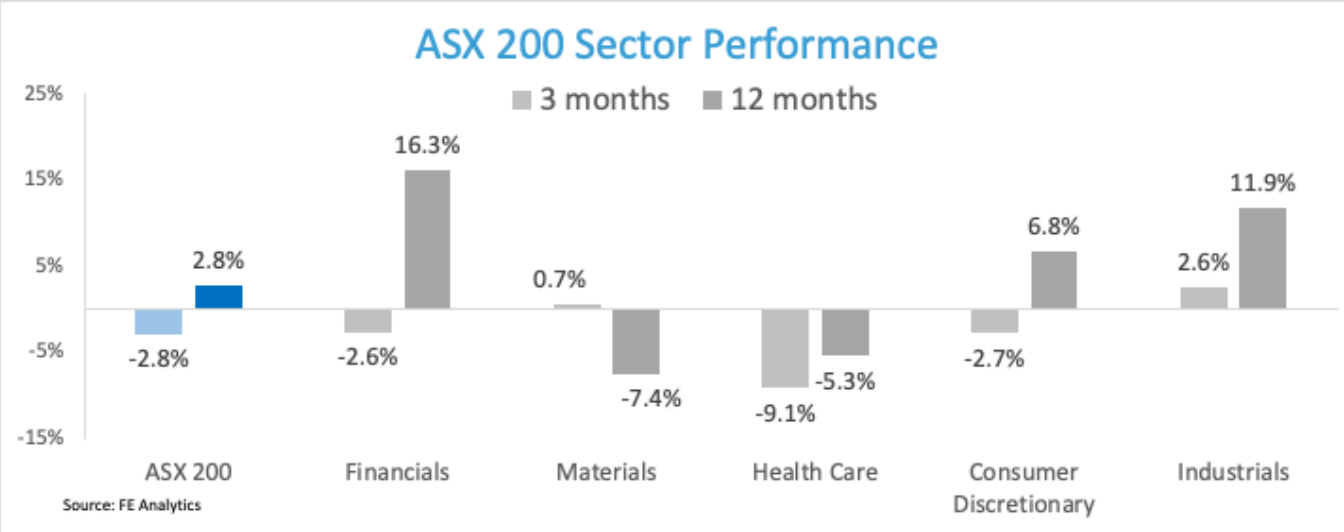
In 2024 Financials and Consumer Discretionary stocks performed strongly, while the Materials sector – dominated by the big miners – was down by more than 10% amidst falling iron ore prices. This quarter Financials, Health Care and Consumer stocks are negative on the back of a handful of large companies. IT stocks have been hit hard on the back of a global reassessment of valuations in this sector, although IT makes up only 3% of the ASX.

Sector	3 months	12 months
ASX 200	-2.8%	2.8%
Communication Services	1.5%	6.5%
Consumer Discretionary	-2.7%	6.8%
Consumer Staple	0.7%	-2.4%
Energy	-5.2%	-21.7%
Financials	-2.6%	16.3%
Health Care	-9.1%	-5.3%
Industrials	2.6%	11.9%
Information Technology	-17.5%	-0.5%
Materials	0.7%	-7.4%
Real Estate	-6.9%	-6.1%
Utilities	2.2%	16.1%

Five sectors make up approximately 75% of the market, with the two largest constituting more than 50%. The bottom chart shows the 12-month performance of the five largest sectors.



Sector	Weight	Cummulative
Financials	33.8%	33.8%
Materials	18.8%	52.6%
Health Care	9.3%	61.9%
Consumer Disc	7.9%	69.8%
Industrials	7.5%	77.3%
Real Estate	6.7%	84.0%
Energy	3.9%	87.9%
Consumer Staples	3.8%	91.7%
Communiation Services	3.8%	95.5%
Information Technology	3.0%	98.5%
Utilities	1.4%	99.9%



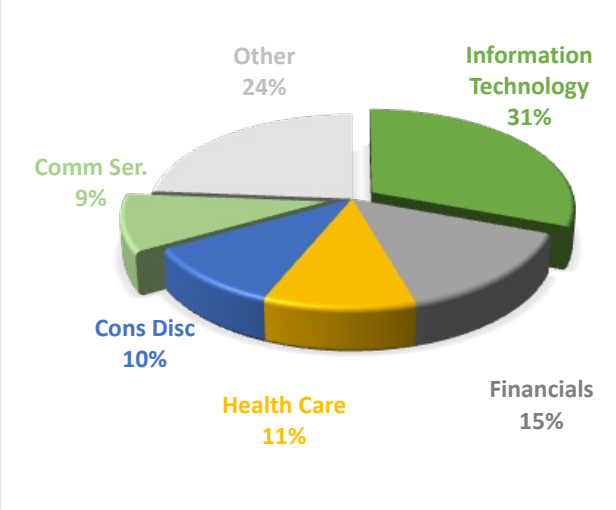
Sector Performance

UNITED STATES

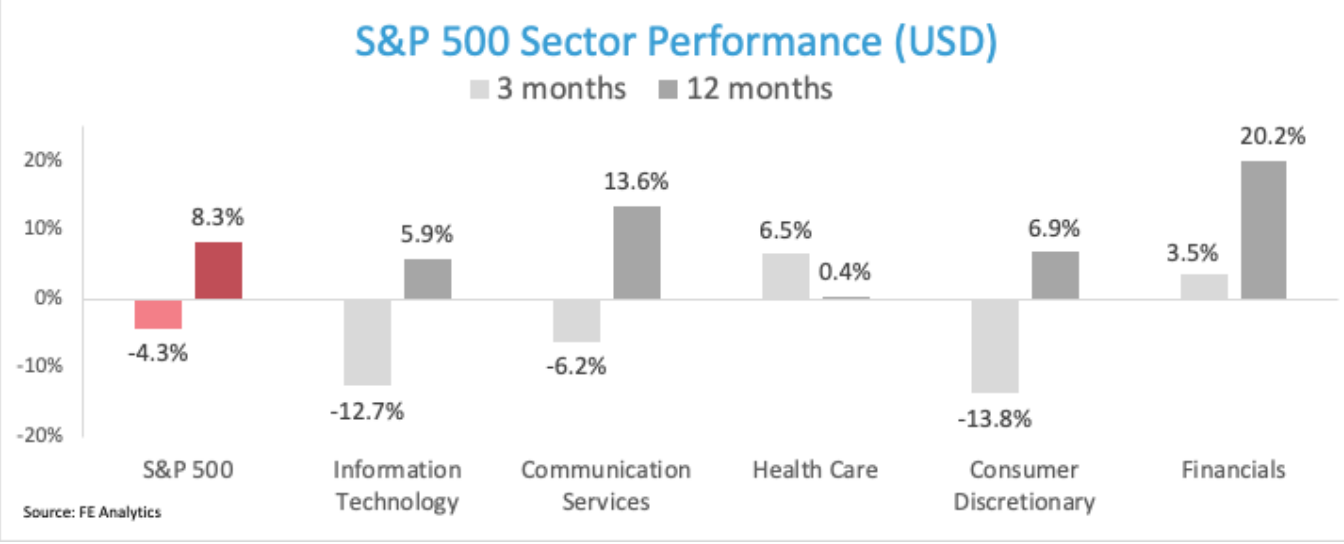
The US Tech sector (Communication and IT stocks) have benefitted from investor enthusiasm for AI over the last several years but have seen a correction this quarter in the wake of Chinese AI competitor DeepSeek and general uncertainty around the economy. Flagging consumer sentiment is reflected by the performance of the Retail (Consumer Discretionary) sector, while Energy stocks are up on rising natural gas prices.

Sector	3 months	12 months
S&P 500	-4.3%	8.3%
Communication Services	-6.2%	13.6%
Consumer Discretionary	-13.8%	6.9%
Consumer Staple	5.2%	12.4%
Energy	10.2%	2.5%
Financials	3.5%	20.2%
Health Care	6.5%	0.4%
Industrials	-0.2%	5.7%
Information Technology	-12.7%	5.9%
Materials	2.8%	-5.7%
Real Estate	3.6%	9.6%
Utilities	4.9%	23.9%

Five sectors make up approximately 75% of the US market, with Tech companies constituting around 40%. The bottom chart shows the 12-month performance of the five largest sectors.



Sector	Weight	Cummulative
Information Technology	30.7%	30.7%
Financials	14.8%	45.5%
Health Care	10.8%	56.3%
Consumer Discretionary	10.5%	66.8%
Communication Services	9.5%	76.3%
Industrials	8.3%	84.6%
Consumer Staples	5.8%	90.4%
Energy	3.2%	93.6%
Materials	2.3%	95.9%
Real Estate	2.1%	98.0%
Utilities	1.9%	99.9%

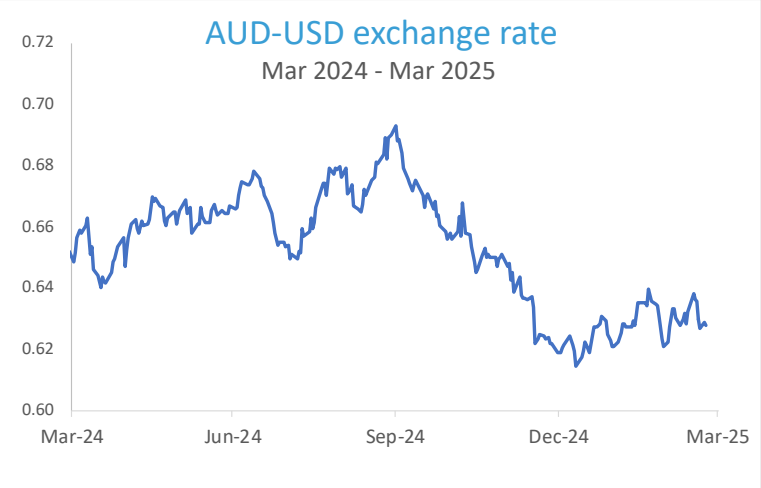


Currency and Commodities

EXCHANGE RATE

The Australian dollar finished just under $0.63 by the end of the quarter as the US dollar weakened on the announcement of increased tariffs on imports. President Trump also confirmed that tariffs would remain in place throughout his second term.

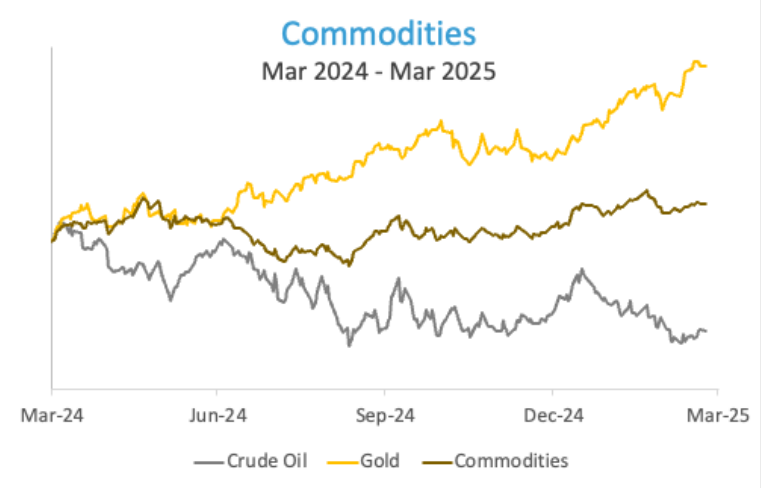
The Aussie is slightly up over the quarter having gained nearly 2% but is down -3.5% from 12 months ago.



COMMODITIES, OIL AND GOLD

The Commodity index is up 6% for the year, buoyed by the rally in gold which is up 19% for the quarter and up over 37% for the last 12 months. Oil and Gold make up around 30% of the Commodity index.

Gold is hovering at record levels mainly on elevated geopolitical risks, while Crude Oil has been negative for the year due to excess supply.



Source: www.investing.com

Dr Steve Garth
Principia Investment Consultants
April 2025