# Monthly Market Commentary with Portfolio Manager, Andrea Ciaccio

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**Market Review**

The America-first trade went into overdrive in November, as Donald Trump reclaimed the presidency, igniting "animal spirits" in US financial markets and corporations. According to data provider EPFR, investors poured 139.5 billion USD into US equity funds following Election Night, the biggest monthly inflow on record going back to 2000. The so-called "fear of missing out" (FOMO) reached such a fever pitch that global allocators pulled money out from the Rest of the World (RoW) to finance their purchases of US stocks. EPFR calculates that emerging market funds suffered net withdrawals of 8 billion USD, including around 4 billion USD exiting China-focused vehicles alone, while funds investing in Europe and in Japan lost around 14 billion USD and 6 billion USD respectively. In other words, it was not a case of a rising tide lifting all boats; instead, Trump's victory and the Republican electoral sweep have created clear winners and losers, at least in the eyes of market participants. The flurry of announcements about second-term cabinet picks and nominees for other top administration positions that came out during the month appear to have reinforced such a conviction, strengthening the trend of US dominance.

The greenback was an obvious beneficiary of the US acting like a sort of "black hole" sucking up global liquidity. The US Fed Trade Weighted Nominal Broad Dollar Index, which includes a larger number of currencies compared to the Dollar Index (DXY), thus reflecting more accurately the relative value of the US Dollar, ended the month only 0.75% below the all-time high it recorded back in October 2022; back then, the stock market was just at the start of the current bull run. The US 10-year yield was an unexpected winner. After spiking 20 bps higher in the aftermath of the election, it spent the second half of the month retracing the movement, closing 12 bps lower than it was at the end of October. On November 22nd, Trump picked the billionaire hedge fund manager Scott Bessent to serve as Treasury Secretary, soothing bond markets nerves. Integral to the newly found calmness is Bessent's ambitious "3/3/3" plan, which calls for achieving 3% annual growth, boosting domestic oil production by 3 million barrels per day and reducing the budget deficit to 3% of GDP (from the current 7.1% level). Not surprisingly, commodities reacted negatively to the news, with the WTI crude falling to a 3-year monthly low, a collateral damage of Trump's promise to "drill, baby, drill".

Volatility was another big loser, with the VIX Index, the measure which estimates the expected volatility of the S&P 500, crashing 41.67% to 13.51, its second most severe monthly decline in history. The MOVE Index, which calculates the future volatility in US Treasury yields implied by the option market, was on the move as well, dropping 29.56% to a still historically elevated 95.22; however, the monthly fall was the 4th largest on record. The prospects of "Trump 2.0" weighed on the already beaten down European assets. During the month, the Euro fell to its lowest level since November 2022 vis-à-vis the US Dollar. Worse still, at the end of the month, the Stoxx Europe 600 was on track to log its worst year of underperformance relative to the S&P 500 since 1976 in local terms, that is, without considering the impact of currency change in the returns, and despite its forward P/E trading at a record 40% discount. In November, the CAC 40 fell into negative territory year-to-date amid the political uncertainty created by the potential collapse of the French government and the developments from across the Atlantic raising the spectre of a new trade war. As a result, France's blue-chip benchmark was trailing its German counterpart by the most since 1993 year-to-date.

The euphoria that gripped crypto currencies deserves a dedicated chapter. Bitcoin jumped 36.90%, closing in on the 100,000 level and overtaking silver in terms of market capitalisation to become the 8th largest asset globally. The iShares Bitcoin Trust, which just launched in January, racked up 5.8 billion USD in inflows to reach 47.8 billion USD in assets. Ethereum, the second largest cryptocurrency in terms of market cap, recorded its 9th best month ever, rising 44.81%. The blockchain industry was looking forward to a new, friendly administration, and based on Trump's selections, it appears it may get its wish. In fact, Howard Lutnick, head of brokerage and investment bank Cantor Fitzgerald, was chosen for the role of Secretary of Commerce. Cantor Fitzgerald, which is majority-owned by Lutnick, is the main custodian of the 134 billion USD in assets, primarily US Treasury bills, which back the value of Tether, the largest stablecoin in the world and the largest cryptocurrency in terms of trading volume. Tether is a digital token pegged 1:1 to the greenback that has come under scrutiny due to its offshore operations and questions about the integrity of its reserves. Back in October, the Wall Street Journal reported that Tether was under investigation by the Treasury and Justice departments for possible violations of anti-money laundering and sanctions laws. Lutnick has already assured that he will step down from the brokerage firm and divest himself from any interest to "to comply with government ethics rules"; however, crypto currencies are betting that his appointment will help Tether's cause.

**International Equities**

US equities recorded their best month of 2024 in November. The S&P 500 added another 5.73% in USD terms, bringing its performance since the beginning of the year to 26.47%, its best 11-month stretch since 2013. The most popular benchmark for US equities was on track to outperform the Nasdaq 100 (+5.23%) on a yearly basis for the third time in the 2020s; however, both averages underperformed the Dow Jones Industrial (+7.54%) during the month, with the latter seeing Nvidia replacing Intel in its composition. The Russell 2000 (+10.84%), the popular benchmark for smaller companies, exploded higher, finally surpassing the prior peak set in November 2021. The "Magnificent Seven" soared as Tesla skyrocketed by almost 40% on expectations that Elon Musk will play a key role in shaping the incoming administration's policy agenda after he spent 259 million USD to help Trump secure the presidential election. The richest person in the world has been chosen along with entrepreneur Vivek Ramaswamy to head the "Department of Government Efficiency" (DOGE), a task force aimed at slashing government spending and regulations. Retail investors snapped up highly speculative stocks, with the GS Non-Profitable Tech and the GS Liquid Most Short recording their 8th and 5th best month in history respectively. Consumer discretionary and financials rose double-digits, with the latter sector seen benefiting from deregulation efforts. The S&P Regional Banks Select Industry Index TR and the S&P 500 Investment Banking & Brokerage Sub Industry Index TR logged their 12th and 9th best month respectively in anticipation of a boom in mergers and acquisitions in the US. Cyclicals beat defensives, with industrials, energy and communication services topping the list, while real estate, consumer staples

and utilities lagged. Healthcare was the worst performing sector, as the nomination of Robert F. Kennedy Jr. to become the next health secretary rattled "Big Pharma".

The "American exceptionalism" was in full display as the MSCI USA Index TR outperformed the MSCI AC World Index ex USA TR Index by the most in history. The RoW ended the month in the red in AUD terms, dragged lower by Europe and emerging markets, while Japan posted modest gains. All in all, the MSCI AC World Daily TR was up 3.74% in USD terms and 4.47% in AUD terms.

**Australian Equities**

Australian equities posted solid gains in November, but could not keep up with their international peers in AUD terms. However, they held up well once the US is stripped out, beating the MSCI AC World Index ex USA TR Index by more than 400 bps for the month. The S&P/ASX 200 ended November on a high note, hitting new all-time highs in the last week of trading. Positive stock-level news flow drove the domestic market higher, more than compensating for the uncertain macroeconomic backdrop weighing on the RoW. The S&P/ASX 300 rallied 3.68%, with several sectors rising by more than 5%. Technology, utilities, financials, consumer discretionary, industrials and telecommunications strongly outperformed the general index on the back of the well-received results released by their major constituents, with Xero, Origin Energy, CBA and QBE all rising double digits. Healthcare trailed the general index and consumer staples continued their lagging streak. Energy bucked the trend, while miners tumbled, driving materials lower despite James Hardie reversing almost entirely the steep losses suffered in October. The Top 20 underperformed mid-caps, but trounced smaller companies. Finally, growth stocks edged out value stocks for the 3rd month out of 11 in 2024.

**International Fixed Income**

Global central banks cut by a cumulative 150 bps during the month. On November 6th, the Bank of England (BOE) lowered its official bank rate by 25 bps to 4.75%, its second reduction since August. On November 7th, the Riksbank, Sweden's central bank, slashed its key policy rate by 50 bps, from 3.25% to 2.75%, its first jumbo cut since July 2014 and the fourth cut since May. On the same day, the FED decreased its target rate by 25 bps, bringing it to a range of 4.50%-4.75%. During his press conference, Chairman Powell stated that he would not step down should Trump, who picked him in 2017, only to criticise him for the following three years, ask for his resignation. On November 27th, the Reserve Bank of New Zealand (RBNZ) lowered its Official Cash Rate (OCR) by 50 bps, from 4.75% to 4.25%. Among major global central banks that met during the month, only the Norges Bank, Norway's central bank, left interest rates unchanged. Across major emerging markets, the Central Bank of Brazil (BCB) hiked rates by 50 bps to 11.25% and left the door open for further increases, urging the government to implement a credible fiscal plan and rein in expenditures.

Two significant milestones were achieved during the month. In Europe, at the end of November, the yield offered by a 10-year Greek government bond was matching that of a French note of the same maturity for the first time on record. In Asia, China's onshore fixed income market flashed a "Japanification" signal, with the difference between the 30-year government bond yields of China and Japan dropping below zero for the first time in history (2.22% Vs. 2.28%). The Bloomberg Barclays Global Aggregate Index hedged back to AUD was up +1.16% for the month, as yields declined across the globe.

**Australian Fixed Income**

On November 5th, the RBA held the cash rate steady at 4.35% for the eighth consecutive meeting, a widely anticipated decision. The Australian Bureau of Statistics (ABS) monthly indicator of consumer prices (CPI) remained steady at +2.1% YoY in October, below the consensus forecast of +2.3% and the lowest annual inflation rate since July 2021. However, the CPI Trimmed Mean, the measure preferred by the central bank, ticked up to +3.5% YoY (from +3.2%), indicating little sequential progress on services inflation. The labour market showed signs of cooling down in October as the unemployment rate came out at 4.1% for the third consecutive month with the participation rate edging down to 67.1%. The Bloomberg AusBond Composite 0+ Yr returned +1.14% for the month, as the Australian yield curve transposed lower, with the 2-, 5- and 10-year yield declining by 9 bps, 15 bps and 16 bps to 3.95%, 3.97% and 4.34% respectively. The Australian Dollar was a mixed bag, weakening against the US Dollar and the Japanese Yen and appreciating vis-à-vis major European and emerging markets currencies.

**Real Assets**

Global property added 2.24% in USD terms and 2.95% in AUD terms in November. The US was the only region to outperform the general index, Australia came a distant second and Europe and Asia finished lower. Sector wise, the positive momentum in data centres persisted, while residential, regional malls and shopping centres rebounded.

Global infrastructure rose 3.19% in USD terms and 3.90% in AUD terms for the month. Energy infrastructure was the best performing segment, with mid-stream and gas utilities leading gains on potential policy shifts. Conversely, renewables, communication infrastructure and transportation stocks lagged.

**Alternatives**

Returns for Alternatives (+0.81%) were mostly positive across strategic mandates in November, with performance dispersion expanding during the month. Event Driven strategies and Long/Short equities benefited from projections of a stronger economy and a more business-friendly regulatory environment.

**Market Outlook**

In a remarkable turn of events, the Democrats managed to lose the White House with the economy growing at an annualised real rate of around +3%, consistent with the trajectory of the past 2 years, the unemployment rate tracking at 4.1%, significantly below the long-term average, and home prices and the stock market at all-time highs. According to the large majority of election post-mortems, Americans decided to look beyond the rosy headline numbers and the splendour of the strongest economy in the world, choosing instead to voice their dissatisfaction over inflation and immigration. The working-class in particular voted for a change, entrusting Trump with the mandate of restoring its purchasing power. Not only do we agree with that reading, but we go further by suggesting that high prices and open borders were the inevitable byproducts of a deliberate policy choice of running the economy hotter for longer. In our view, the unprecedented amount of deficit spending unleashed by the government in response to the pandemic first, and by "Bidenomics" afterwards, was the deeper cause of the "great inflation", defined as the US CPI rising by +5% or more year-on-year, experienced between May 2021 and April 2023. Initially, the FED enabled such fiscal generosity by continuing to increase the size of its balance sheet via Quantitative Easing (QE) and by maintaining its target rate at the zero-bound. In fact, the central bank stopped its purchases of Treasuries and administered its first 25 basis point hike only in March 2022, when inflation was already running at +7.9% year-on-year and accelerating. However, after it became apparent that price pressures were not "transitory", the FED responded forcefully and embarked on its most aggressive tightening cycle in decades. Fast forward to August of this year, Chairman Powell took the podium at the Jackson Hole conference to declare "mission accomplished" on inflation; on that occasion, he attributed the merit of achieving stable prices without a sharp rise in unemployment to the actions of the central bank.

In reality, monetary policy tells only one part of the story; another crucial factor had been at work under the surface all the while, preventing wage growth from spiralling out of control while, at the same time, sustaining the economy, and that was immigration. A recent article published by the New York Times analyses the data provided by the Congressional Budget Office (CBO), a federal agency tasked with providing budget and economic information to Congress, and concludes that "the immigration surge of the past few years has been the largest in US history, surpassing the great immigration boom of the late 1800s and early 1900s". In fact, annual net migration, that is, the number of individuals coming to the country minus the number leaving, averaged 2.4 million people from 2021 to 2023, propelling net migration during the Biden administration to exceed 8 million people, the most rapid surge in population since at least 1850. But there is more. It is estimated that the entire increase in the labour force observed post-COVID was driven by immigration. Also, according to Goldman Sachs, about 60% of immigrants who have entered the US since 2021, that is, around 5 million people, have done so without legal authorisation. The unprecedented population influx, coupled with the disproportionate representation of "illegals", "helped cool wage growth" and benefited Americans with higher income, "who do not compete for jobs with migrants", by reducing the cost of services. The article notes that "wage growth for Americans who did not attend college will be lower than it otherwise would have been for the next few years because of the recent surge". Those findings are coherent with what the FED itself pointed out in a note published back in October. It tells the tale of an increasingly bifurcated economy, one in which lower-income consumers are squeezed while wealthier Americans keep spending on the back of the "wealth effect", as "their homes and investments increase in value, while they also receive more interest and investment income during periods of higher interest rates".

The immigration wave appears to be behind us, but the government has so far refused to tighten its belt. To the contrary, the Biden administration has been rushing to spend as much money as allowed under federal law before the end of the term, continuing to dole out cash to the various initiatives launched under the Bipartisan Infrastructure Law, the CHIPS and Science Act and the Inflation Reduction Act. As a result, in the first two months of the fiscal year 2025 alone, the budget deficit has blown out to 624 billion USD, a 64% increase compared to the same period last year. Moreover, in the fiscal year 2024, the US government recorded a budget deficit of 1.8 trillion USD, around half of which, that is, 882 billion USD, was due to net interest rate payments. That compares unfavourably with the roughly 1.4 trillion USD recorded in nominal GDP growth over the same period, with the difference adding to the burden of the national debt. In other words, the US government appears to have hit the law of diminishing return, as an increasingly higher level of budget deficit is required to "purchase" a progressively lower level of economic activity. Treasury Secretary nominee Scott Bessent intends to reduce the budget deficit to 3% of GDP by 2028. He may be correct in his aim, but, in our opinion, he does not appear to have many tools in his arsenal to succeed, at least not in the short term. He can no longer boost economic growth via immigration, nor via job gains, as the US economy has continued to operate pretty much at full employment. He cannot count on the FED lowering rates enough to lessen the cost to service the exploding government debt, which has reached 123% of GDP. Tariffs on trade partners and the increased productivity resulting from deregulation have the potential to increase tax receipts and boost economic growth, achieving the desired outcome, but they are long-term fixes. For those reasons, we continue to think that the only way he can try to normalise the size of the US government relative to GDP next year is by "fiscal consolidation", that is, by reducing discretionary spending (at the margin) for the first time since 2022.

Putting it all together, we think that the risks to economic growth outweigh the risk of an inflation revival going into the first half of 2025. At the time of writing of this note (December 19th), financial markets across the globe have been spooked by the (allegedly) hawkish pivot of the FED. In fact, the central bank has lowered its target rate by 25 basis points to a range of 4.25%-4.50%, as expected, but it has reduced by 50 basis points the median projection for cuts over 2025 and 2026, raising the estimated level of the target rate to a range of 3.75%-4.00% in 2025 and 3.25%-3.50% in 2026. Following the news, stock markets have plummeted, government bond yield curves have transposed higher, and the Dollar Index (DXY) has spiked to its highest level since November 2022. While we did not expect the central bank to ditch its "asymmetrically dovish" reaction function so soon, such a shift removes the only option that was left to preserve and prolong the economic expansion, as everything else seems to be exhausted at the current juncture.

We see an increased probability of the macroeconomic backdrop evolving from one of a re-acceleration of the economy to a "growth scare", the exact opposite of what happened in Q4 after the central bank decided to kickstart its easing cycle with a bang, cutting by 50 basis points. As a result, we remain comfortable maintaining a fixed income exposure characterised by a duration comparable to that of the benchmark. The carry remains attractive, and more so after the recent, significant boost. Paradoxically, we suspect that next year the FED may end up cutting by the 100 basis points it was projecting at the end of September precisely because of its decision to guide for a lower number of cuts at its last FOMC meeting of the year. If our thesis is correct, this may put downward pressure on the US Dollar from here, with positive repercussions on growth assets once the current bout of volatility subsides.

**AZ Sestante**

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E: invest@azsestante.com | www.azsestante.com

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ESG pillar scores are displayed as a number between 0 and 100 with most scores range between 0 and 25. It is the asset-weighted average of the company environmental, social, governance risk scores for the covered corporate holdings in a portfolio. The scores measure the degree to which a company's economic value may be at risk driven by environmental, social, and governance factors. The risk represents the unmanaged risk exposure after taking into account a company's management of such risks.

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