ELEY GRIFFITHS GROUP

TO OUR PROFESSIONAL AND WHOLESALE INVESTORS

Market Review & Strategy

Global small and mid-cap stock indices spent June quarter consolidating the strong rally from October 2023, underperforming broader stock indices in the process.

It quickly became apparent that the 'Fed pivot trade' needed quenching, global economic activity was slowing and growing fear that the US Federal Reserve would not be capricious in lowering interest rates anytime soon. But that didn't last, with US breakeven inflation rates (a measure of short-long term inflation expectations) peaking and in retreat by mid-April, sparking a rally in US treasuries and thenceforward US stocks through quarter end.

Local equities traced a somewhat reluctant path to record closing highs in May. This was dampened by a mounting list of negative trading updates from ASX names, as well as an increasingly hawkish domestic environment of indefinitely higher rates and broadening inflation impulse.

June quarter seasonally marks the onset of earnings confessions, typically commencing from the annual Macquarie Australia Conference. Subdued trading commentaries included updates from a number of consumer-facing businesses such as **Kogan**, **Collins Foods**, **AP Eagers** and **Baby Bunting** resulting in lower share prices. Several companies active in NZ reported on-going challenging conditions whilst **Aristocrat Leisure** and **MMA Offshore** were among a few stocks who raised their earnings outlooks.

Merger and acquisition activity continued to ramp-up with ~ 13 new takeover bids launched during the quarter, making it 37 bids cumulatively since the market lows in October last year. This marks a return to levels of corporate activity last seen a decade or more ago. Takeovers/merger proposals were received for **Bapcor**, **Austal**, **APM**, **PSC Insurance** and **Capitol Health** just to name a few**.** **CSR** concluded its sixty-two-year listed life on the Australian Stock Exchange/ASX following a takeover by Cie de Saint-Gobain SA. The **C**olonial **S**ugar **R**efining Company was founded in 1855 and was one of Australia's oldest corporations.

Equity raisings and secondary sell downs were commonplace during the three months to end of June. The diversity (across industry) and deal size speaks to a growing confidence among investors, investment banks and corporates. Interesting to note the recent heightened level of global junior resource share issuance through the period according to analysis prepared by Morgans Financial. Raisings tallied ~ US$2.1bn for the quarter, appreciably higher than 12 months ago. Gold company equity issuance is back at the highest levels since December quarter 2021.

Highly anticipated IPO, **Guzman y Gomez,** joined the ASX in June. With expectations pitched high and, at times, baleful media coverage, the company debuted strongly with solid institutional investor support (Eley Griffiths Group included) and a price move of +36% on the first day of trade.

Technical Summary

Stocks

The US market is probably overbought by most short-term measures. Investors who subscribed to the time-honoured maxim of buying new highs in the **S&P500** have booked solid gains since January this year. Perversely, extreme 'overboughtness' in stock oscillators, such as that reflected in the RSI or Williams % R readings is indeed a very bullish signal and has been a reliable portend for stock prices this year.

I alluded to a looming change in the market order in the last *Encyclical*. This relates to the increasing stock concentration of the S&P500 with the top 10 stocks now comprising ~35.8% of the index, a 40-year high.

Market breadth and stock correlation measures are plumbing new lows. This clustering will move to crescendo at some point when investors recognize that for the top 10, 'mega-tech' names, cycling sequentially higher quarterly earnings growth becomes increasingly difficult. The law of large numbers begins to impact.

New stock leaders will be sought out from sectors whose earnings begin to recover from depressed levels. Materials/energy, healthcare and industrial sectors might be where the hunting is best. The de-concentration (rotation) process once underway historically runs for multiple years.

Experience tells me that stock market trends nearly always play out longer than investors expect, implying extended market concentration might have further to run.

At the time of writing the Australian share market was within cooee of its May, all-time high yet there is a dearth of excitement associated with this development. Investor indifference and a reluctance of players to 'buy' the bull market are important elements of any market campaign. June quarter saw a resurgence in the dominance of the **ASX20,** primarily led by powerful rallies in the banks.

Commodities/Currencies

The **US Dollar Index (DXY)** looks constructive, pacing a nicely balanced (in price and time) advance through recent highs and should not be underestimated. Strength against the yen has been simply stunning and the long term **USDYEN** chart is a textbook depiction of how unfolding bull market's take shape.

The **AUDUSD** cross rate is, more or less, trading in line with where it was one year ago and appears poised to break topside. Price action has been conforming into a tightening symmetrical triangle, with a covid-originated support line holding the unit in whilst a resistance line from September 2011 has checked all rallies since this time. The Aussie dollar will need to clear $0.7021 to confirm the commencement of a major bull campaign.

Gold is continuing to congest its big run up from February 2024. Recent all-time highs at US$2450/oz will provide resistance to the next up thrust. The chart does not appear overextended in contrast to when we last wrote about the metal post its melt-up. Futures positioning at 7.4:1 (long/short) is more acute than at March quarter close, where it sat at 4:1, which points to some vulnerability should prices not hold current levels.

Similar sentiments prevail for **silver** with any move through US$32.52/oz a potential precursor for a push to the historic high of US$49.50/oz (struck in 1980 and 2011 most recently). Trader positioning at 3.2:1 is healthier than that of gold.

Popular yardstick, the Gold-Silver ratio, currently sits at ~78x (90x at March quarter end), its retracement reflecting a bigger relative retreat from gold versus silver in the most recent downdraft. Elsewhere, traders should view the interesting set-up taking shape in the **palladium** market, with the metal recently validating support from 2008 and may have just found buyer interest precisely where it counts.

The LME's base metal index continues to grind higher in accordance with the primary trend. Copper's spectacular early June quarter rally had exhausted itself by period close, correcting to the midpoint of the past 4 years trading range. The 100 day moving average (aka the investment line) caught the sell-off and its upward trajectory confirms the trend to be intact.

The US-listed **S&P Metals and Mining ETF** remains a useful check on equity investor appetite for industrial metals and carbon steel producers. It remains in consolidation mode following a multiyear advance.

My enthusiasm for the energy complex in the March quarter *Encyclical* remains undented despite the subdued price action in the **Bloomberg Energy Index** (an amalgam of several oil and gas contracts) of late. A support line originating from March 2020 continues to guide the index higher. Worth noting that WTI Crude is clearing a series of resistance fans, indicative of renewed upside momentum emerging in the oil price.

The **US 10 year note** predictably stalled at ~ 4.63% and tracked lower, only to be caught by a support line from December 2021. The notes feel 'sticky-downward' (in terms of yield) with the likely path of least resistance upward. The long-term chart is indisputably bearish for bond prices moving forward.

Outlook

It is extraordinary the number of developed share markets perched or on the threshold of historic highs. Excluding the US stock market, investors either aren't aware of this or incredulous about this reality. I cannot recall the last *Australian Financial Review* headline proclaiming share prices at new highs or being dangerously overextended. In fact, the rally could do with some copy like that!

Equity markets have been quietly climbing the proverbial wall of worry with unrelenting geopolitical misery and macroeconomic challenges almost a daily event and not deterring the weight of money.

In an excellent recent *Goldman Sachs Exchanges* podcast, GS asset allocation strategist Christian Mueller-Glissman confirms the US economy to be at a classic late-cycle stage (viz. valuations full, margins high, Output gap positive and ERP low) with slowing earnings momentum and the need for a structural/innovation catalyst. It appears this business cycle has no shortage of innovation catalysts: Generative AI, de-carbonisation and a healthcare revolution, he offers. You could also throw in crypto/blockchain and infrastructure/re-shoring investment as well.

These structural catalysts are already providing additional runway for stocks, notwithstanding the late cycle phase tends to play out over and extended timeframe.

US credit spreads are tracking to normal settings whilst inflation continues to moderate and softer data and high real interest rates are framing the conditions for lower interest rates going forward. This is manna for risk assets.

The Australian business cycle is less advanced than its offshore counterparts with an involuted inflation position and the chance of lower rates a distant prospect. This is **not** news to investors but the ASX200 being 2% from all-time highs probably is!