ELEY GRIFFITHS GROUP

The Encyclical

September Quarter 2025

To: Our Professional and Wholesale Investors - Not for Retail Distribution

Market Review & Strategy

The September quarter saw equity markets extend the gains of the prior quarter with infrequent share price sell-offs providing the rarest of entry points for argus-eyed investors.

The US stock market climbed the proverbial wall of worry, inure to trade/tariff policy volatility, threats to Federal Reserve independence and the overthrow at the US Bureau of Labor Statistics.

Investors instead elected to focus on pending FOMC accommodation, tightening credit spreads (the thinnest since 1998), new floats in technology and fintech names (busiest since 2021) and the unfolding AI phenomenon with all its multipliers.

The US Fed actioned a heavily caveated rate cut late in the quarter, its first for 2025.

The local market saw the busiest quarter *The Encyclical* can recall. In fact the S&P/ASX Small Ords Accumulation Index had its second best quarter in a decade (+15.3%), only bettered by the index's June quarter 2020 rally (+23.8%).

The August reporting season generally bettered expectations, although FY26 earnings in aggregate were downgraded by brokers. Bank trading commentaries were constructive, retailers reflected buoyant consumer conditions and IT/financial names provided upbeat outlook commentaries. Domestic healthcare operators bemoaned weaker volumes and companies exposed to the US construction cycle felt the pressure of a challenging operating environment.

Professional investors will remember the results season for the extreme levels of share price volatility for companies whose earnings, guidance or both disappointed. Goldman Sachs strategist Matthew Ross observed that 46% of reporting ASX companies moved +/- 5% on result day, reportedly a record of sorts[1].

Stunning stock price implosions abound, among them included **James Hardie Industries PLC, Reece Limited, Sonic Healthcare Ltd** and **IPH Ltd**. Scant buying interest had returned to these names by the time of writing.

[1] Ross, M., "Australia's Key Themes from FY25 Earnings Season," Goldman Sachs Australia, 4 Sep 2025.

Perhaps the most remarkable share price response was reserved for **CSL Ltd**, a one-time top three ASX company (by market capitalization) and portfolio staple. An earnings and guidance miss, an R&D *mea culpa* from management, a proposed spin-off of the legacy vaccine business and a $750m stock buy-back landed poorly with investors. Summarised succinctly by one analyst as a 'Strategy air-swing', the stock finished September down 28% from its late July highs[1]. Fund managers can work a lifetime and not witness such a reaction from a market leader like CSL!

Equity capital markets were busy during the September quarter with new stock issuance and shareholder sell downs almost a daily event. Interests associated with the founding shareholders of Chemist Warehouse sold ~ $700m worth of **Sigma Healthcare** (resultant shares from the two-group merger) shares. Brookfield cheekily sold its second 26% tranche of **Dalrymple Bay Infrastructure Ltd**, Potentia quit its 19.8% interest in **Vista Group Ltd** and US agriculture group AGR Partners reduced its exposure to **Ridley Corporation Ltd**.

Significant equity raisings during the quarter included $750m for **Lynas Rare Earths Ltd**, $416m for **TUAs Ltd,** $316m from **Liontown Resources Ltd** $300m from **Paladin Energy Ltd,** $240m for **Sky City Entertainment Group Ltd** and $175m for **Cobram Estate Olives Ltd**.

Corporate activity remained a feature of the Australian market during the quarter. Notable was the elevated buy-side interest of financial sponsors, or private equity groups, with the collective lodging bids for **Johns Lyng Group Ltd**, **Infomedia Ltd**, **Lynch Group** and **Apiam Animal Health**. Caterpillar Inc bid for **RPM Global Holdings Ltd** and **Washington H Soul Pattinson & Co Ltd** completed its merger with **Brickwork**s Ltd, concluding the latter's 63-year ASX trading epoch.

Emeco Holdings Ltd and **Tyro Payments Ltd** each disclosed several unsolicited approaches during the period and Mitsubishi acquired a 15% interest in **FleetPartner**s, adding to its 5.15% position.

Technical Summary

Stocks

Our opening remarks in last quarter's *The Encyclical* now appear prescient given the ~35% rally in the S&P 500 since the Liberation Day lows.

It is significant that price action for the S&P500 found medium term trend support on April 7 on a trendline originating from the Covid March 2020 low (✓). Maximum bearish readings on the AAII survey of investors also printed at the time of this low (✓). This author cannot recall having previously seen a ~ 15:1 up day, such that occurred on April 9 in NYSE stocks. 10:1 up days are rarely seen and are unequivocally bullish when they present, so added certainty likely comes with this move (✓). It is heartening to see the equal-weight S&P500 level-pegging with the more popular market cap weighted version, suggesting a healthy participation from more and more stocks, making for a broader based rally (✓).

Investor (and financial media) interest has progressively rotated to small (Russell 2000) and mid (S&P400) cap companies, in step with the reactivation of FOMC accommodation. The Liberation Day lows were significant for these indices in that they threw off strong 'Coppock Indicator' BUY signals. At the time of writing, both indices had traded within reach of historic highs.

It is interesting to see Futures positioning in E-mini S&P500 futures swing around from 2.5:1 (long:short) at June quarter end to ~ 1.8:1 (short:long) indicating some caution on a part of professional investors post the upward move in stocks and should be viewed constructively.

It is instructive to observe Cathie Wood's **ARK Innovation ETF** + 52% CYTD and the **GS Non-Profitable Tech Index** +40% CYTD, classic indicators of the return of *animal spirits* and a newfound investor willingness to invest beyond the biggest 500 names in the US market.

Locally, the **All Ordinaries Index** has been on a breakneck trajectory to all-time highs, with expanding daily turnover and improving stock participation with each passing day. The benchmark spent September consolidating its run-up from the April sell-off, bringing the Williams %R oscillator back into a neutral setting, a valuable recharge station for stocks.

The **ASX Small Ordinaries** has been a massive outperformer since the Liberation Day lows, with price action effortlessly clearing the ominous triple-top formation of the December quarter 2021 and now in the rarified air of the early days of 2008-a period *The Encylical* would prefer to forget!

The dominant sub index performer being the **ASX Small Resource Index** up ~56.2% versus the **ASX Small Industrials Index**, up 16.4% CYTD.

Significantly, the Small Ordinaries benchmark is enjoying its best ever breadth, with 70% of constituents (as at 24 September) trading above the *investment line*, aka 100 day ma. As a reminder, good bull market health sees 55%-63% of stocks above, poor around 22%-25% this line.

The Small Ords is now within line of sight of the December 2007 all-time high of 4177.

The **ASX Mid Cap 50 Index** extended its climb to new highs, so too did the **ASX Emerging Companies Index**, long a laggard to the main indices but claiming historic highs in September.

Commodities/Currencies

The **US dollar** is continuing with its corrective phase with the break of support in May 2025 validated by the failed July 2025 return move. A close below the swing low of 96.22 is required before the next down leg can commence. The various US dollar cross rates confirm this precarious positioning.

The **AUDUSD** is a most beguiling chart. Several tests of a downtrend line originating in February 2021 have failed to yield, whilst a 24 year valid support line underpins the currency's primary uptrend with several test-and-hold sorties through the passage of time. Futures positioning, whilst net short, has seen reducing in recent weeks (from 100k lots net short to ~ 60k lots now). No shortage of fundamental reasons can be proffered for a move higher (refer to **The Log** below) and it is comforting to have the support of a sound technical set-up to further support the long case.

Currently **Gold** price action is enjoying the guiding hand of the *investment line*, as it powers to all-time highs post a mid-year period of consolidation between US$3205/oz and US$3425/oz. Our last commentary being that we were uncertain as to whether the hidebound price action was a portend to lower prices (exhaustion playing out) or higher prices (re-charging occurring). The resultant move in bullion now clarifies this dilemma! Futures positioning is a notch more extended than the close of June quarter at 5:1 long but well below the somewhat hysterical 8:1 settings of December 2024.

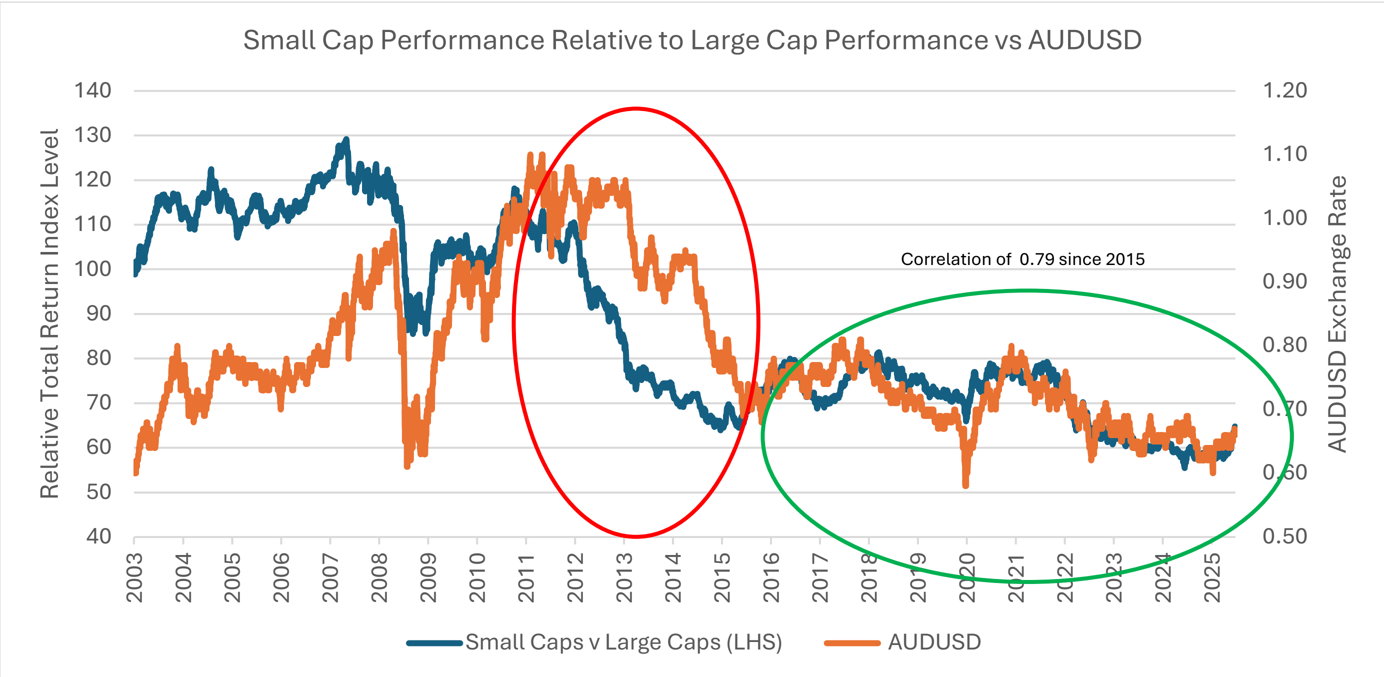
Gold equities, as expressed by the **VanEck Gold Miners ETF**, have finally taken out the highs struck in September 2011 in dramatic fashion whilst its more speculative sibling the **VanEck Junior Gold Miners ETF** is trading well shy of the highs of December 2010

The **silver** chart ha**s long** captivated *The Encyclical* as the magnetic effect of the all-time high of ~ US$49.00/oz-US$49.60 (chalked up in March 1980 and June 2011) pulls on the metal, last trading at US$48/oz. The zone of critical resistance between US$35.40/oz-US$37.40/oz gave way in August 2025 and cleared the path for an assault on the historic highs. Silver equities look primed with the **Global X Silver Miners ETF** conforming to a broad trend channel since 2016, its upper bound breached in September as share prices surged exponentially.

The gold/silver ratio has proven a useful relative yardstick for investors having averaged ~ 65x since the 1970's but within a recent range of 30x (2011) and ~120x (during covid). It currently sits at ~ 80x, suggesting a silver price catch up or mean reversion move is past due.

The Log – Back to the Future

When it comes to the outlook for Australian small caps, the AUDUSD exchange rate is a good tool in the investor's toolkit. Indeed, the correlation between the AUDUSD and the performance of small caps relative to the performance of large caps has been 0.79 since 2015. Periods like the Eurozone Crisis, when equity risk appetite was subdued, means the correlation was lower before then, but they still tended to move in the same direction.



Source: FactSet, Eley Griffiths Group. Small Caps is the S&P/ASX Small Ords Accumulation Index. Large Caps is the S&P/ASX 100 Accmulation Index.

In addition to both benefiting from broader sentiment and risk appetite, there is another fundamental reason why Australian small caps tend to coincide with a higher AUDUSD. According to data from UBS and FactSet, Australian small caps derived 63% of their aggregate last reported sales from Australia but that number for large caps was only 52%. Naturally, Australian small caps get a relative profit boost when the AUD appreciates; even better if their costs are in USD, as is the case for many small retailers.

There are several tailwinds for a stronger AUD, and by extension, Australian small caps but here are the two main ones in our view. First, outflows from US assets on the back of tariffs could boost the AUD (both directly from capital flows into Australia and indirectly from the stimulatory effects of a lower USD). Second, the US Federal Reserve may cut rates by more than the Reserve Bank of Australia (RBA) from here. Indeed, the RBA started cutting in February but held the cash rate steady at 3.6% at the September meeting, whereas September saw the Fed cut for the first time this year to 4.125%. If they continue cutting faster than the RBA, a relatively higher RBA cash rate would make the yield on AUD cash and assets more attractive and boost the demand for AUD.

The "parity party" period of the early 2010s, where 1 AUD bought you 1 USD is a distant memory for many. But a return to those levels would likely give small cap investors a reason to celebrate as well.

Outlook

Small cap stock indices appear to be in their *salad days* across global markets right now. This is in part due to the propensity of central banks toward lower interest rates and in part attributed to the broadening stock participation in a maturing share market rally.

Earnings certainty (and investor conviction), once the exclusive domain of large caps is now rotating to the mid-small company segment of the market.

Take the Australian landscape for example. FactSet estimates for FY26 highlight the Small Ords benchmark trading at a PE discount of ~ 7% versus the S&P/ASX100 despite offering 28.2% earnings growth against 5.3%. Excluding resource stocks, both segments trade at a PE of ~21.6x for their industrial stocks but with earnings growth of 15.7% for small versus 6.2% for large.

The forthcoming annual general meeting season will provide a window for investors to recalibrate these earnings expectations if deemed necessary. By November 28, when the season concludes, traders will have a better idea of how firm the ground is underfoot.

The Log above carefully articulates the close historical correlation between the direction of the AUD/USD and the performance of Australian listed small caps. The Eley Griffiths Group house view (including technical analysis above) has for some time advocated for a stronger currency moving forward. This should support small companies.

Prominent US strategists Andrew Parker and Mike Wilson on Morgan Stanley's excellent podcast *Thoughts on the Market,* craft a neat take on the health of the all-important US stock market. The duo contend that the US economy is presently transitioning from a rolling recession to a rolling recovery and new bull market. They offer a bottoming in the US labour cycle and a revival in earnings revision breadth as evidence for this. Further, the emergence of positive operating leverage has assisted, with a recovery in median earnings per share growth from flat to +6% starting from Liberation Day in early April 2025[2].

The *Encyclical* remains vigilant to the emergence of market deadfalls. The boom in US listed microcaps complete with mischievous 'pump-and-dump' schemes, as well as the exuberance on show in cryptocurrencies and associated treasury vehicles, are reflective of heightened investor 'animal spirits' and will need to be monitored as the market extends its advance.

[2] *Parker, A. & Wilson, M., "Why the Rolling Recovery Has Already Begun,"* Thoughts on the Market, Morgan Stanley podcast, 23 Sep 2025.