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# MORROWS PRIVATE WEALTH HALF-YEARLY MARKET UPDATE FEBRUARY 2025



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tailored your way



# MPW Half-Yearly Market Update - February 2025



## General Advice Disclaimer

The purpose of this presentation is to provide you general advice and insight into MPW's current market outlook and investment philosophy.

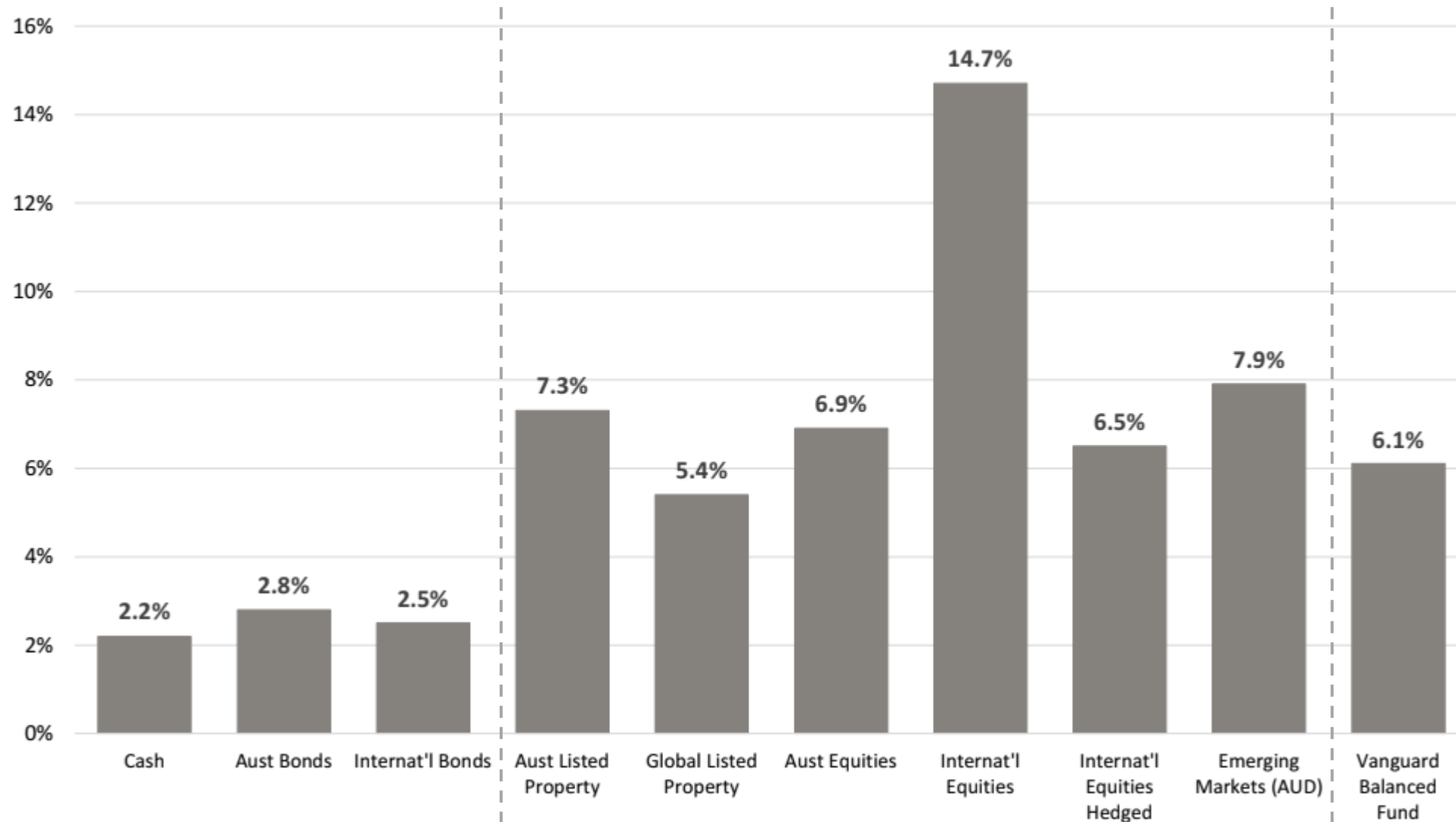
Where our presentation provides general advice, we must explain that this advice has been prepared at this time without taking into account your individual personal needs, objectives, or financial situation, and the personal information we hold about you has not specifically been considered in forming our views.

You should not act on any advice that has not been tailored to you or considered in light of your full individual personal circumstances, as there is a risk that such actions may not be appropriate for you or be in your best interests.

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# Asset Class Returns 6 Months to 31<sup>st</sup> December 2024



# The Narrative Changed in Back Half Of 2024

US **Leading Economic Indicators (LEI's)** were suggesting that recession risk was high, but there was a sharp rebound in these LEI's through the back half of 2024 which reduced the risk of recession, and improved economic and market sentiment.



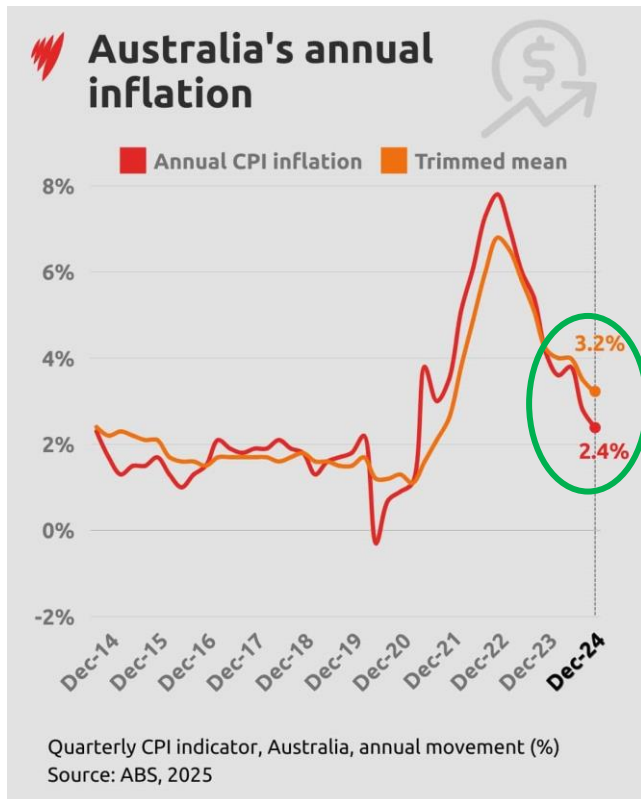
# MPW Outlook: Expect Volatility, But No Recession

1. Negative Growth (Recession) MPW Probability = Low	2. Trend Growth (Current) MPW Probability = Medium	3. Strong Growth (Bull Market) MPW Probability = Medium
<ul style="list-style-type: none"><li>• Inflation is sticky and moves higher</li><li>• Central banks hold or raise rates</li><li>• Unemployment rises 1-2%</li><li>• Savings rates evaporate</li><li>• Consumer spending slows sharply</li><li>• Economic data deteriorates</li><li>• Corporate earnings fall</li><li>• Geopolitical risks intensify (wars)</li><li>• Tariffs create global trade wars</li></ul>	<ul style="list-style-type: none"><li>• Inflation is sticky but moderates</li><li>• Central banks slowly cut rates</li><li>• Unemployment rises marginally</li><li>• Savings rates are neutral</li><li>• Consumers continue to spend</li><li>• Economic data not too hot or cold</li><li>• Corporate earnings remain positive</li><li>• No further sanctions or conflict</li><li>• Tariffs are moderated</li></ul>	<ul style="list-style-type: none"><li>• Inflation falls to central bank targets</li><li>• Central banks are accommodative</li><li>• Employment growth remains strong</li><li>• Savings rates increase</li><li>• Consumer confidence picks up</li><li>• Economic data strengthens</li><li>• Companies improve productivity</li><li>• Geopolitical risks and conflict abates</li><li>• No tariffs and global trade picks up</li></ul>
Markets are <u>not</u> priced for this, expect further decline from here (~-20% plus)	Markets <u>are</u> priced for this, value can be selectively found at current levels	Markets are <u>starting to price this</u> , risky assets will perform very strongly

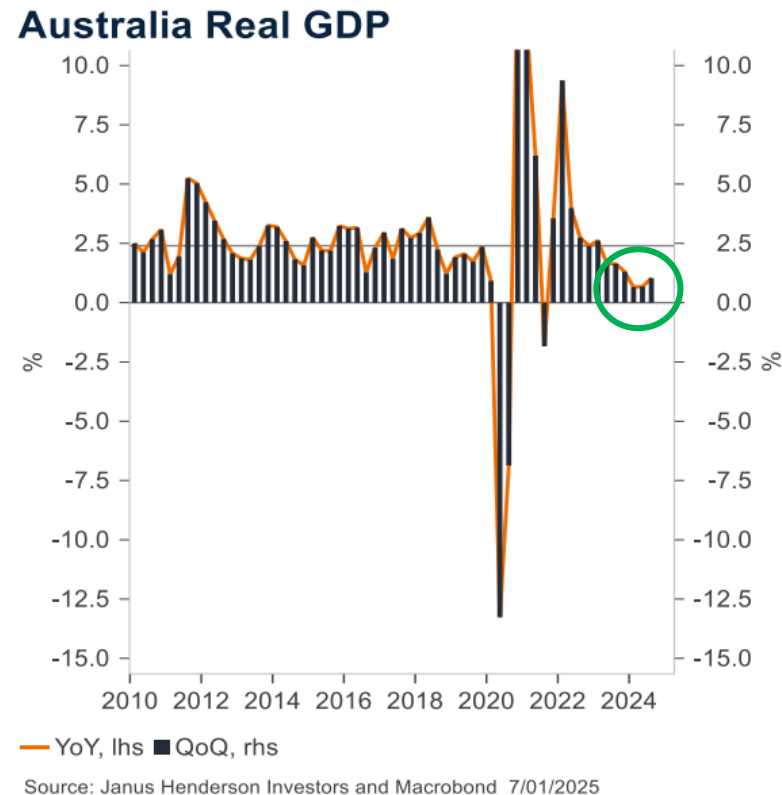


# Australian Inflation Risk vs Recession Risk

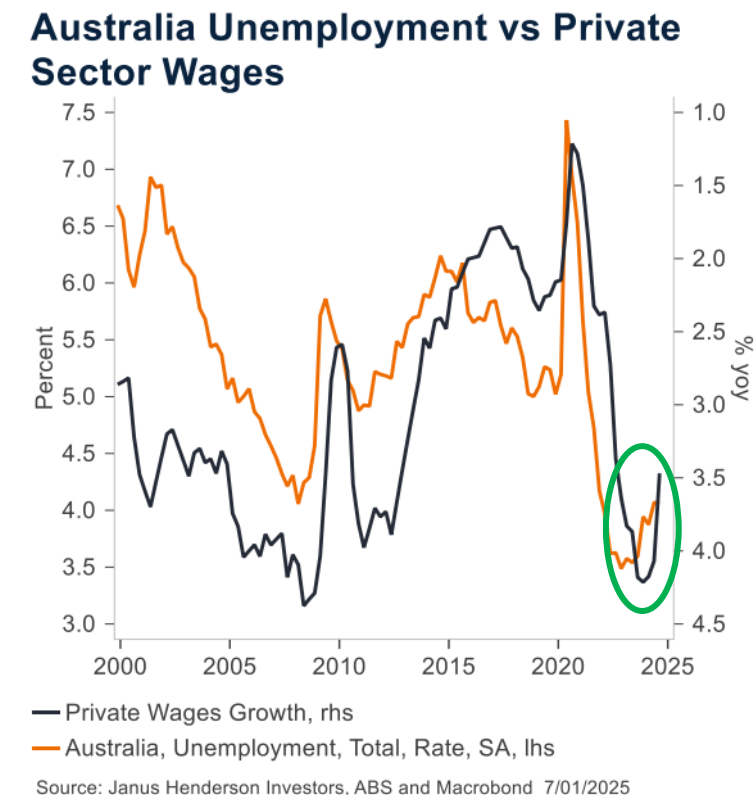
**Underlying Inflation** has fallen to 3.2% and CPI has fallen to 2.4%, prompting the RBA to cut interest rates 25 bps.



**GDP growth** has been low despite governments running large fiscal deficits to stimulate the economy.



**Unemployment** has risen from 50-year lows but remains tame at 4% and wages growth remains positive.

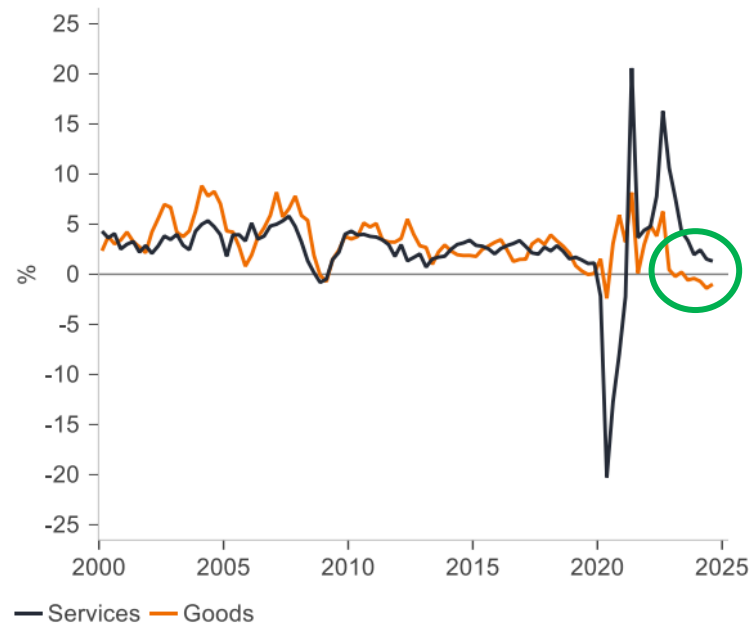


# Australian Consumers Have Been Resilient

**Household spending** is only on essentials and services, not goods, despite a rise in real incomes.

## Household Final Consumption Expenditure

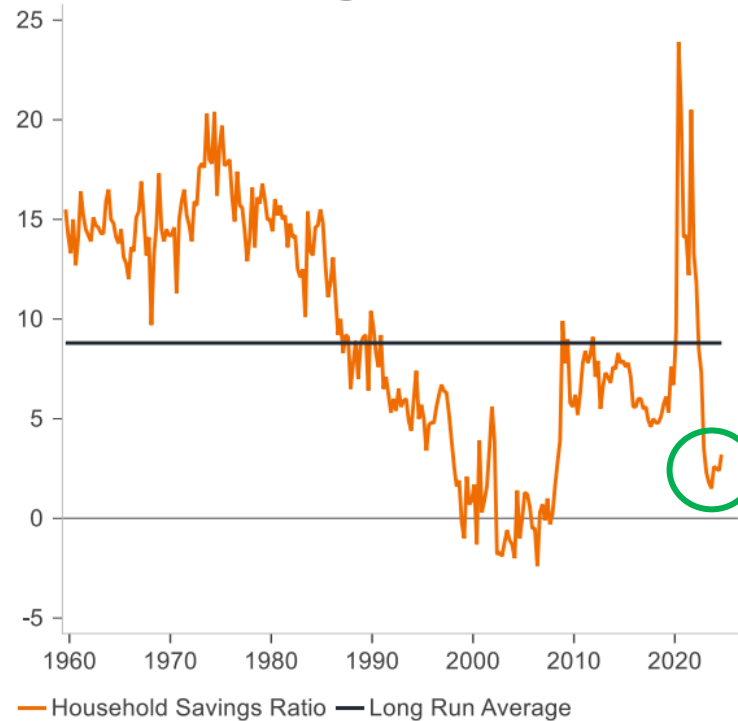
Chain weighted



Source: Janus Henderson Investors, ABS and Macrobond 7/01/2025

**Household savings** have started rising as inflation pressures reduce and consumer sentiment picks up.

## Household Savings Ratio

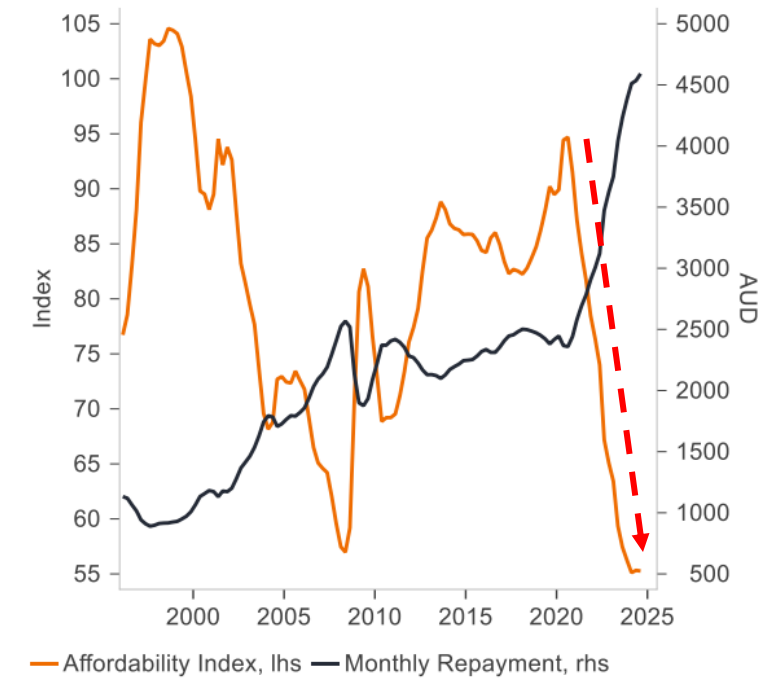


Source: Janus Henderson Investors, ABS and Macrobond 7/01/2025

**Housing affordability** is at historical lows whilst monthly mortgage repayments remain very high.

## Australia Housing Affordability

HIA. Lower index denotes worsening affordability.

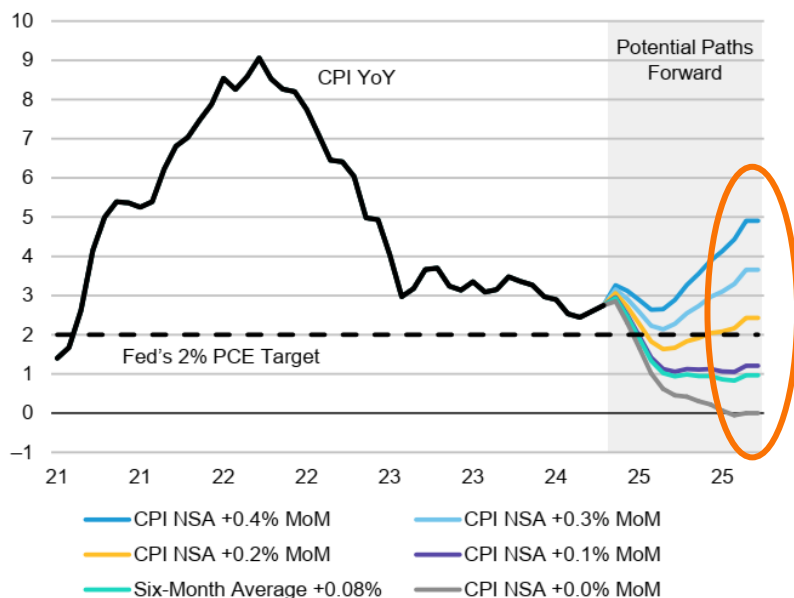


Source: Janus Henderson Investors, ABS, HIA and Macrobond 7/01/2025

# US Inflation Risk vs Recession Risk

**US inflation** remains 'sticky' and had a surprise uptick in January, meaning the Fed will hold rates.

Most Paths Forward Suggest Lower Inflation in 2025...but Beware the 1Q Data Seasonality (Percent)



Source: Bloomberg, US Bureau of Labor Statistics and AB

**US unemployment** is historically low, and the change in the rising trend reduces recession risk.

U.S. unemployment rate

January 2021–January 2025

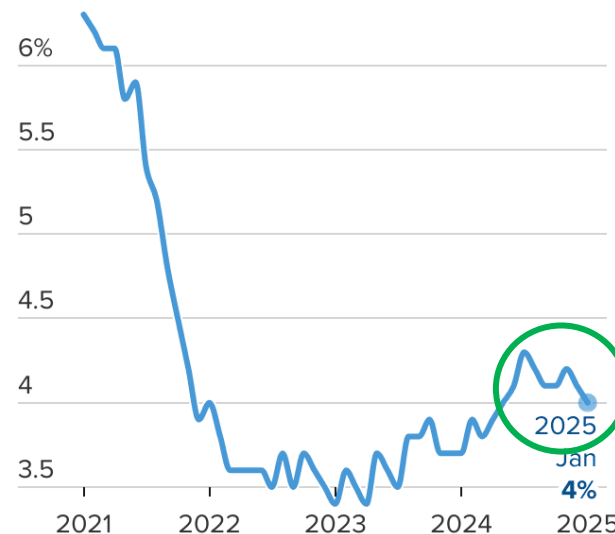
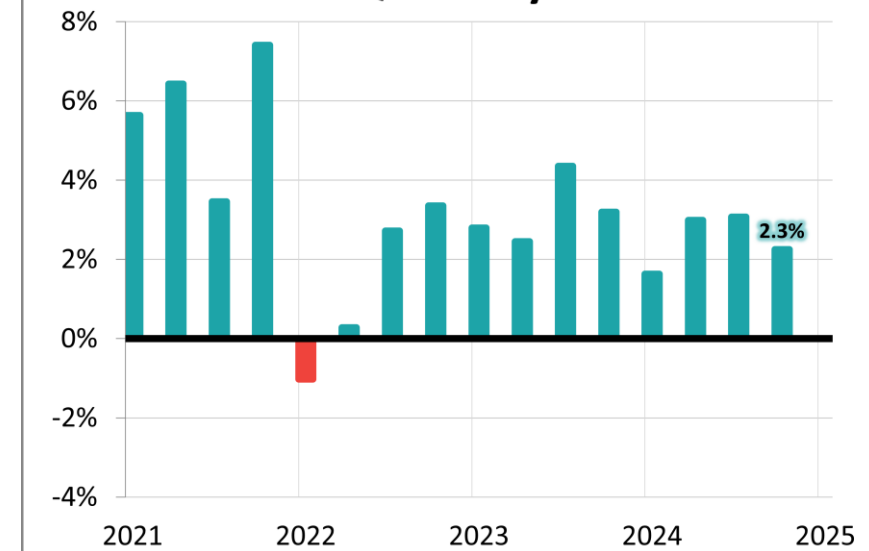


Chart: Gabriel Cortes / CNBC  
Source: U.S. Bureau of Labor Statistics  
Data as of Feb. 7, 2025

**US GDP Growth** remains solid and whilst it is expected to weaken it seems unlikely that a recession will unfold in 2025.

Real Quarterly GDP



VettaFi Advisor Perspectives

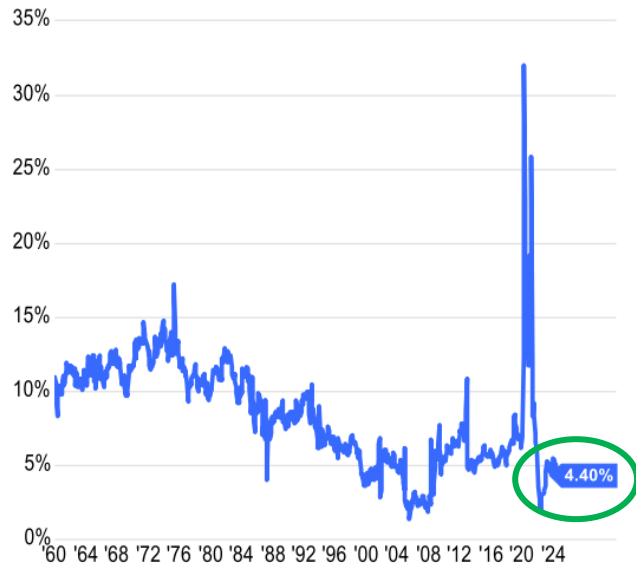


# US Consumers Continue To Borrow & Spend

**Personal Savings Rates** have moved higher supported by lower inflation and interest rate cuts.

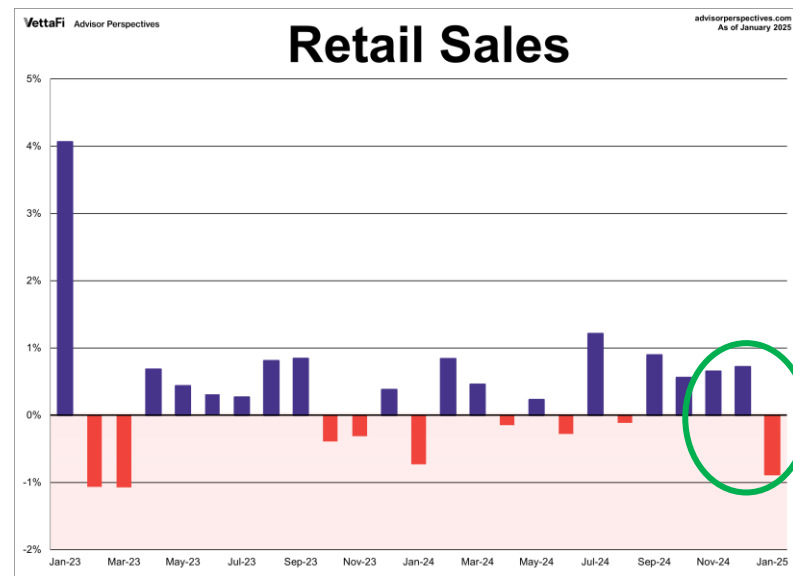
## U.S.: Personal Savings Rate as a % of Disposable Income

12/31/1959 to 11/29/2024



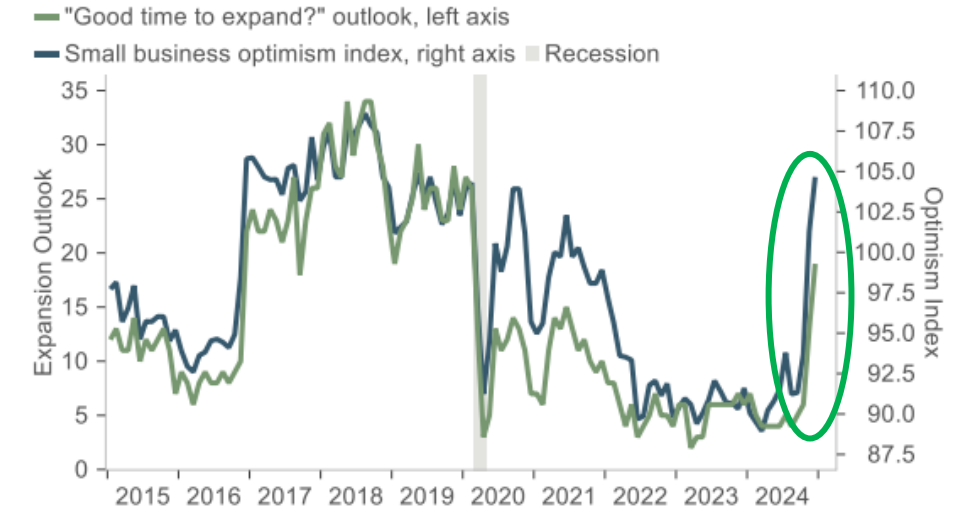
Source: FactSet, Federal Reserve System.  
Slide created by Franklin Templeton's Global Research Library.

**US Retail Sales** have been strong until January so we will see if this can reverse in coming months.



**Small Business Optimism** has spiked on the back of Trump's election win and policies.

## U.S. small business optimism has moved sharply higher



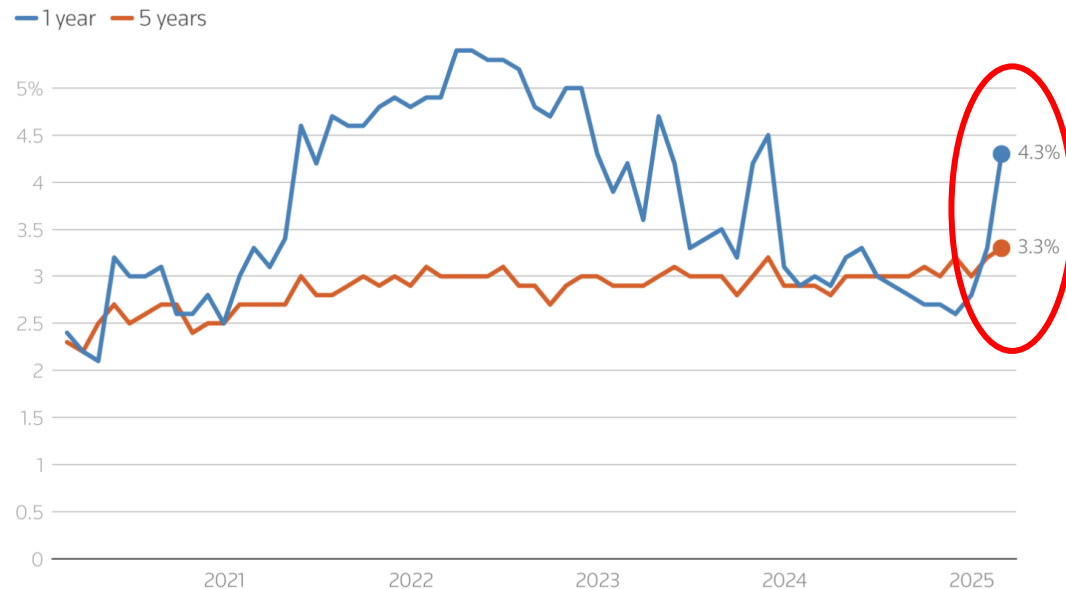
Sources: New York Life Investments Global Market Strategy, National Federation of Independent Business, NBER (National Bureau of Economic Research), Macrobond, January 2025.

# “Sticky” or Higher Inflation Is The Key Risk

Year-ahead **US inflation expectations** jumped from 3.3% to 4.3% in February, the highest since November 2023. Why? Large fiscal deficits & tariffs result in higher prices!

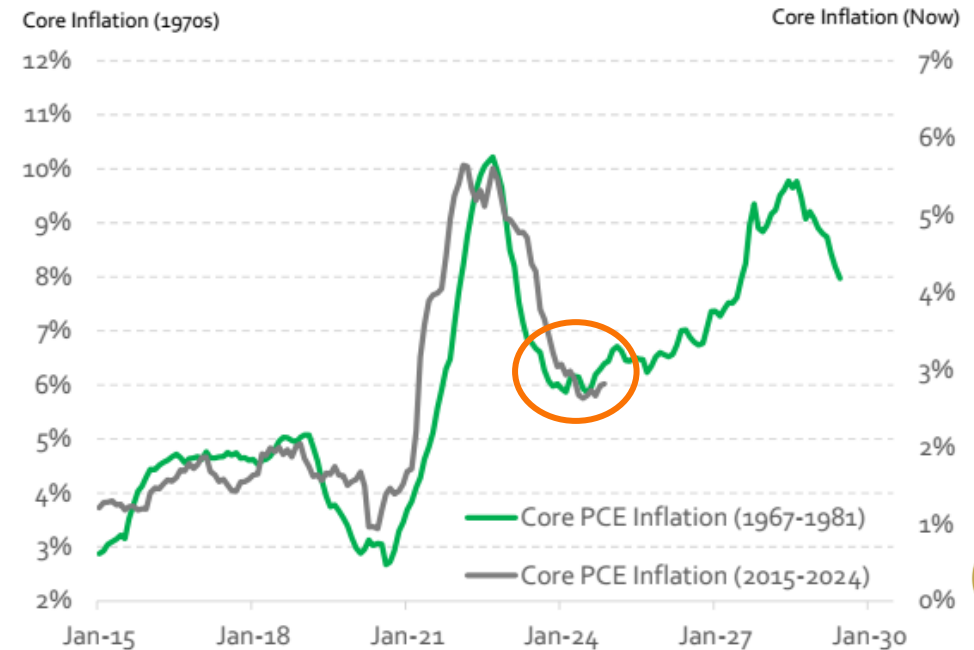
Does this mean the **US Fed** is on hold with further interest rate cuts? Maybe, as they don't want to repeat the mistakes of the 1970's which looks ominously close.

Inflation expectations of US consumers



The latest results are preliminary. Published February 7, 2025 at 3:08 PM GMT  
By Reuters • Sources: University of Michigan Surveys of Consumers, LSEG  
A line chart titled "Inflation expectations of US consumers" that tracks the metric over five years.

US Inflation – 1970s vs Today



Source: ABS, US Federal Reserve, EQ Economics

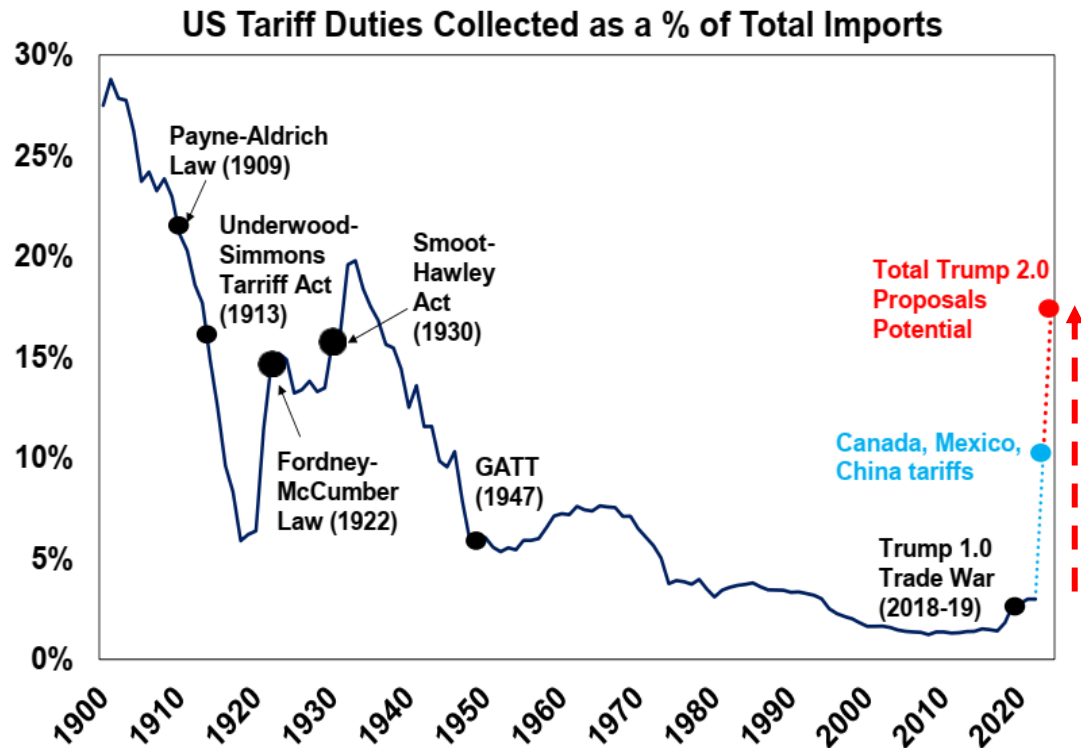


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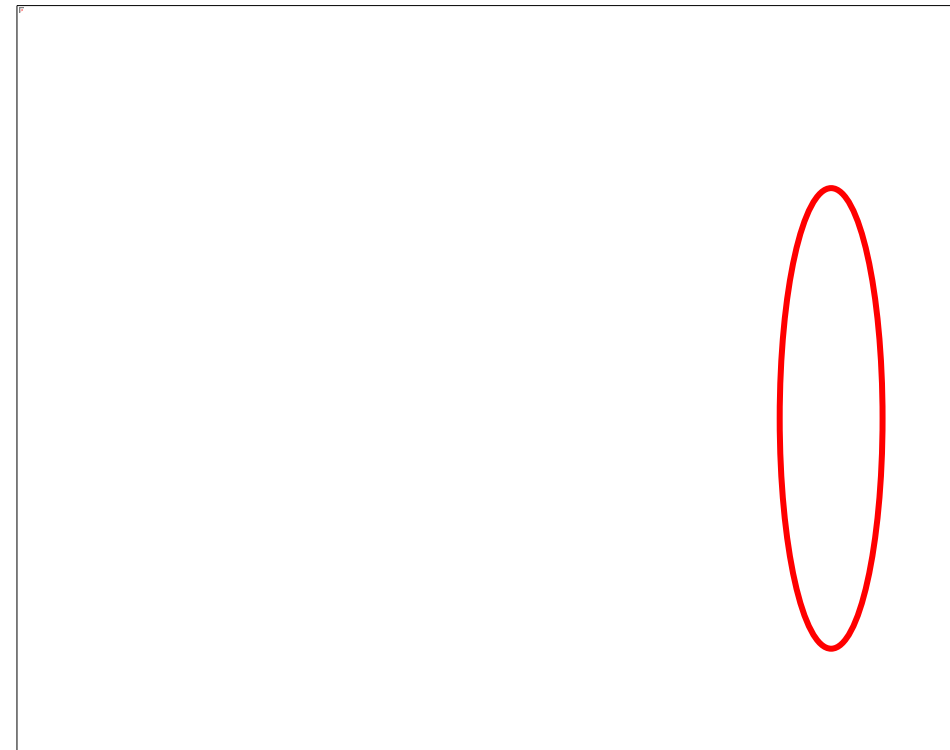
# Trump Trade Tariffs & Policy Uncertainty

The announced **tariffs** if implemented will mean a modest and hopefully temporary hit to global economic activity due to disruption to supply chains and export demand. A retaliatory trade war would be bad.

The **Trump Administration** is going to implement large scale policy changes at the same time, and this increases the chance of policy mistakes being made.



Source: US ITC, Evercore ISI, AMP. Trump 2.0 assumes 10% general tariff and 50% on China.



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# So What Does This Mean For Markets?

Economic fundamentals remain solid and we will likely avoid a near-term recession, but this requires inflation to keep falling so the Fed can cut interest rates further.



Falling Inflation = Fed cuts rates, pro-growth  
Outcome: **Growth assets likely outperform**

**BUT...**

If our view is right that it is too early to call victory on the inflation fight, then expect higher interest rates for longer which will impact growth and increase recession risks.



Rising Inflation = Fed hikes rates, growth scare  
Outcome: **Growth assets likely revalue down**

# MPW Recommended Portfolio Strategy



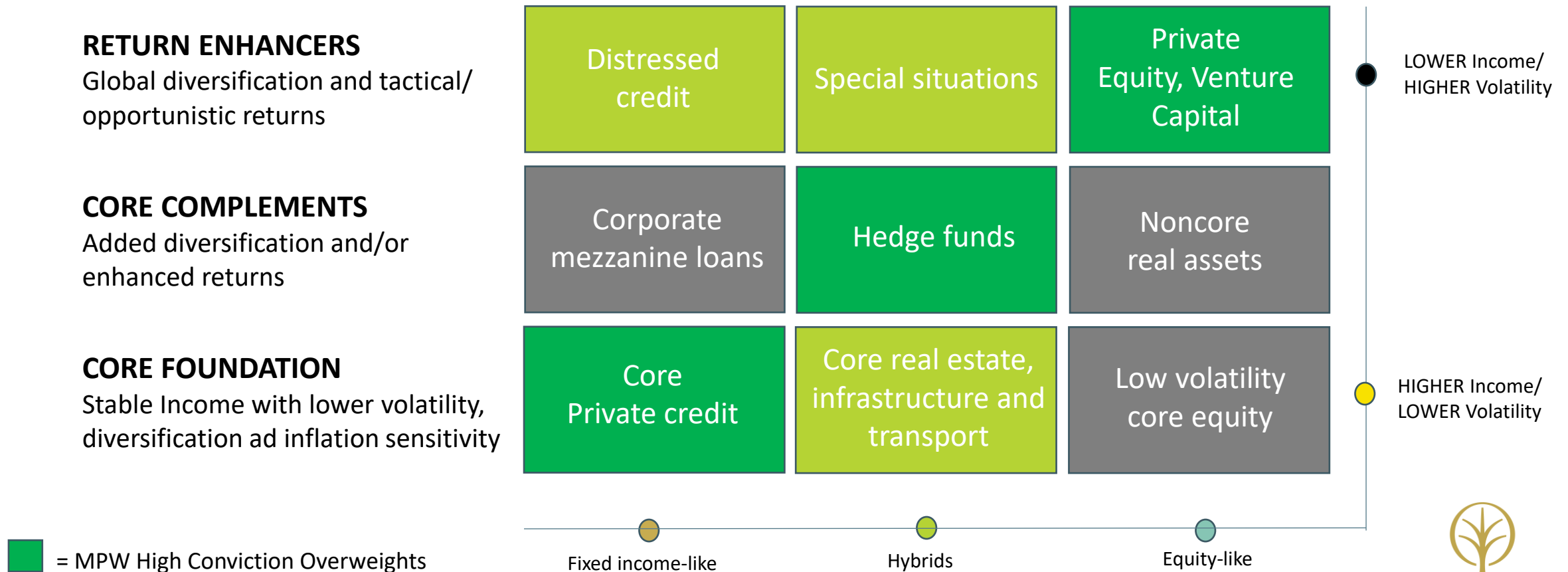
Asset Class	Tactical Position	Comment
Currency (AUD vs USD)	Hedged	Hedging USD at current levels, AUD may fall further but it is below the long-term average
Cash & Liquidity	Neutral	RBA may cut once or twice more into year end, hold cash for buying opportunities
Government Bond Duration	Underweight	Long-duration bonds are not pricing in higher for longer inflation. Prefer private debt
Corporate Credit & Debt	Underweight	Listed credit spreads are very low by historical measures, so higher risk. Prefer private debt
Listed Property & Infrastructure	Underweight	Listed assets have had a strong run on rate cuts, prefer to own selective unlisted assets
Listed Australian Shares	Underweight	Expensive, prefer value over growth, resources over banks, and small caps over large caps
Listed International Shares	Underweight	US expensive, Europe and Emerging Markets cheaper, small caps over large
Liquid Alternative Assets	Overweight	Selective hedge funds, private debt and equity, commodities, and niche opportunities
Illiquid Alternative Assets	Overweight	Private debt and equity, niche illiquid strategies can provide a long-term return premium





# The Role of Alternative Assets In Portfolios

Framework-driven portfolio construction: What role do different categories play in the portfolio?

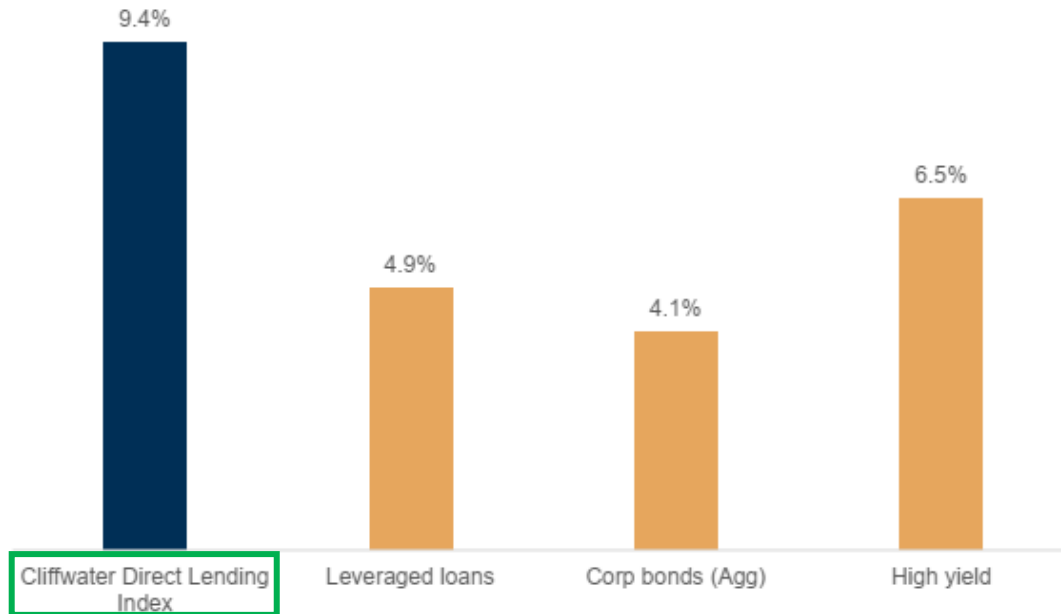


# Why We Like Private Debt Over Listed Debt

Private direct lending (debt) strategies are yielding 9% pa and provide equity-like returns with less volatility than public market debt strategies.

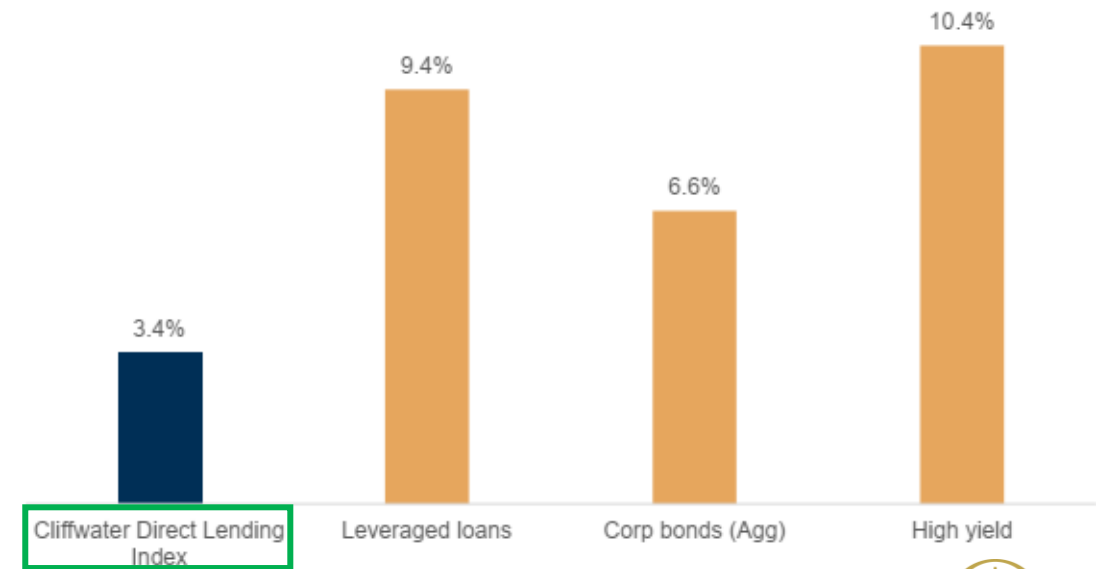
## Attractive return potential

Annualized return by asset class, 2004-2024



## Lower historical volatility

Annualized volatility by asset class, 2004-2023



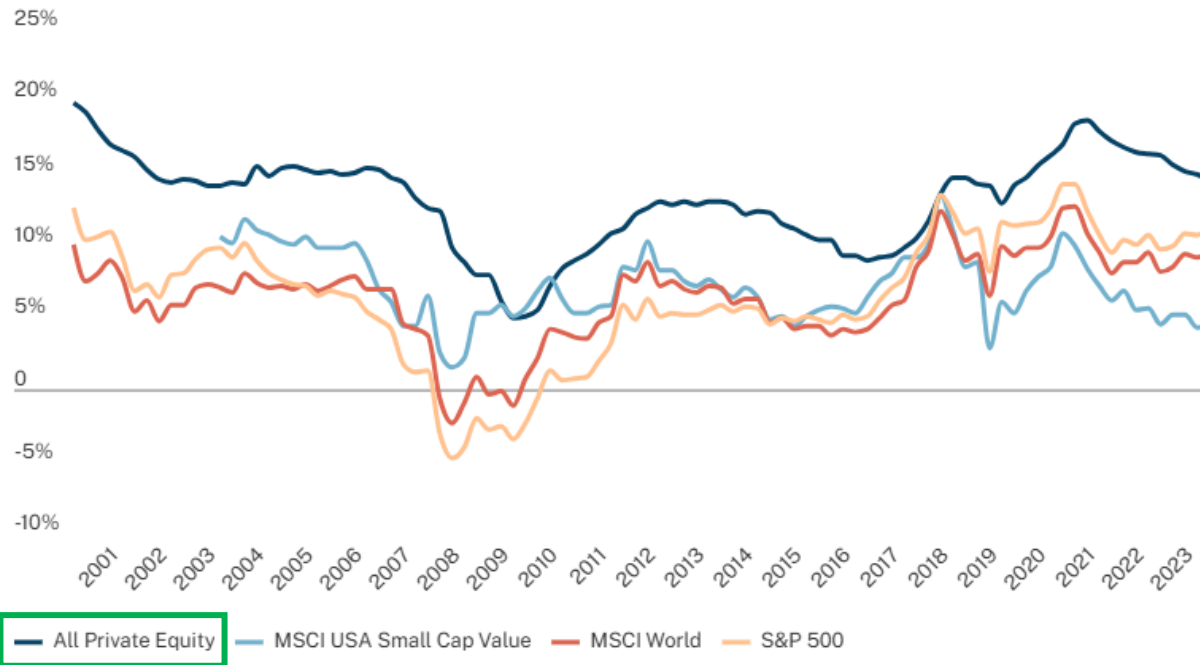
Sources for both charts: Apogem analysis. Direct lending returns are sourced from Cliffwater Direct Lending Index. Source for public credit returns (leveraged loan, corporate bonds, and high yield bonds) is Bloomberg. Data through December 31, 2024.

Our portfolios have a high weight to private debt for increased yield and strong risk-adjusted returns.

# Why We Like Private Equity Over Listed Equity

Private Equity has outperformed listed share markets across all regions over the long-term.

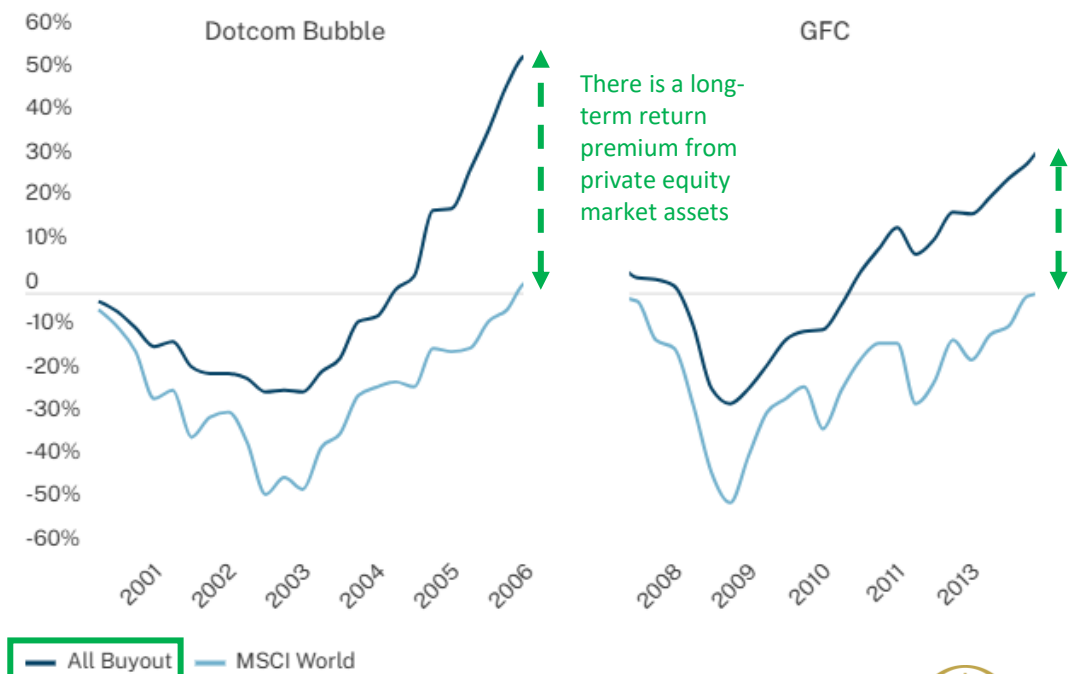
All Private Equity 10-Year Rolling Time-Weighted Returns



Source: Hamilton Lane Data via Cobalt, Bloomberg (October 2024)

Private Equity has provided strong downside protection in falling markets and has long-term compounding benefits.

Cumulative Returns During Equity Market Drawdowns



Source: Hamilton Lane Data via Cobalt, Bloomberg (October 2024)

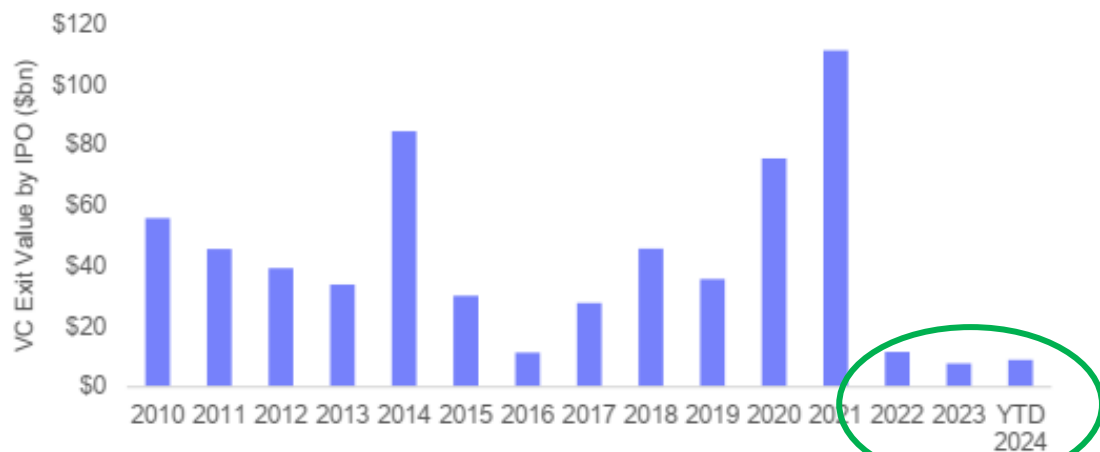
Our portfolios are overweight to private equity for strong long-term risk adjusted returns.

# Private Equity Exits... A 2025-26 Rebound Story?

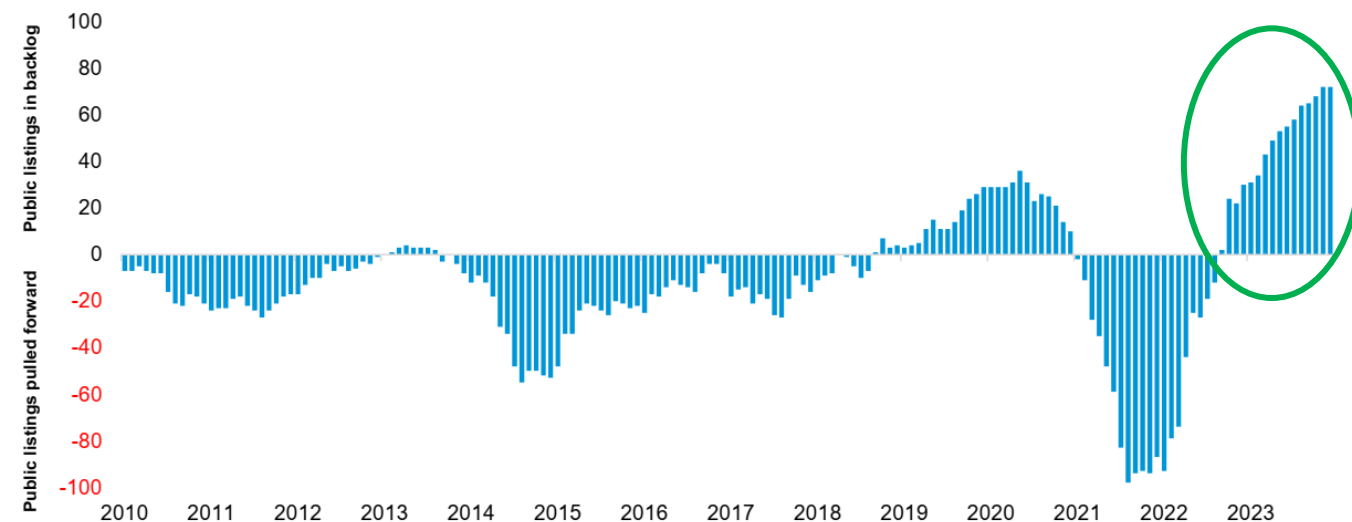
The US Venture Capital Market has effectively been shut out of exits given that listings on public markets (IPO's) have been non-existent. But that could change in 2025.

There is a significant backlog of private companies that are waiting to IPO on listed markets in the US when the environment and opportunity presents in 2025 onwards.

THE IPO ROUTE FOR VC EXITS HAVE REMAINED MUTED



Estimated IPO Backlog



Source: Pitchbook – Geography: US; as at 31 December 2023.

These businesses waiting to IPO have just stayed private for longer, increasing earnings and improving balance sheets in anticipation of an IPO. We could see material valuation uplifts for these private companies on IPO.

# MPW Concluding Summary

**MPW Outlook:** Recession risk has subsided, market optimism is high, but inflation may surprise to the upside.

**Inflation Keeps Falling Scenario:** *This is the consensus view and markets are pricing this outcome, believing further interest rate cuts are coming alongside strong fiscal spending.*

- Risk assets should do well but will need earnings growth to support valuations.

**Higher Inflation For Longer Scenario:** *This will come as a shock to markets as central banks may need to raise interest rates again, causing a growth scare and recession fears.*

- After such a strong run, expect a sizeable market pullback if inflation trends higher.

## **Portfolio Implications:**

- Expect higher market volatility
- Own alternative assets & private markets







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