2024 Year in Review & Outlook for 2025

December 2024

Summary

- For the second consecutive year, equity markets have performed extremely well with the ASX 200 All Ordinaries Accumulation Index adding 13.2% to date in 2024.[1]
- Outpacing the Aussie performance, yet again, was the US Benchmark S&P500 Index which gained 26.9%[1], making it back-to-back years with gains above 20% for the first time since 1999.
- From a sector perspective, the ASX saw strong gains delivered by the IT sector and from interest rate sensitive sectors including Financials, Consumer Discretionary and Property Trusts. On the negative side of the ledger were large declines from the Energy and Materials (i.e., Resources) sectors.
- The strong gains from the ASX200 over the course of 2023 and 2024 has in large part been driven by an expansion in the valuation multiples being applied to earnings expectations. This has resulted in the valuation of the broader market sitting ~13% above its historic level.
- Reflecting these heightened equity market valuation levels, coupled with the relatively attractive returns we continue to see from income-based investments, our slightly cautious stance is maintained.
- In *Other Things*, we discuss some topics that have piqued our interest recently, including (the lack of) productivity growth, how investment markets can remain the same through time and a quick look at how Alphabet makes its money.

Thank you again for entrusting the management of your portfolios to the Entrust team. We wish you and your families a very happy Christmas and New Year. Should you have any questions on your portfolio or investment markets in general, please give us a call.

Kind Regards

Rowan Jones
Head of Entrust Wealth Management

Better Than Expected

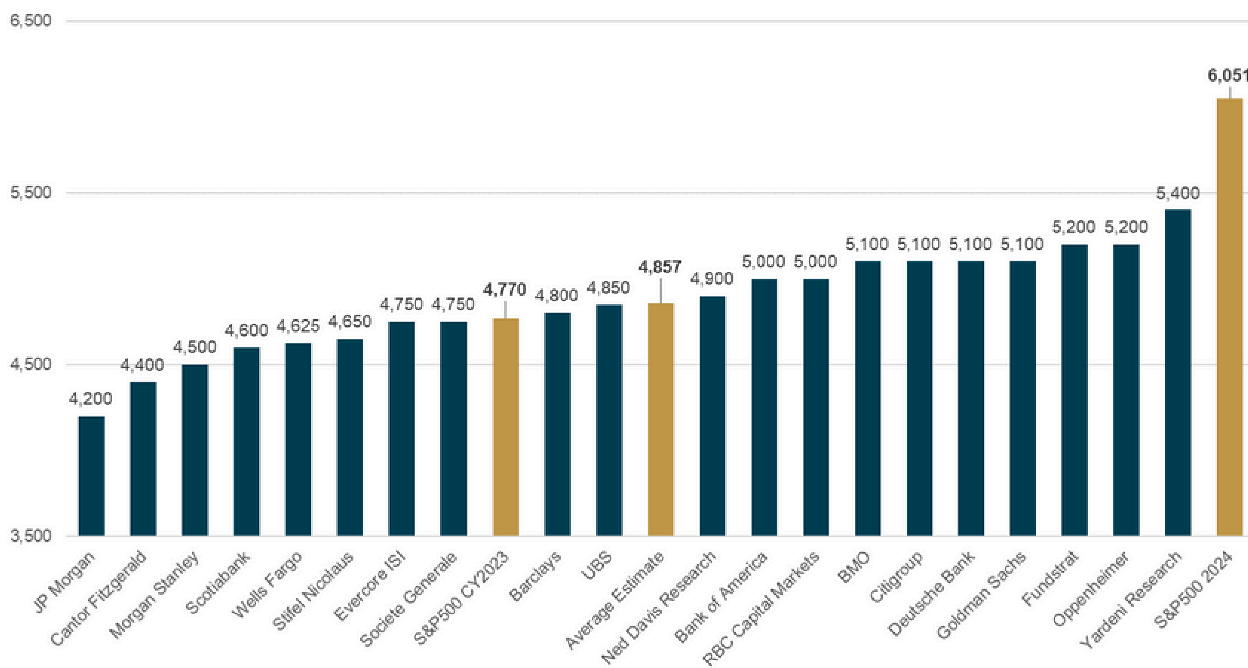
Those with a keen eye will notice that we open this year's note with the same title as per our *2023 Year in Review*.

Building on the strong performances of 2023, equity markets in Australia and the US are stronger again in 2024[1]. The ASX200 All Ordinaries Accumulation Index is up 13.2% to date, adding to 2023's gain of 12.4%.

Providing further evidence to support those (including us) who sit in the "*you can't predict markets camp*", for the second year running the performance of the US S&P500 Index is well-placed to beat the average estimate of major Wall Street market strategists **by over 25%.**

Entering 2024, the average expectation was for the S&P500 to eke out a 1.8% gain over the course of the year (Chart 1). As it transpired, by the mid-point of 2024 the S&P500 Index already sat at 5,460, ahead of all estimates for the full year. This strong market performance continued over the second half of the year with the S&P500 now at 6,051[1], representing a gain of 26.9% during 2024.

Chart 1 – S&P500 Performance in 2024 v Wall Street Estimates



Source: Charlie Bilello

1. As at 13 December 2024

The consecutive 20%+ returns achieved over 2023 and 2024 marks the first time this has occurred since 1999 (Chart 2).

For those with a glass half full point of view, the period from 1995-1999 saw an incredible run of five years of 20%+ returns; so maybe things are just warming up?

Or, for those who prefer a more glass half empty approach, 1999 marked the last year of (equity market) joy, prior to the "Tech Wreck" and the subsequent ~40% decline in the S&P500 over the following three-year period to the end of 2002.

Chart 2 – S&P500 Total Returns

S&P 500: Total Returns (1928 - 2024 - As of 11/25/24)									
Year	Return	Year	Return	Year	Return	Year	Return	Year	Return
1928	43.8%	1948	5.7%	1968	10.8%	1988	16.6%	2008	-37.0%
1929	-8.3%	1949	18.3%	1969	-8.2%	1989	31.7%	2009	26.5%
1930	-25.1%	**1950**	**30.8%**	1970	3.6%	1990	-3.1%	2010	15.1%
1931	-43.8%	**1951**	**23.7%**	1971	14.2%	1991	30.5%	2011	2.1%
1932	-8.6%	1952	18.2%	1972	18.8%	1992	7.6%	2012	16.0%
1933	50.0%	1953	-1.2%	1973	-14.3%	1993	10.1%	2013	32.4%
1934	-1.2%	**1954**	**52.6%**	1974	-25.9%	1994	1.3%	2014	13.7%
1935	**46.7%**	**1955**	**32.6%**	**1975**	**37.0%**	**1995**	**37.6%**	2015	1.4%
1936	**31.9%**	1956	7.4%	**1976**	**23.8%**	**1996**	**23.0%**	2016	12.0%
1937	-35.3%	1957	-10.5%	1977	-7.0%	**1997**	**33.4%**	2017	21.8%
1938	29.3%	1958	43.7%	1978	6.5%	**1998**	**28.6%**	2018	-4.4%
1939	-1.1%	1959	12.1%	1979	18.5%	**1999**	**21.0%**	2019	31.5%
1940	-10.7%	1960	0.3%	1980	31.7%	2000	-9.1%	2020	18.4%
1941	-12.8%	1961	26.6%	1981	-4.7%	2001	-11.9%	2021	28.7%
1942	19.2%	1962	-8.8%	**1982**	**20.4%**	2002	-22.1%	2022	-18.1%
1943	25.1%	1963	22.6%	**1983**	**22.3%**	2003	28.7%	**2023**	**26.3%**
1944	19.0%	1964	16.4%	1984	6.1%	2004	10.9%	**2024**	**27.1%**
1945	35.8%	1965	12.4%	1985	31.2%	2005	4.9%		
1946	-8.4%	1966	-10.0%	1986	18.5%	2006	15.8%		
1947	5.2%	1967	23.8%	1987	5.8%	2007	5.5%		

Source: Charlie Bilello
NB. Chart shows Total Returns (inclusive of dividends)

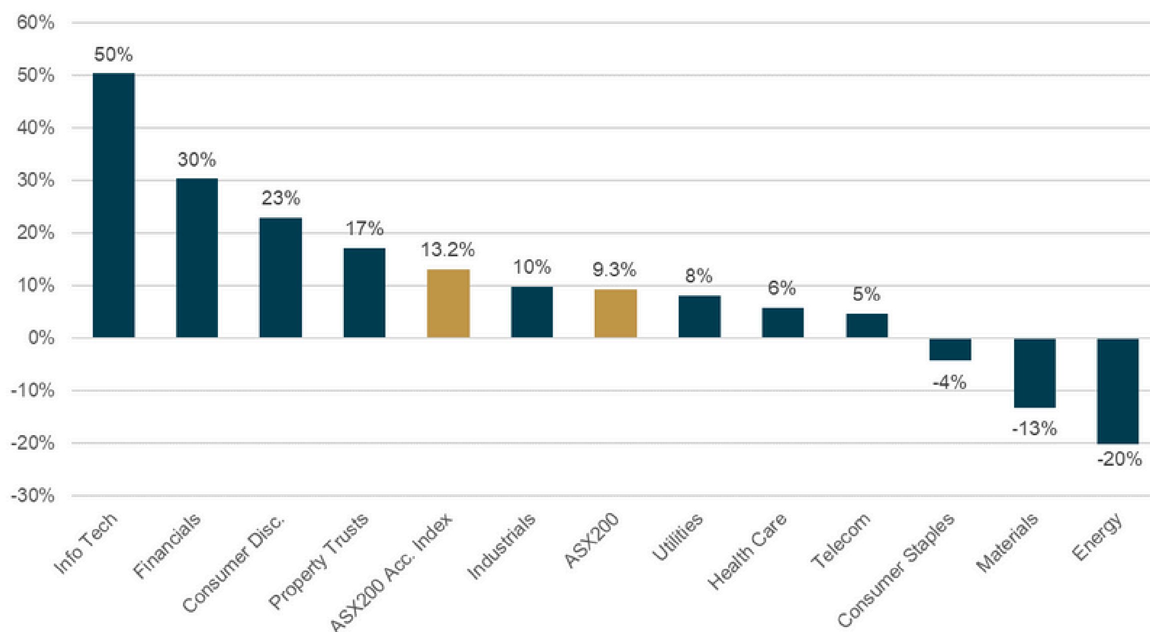
Equity Market Performance

The ASX200 Accumulation Index (i.e., inclusive of dividends) has delivered a calendar year return of 13.2% as at 13 December 2024.

Chart 3 shows the performance of the ASX200 component sectors. Technology stocks again lead the way, while the Energy and Materials (i.e., Resources) sectors saw sizable declines. In a year when the RBA kept the official Cash Rate on hold (at 4.35%) it was interesting to see the strong performance of interest rate sensitive sectors; Financials, Consumer Discretionary and Property Trusts.

Given expected interest rate cuts didn't eventuate in 2024 the strong performance of these sectors may surprise some as, in very simplistic terms, lower interest rates generally correlate with higher equity valuations. However, this ignores innumerable other things that can move markets and their component sectors; the figurative flapping of a butterfly's wings. This underlines that not only is it difficult to correctly predict what will happen (in this case, interest rates remaining on hold), it is equally, if not more, difficult to predict the impact (in this case, heightened equity valuations) should your original prediction come to pass.

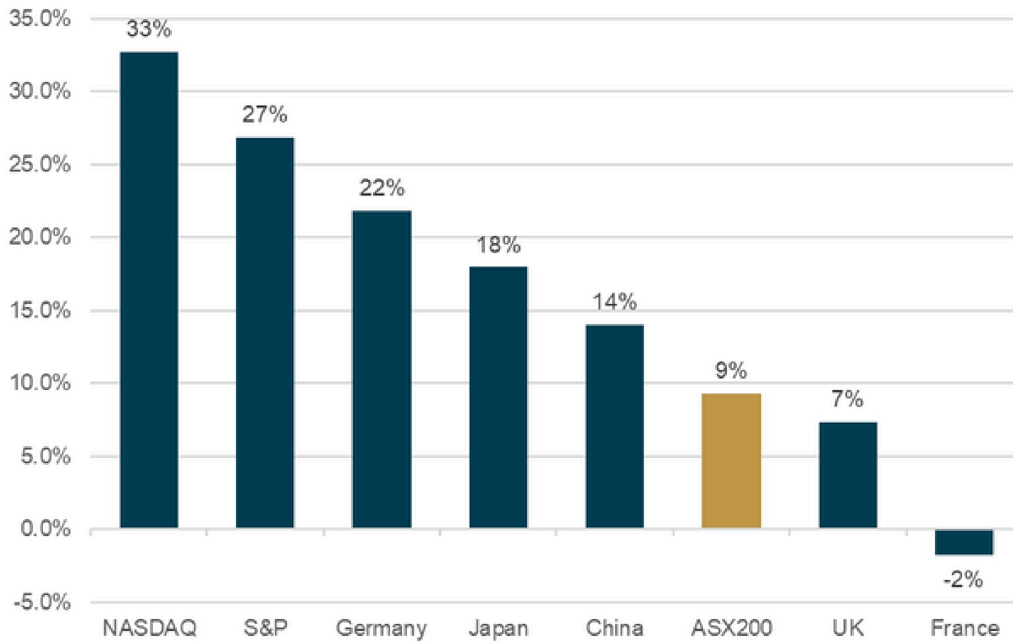
Chart 3 – ASX200 Sector Performance; Calendar 2024[1]



Source: IRESS

The returns delivered by the ASX200 have been strong, yet they again pale into comparison with the major global share markets (Chart 4).

Chart 4 – Global Equity Market Performance; Calendar 2024[1]



Source: IRESS
NB. Chart is exclusive of dividends

Outlook - 2025

In simplistic terms, the key driver of equity market performance in any one period comes from a combination of the ***earnings*** expected to be delivered by the individual companies that make up the market and the ***valuation multiple*** that market participants ascribe to those earnings expectations.

Over the last two years the overall strength in equity markets has in large part been driven by an increase in the valuation multiple that investors are willing to pay.

Chart 5 shows that over the previous 10 years the ASX200 has traded at an average multiple of 16.2x the level of earnings expected to be generated over the following 12 months. At the end of 2022, the multiple sat at 14.1x as investors fretted over the outlook for the domestic and global economies (amongst other things). Fast forward to today and the market is now paying a multiple of 18.3x earnings expectations, to sit 13% above the 10-year average.

Chart 5 – ASX200 PE Multiples – 10yr history

Source: FactSet

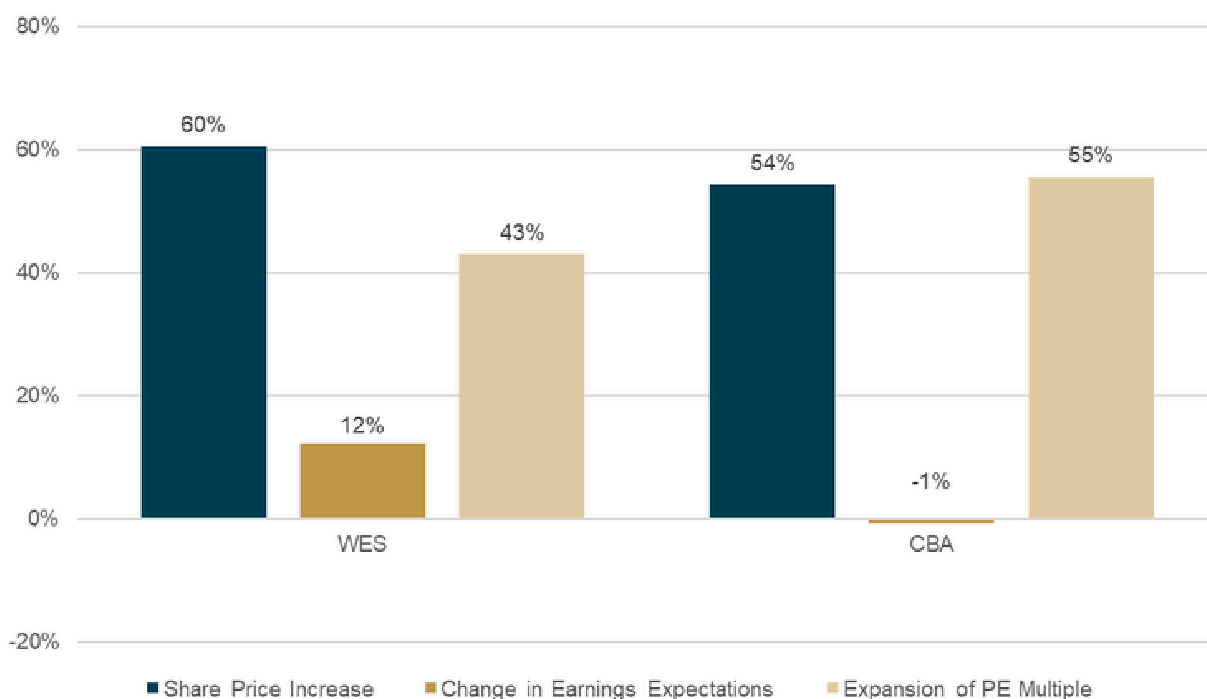
Breaking this down, the 18% return achieved by the ASX200 (excluding dividends) since the end of December 2022 has been driven by a 30% expansion in the PE multiple, partially offset by a 10% decline in forward earnings expectations.

Using company specific examples, Chart 6 shows the composition of the strong share price gains of both Commonwealth Bank (CBA) and Wesfarmers (WES) since the end of December 2022.

Over this period the WES share price has risen 60% to $73.65 [1] from $45.91. This has been driven by a 12% increase in the forward earnings expectations coupled with a 43% expansion in the Price to Earnings (PE) multiple applied to these future expected earnings.

In the case of CBA, its share price has risen 54% to $158.21 [1] from $102.60. With a 1% decline in forward earnings expectations being offset by a significant 55% expansion in the PE multiple.

Chart 6 – CBA and WES Share Price Drivers



Source: FactSet, IRESS

Portfolio Positioning

We have for some time considered that equity markets have been on the upper-side of fair value. With further recent market gains our view here remains unchanged. Reflecting this, over the course of 2024, where appropriate, we reduced some holdings in stocks that had rapidly appreciated in value. As discussed in our *September 2024 Quarterly* this was in part driven by the fact that we have been able to redeploy these funds into income-based investments (e.g., Bank Hybrids, Fixed Interest, Australian Bonds) that are providing attractive returns given the relatively low levels of risk.

While we maintain a slightly cautious stance, acknowledging that we do not know what markets have in store for us over the coming year (be it positive, negative or somewhere in between), client portfolios continue to be positioned such that we believe they are best placed to meet the long-term goals of each individual client.

Markets have a way of producing events that seemingly come out of the blue, this will no doubt continue to be a feature. Below we touch on two events that we know will occur; the phasing out of Bank Hybrid securities and the re-instatement of the US Debt Ceiling.

Hybrid Securities on the way out

On December 9, the Australian Prudential Regulation Authority (APRA) confirmed the phased removal of the bank hybrid market, with the transition set to conclude by 2032. This decision traces back to September 2023, when APRA released a discussion paper evaluating the suitability of hybrid securities for retail investors. In September 2024, APRA followed up with a proposal to discontinue the issuance of new hybrid securities, a move it has now formally confirmed.

We are disappointed with APRA's decision to halt the issuance of new hybrid securities. We have long maintained that the Australian banks we invest in on behalf of our clients possess exceptionally strong balance sheets, ensuring the ability of the Bank Hybrid securities to provide consistent, healthy returns to investors to maturity. As an example of the low-risk, solid returns generated from Hybrids, Chart 7 shows the performance of the Elstree Hybrid Fund, an investment held across many client portfolios where appropriate, which over the last three years has generated returns of 7.0%p.a.

Chart 7 – Elstree Hybrid Fund

Performance as of 30 November 2024	1 months	3 months	1 year (p.a)	3 years (p.a)
Elstree Hybrid Fund NAV + Franking (EHF1)	0.1%	2.9%	10.4%	7.0%

Source: Elstree

While we will continue to invest in existing hybrid securities for clients, we also anticipate the introduction of new fixed-interest offerings in the coming years. These products are expected to serve as suitable replacements for hybrid securities, providing alternative investment opportunities.

US Debt Ceiling

As always, there are plenty of things that may arise over time that can impact upon investment markets to varying degrees. One of these 'things' that hasn't received much publicity in recent times is the *US Debt Ceiling*, also known as the *US Debt Limit*.

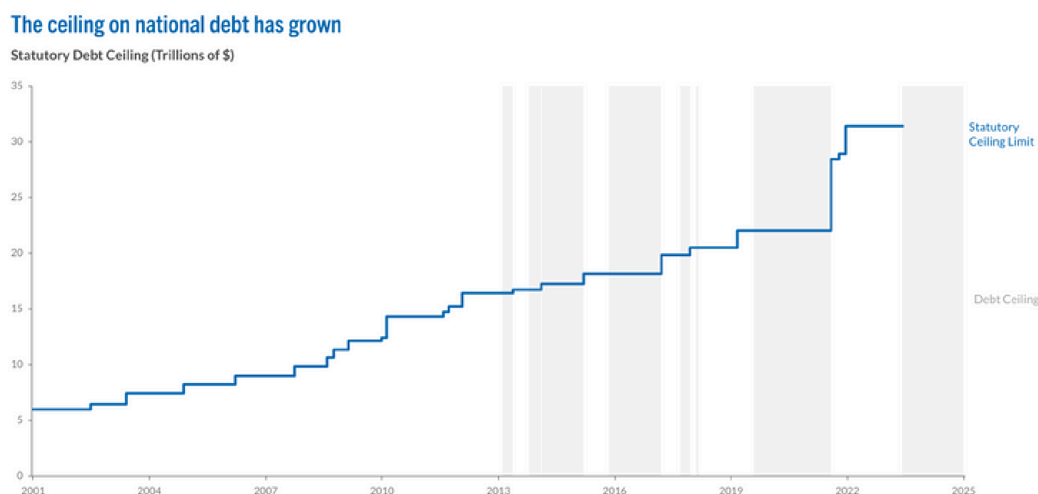
The US Department of The Treasury defines the Debt Limit as "*the total amount of money that the United States government is authorized to borrow to meet its existing legal obligations, including Social Security and Medicare benefits, military salaries, interest on the national debt, tax refunds, and other payments. The debt limit does not authorize new spending commitments. It simply allows the government to finance existing legal obligations that Congresses and presidents of both parties have made in the past*."

The US Treasury notes that since 1960, the US Congress has always acted when called upon to raise the debt limit. This has been required on 78 separate occasions to either permanently raise, temporarily extend or revise the definition of the debt limit.

The reason that markets have heard little of the Debt Ceiling in recent times is due to the limit being suspended in June 2023, until 1 January 2025. The Peter G. Peterson Foundation notes that on this date, the Debt Ceiling will be re-established based on the amount of debt existing at that time. At that point, the Treasury will once again start using extraordinary measures to temporarily keep the government from defaulting on its debt. Policymakers will need to enact legislation to raise or suspend the debt ceiling before those measures lapse to avoid a default.

US Government Debt has exploded in recent times (Chart 8) and currently sits at over US$36 trillion, equivalent to over US$107,000 for every one of the ~335m people living in the US.

Chart 8 – US Debt Ceiling



Source: Peter G. Peterson Foundation

While the US Congress has never failed to raise the Debt Ceiling, more recently whenever the Debt Ceiling has needed to be raised, it generally gets to the last minute before a deal is agreed, causing uncertainty for financial markets and raising concerns for investors as to the safety of US Treasuries.

While it is generally considered a fait accompli that the Debt Ceiling will continue to be raised, there are some highly respected voices that are questioning the sustainability of the path that the US is on.

In our *September 2024 Quarterly*, we highlighted Howard Marks views on this issue, with Marks commenting that frankly the level of US Debt was an embarrassment, noting that the US acts like it has a credit card with no limit and no requirement to pay it off. Marks signed off this topic, quoting Stein's Law "*If something can not go on forever, it will stop*."

In a similar vein, US billionaire investor, Stanley Druckenmiller was recently quoted on the topic of US Debt levels in Grant's Interest Rate Observer: "*being the reserve currency, being the strongest military might in the world and, frankly, still being the most desired destination in the world,* ***none of this stuff matters, until it matters***". (emphasis added)

The key questions in our mind:

- For how long will investors remain comfortable with the ability of the US to pay its debts?
- What level of compensation (i.e., interest rate) will investors demand from the US Government to encourage the continued purchase of US Treasuries?

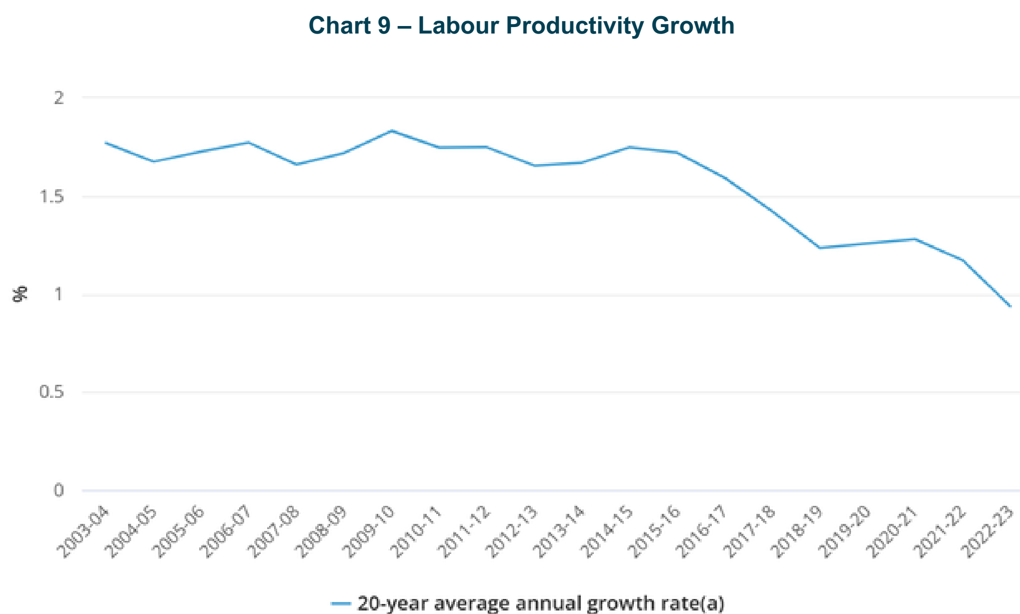
Other Things

In this section we discuss some of the topics that we have been thinking about.

Productivity / Government Inefficiency

We have been hearing plenty recently about Productivity, or lack thereof in Australia. Productivity, as defined by the Productivity Commission, measures how efficiently inputs (e.g., labour, capital and raw materials) are used to produce outputs (goods or services). The more goods and services that can be produced from a given set of inputs, the better the standard of living of a society. Chart 9 shows the ongoing decline in Labour productivity growth in Australia.

Chart 9 – Labour Productivity Growth



Source: ABS

In a recent article published in *Firstlinks*, Peter Swan and Dimitri Burshtein noted that "*Economic growth stems from the expanded production of goods and services which is driven by savings, investment, entrepreneurship, and innovation. Importantly, growth is determined through how resources are used, principally labour and capital, and most importantly, how productively these inputs are used*."

The article argues that Government interference through various forms of regulation, legislation and subsidies is smothering capitalism's competitive fire and slowing productivity growth. The authors wryly noting "*it was not government planning, regulation or industry protection that led to the creation of the steam engine, automobile, or smartphone. If these innovations were developed today, governments likely would impose taxes and regulations to protect jobs in the telegraph and horse-and-buggy industries*."

We are also now seeing instances of the Private Sector pushing back on the bashing some have received for having the temerity to seek to generate a profit. At its recent AGM, Wesfarmers (WES) Chairman Michael Chaney made the following comments:

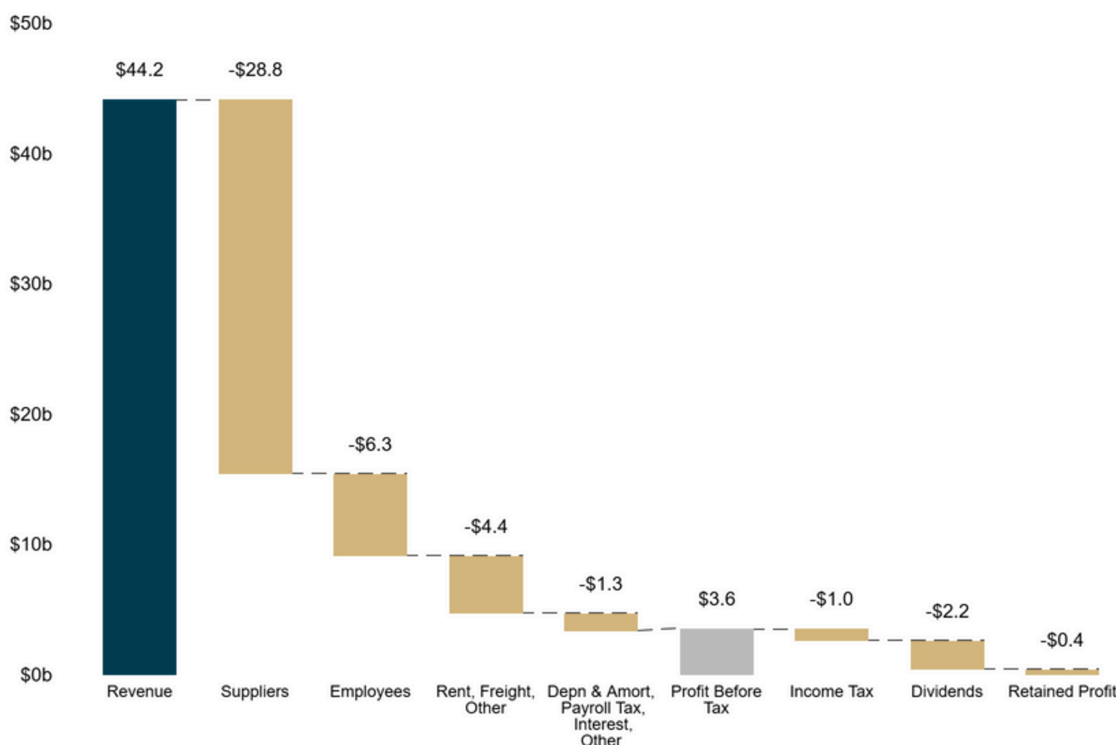
"*…for some external parties, profit seems to be a dirty word, but it is important to understand how profitable businesses are essential to our economy and future prosperity.*"

"*…companies have to be profitable in order to continue to operate…employing people, sourcing products and services from suppliers, providing customers what they need and supporting their communities*."

"*It would be good to hear political leaders of all persuasions acknowledge their understanding of these facts – that large companies like ours constitute a vital part of the economy, generate enormous benefits to the community and make a huge contribution to society. Companies, large and small, deserve their support. Such an understanding would, I believe, lessen the chance of governments enacting laws that…work against the national productivity improvements that Australia so urgently needs.*"

Chart 10 shows where the $44bn of revenue generated by WES in FY24 went. After paying suppliers, employees and other costs of operation, a residual ~8% of the original $44bn became Profit Before Tax. Of this amount ~$1.0bn was sent to the Federal Government, shareholders received $2.2bn in dividends and ~1% of the original revenue generated was retained by the company. Mr Chaney's summary; "*So, in other words, almost all of the profit ended up outside the company, supporting the economy and community in different ways.*"

Chart 10 – WES FY24 – where the money went

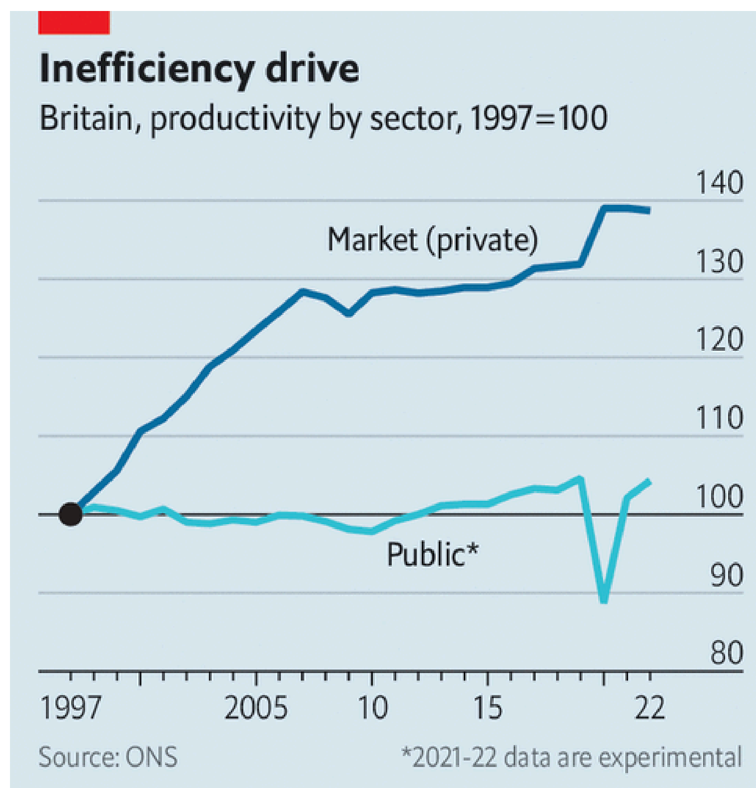


Source: WES

At its AGM, Coles (COL), which over the prior twelve months has participated in nine separate Federal Government, State Government, and ACCC official reviews into some aspect of supermarkets, through Chairman James Graham noted that "*…it has been disappointing to see how cost-of-living issues have been politicised and targeted at supermarket operations. This is in sharp contrast to the level of engagement and support of supermarkets by Governments and regulators during the COVID lock down years. That experience and the results of working together in the face of floods, bushfires and other natural disasters have shown the benefits of constructive engagement between business and Governments, which is hopefully the template for the future when it comes to addressing the impacts of complex issues like inflation.*"

We are not alone in the battle against declining productivity growth, Chart 11 shows that over a generation the UK Public Sector has effectively achieved nothing in the way of productivity gains, which is quite something when you consider the past 25 years has seen the rise of the internet and mobile communications among a host of other productivity enhancing developments.

Chart 11 – British Productivity



Source: ONS; X

The more things change....

Warren Buffett first met Bill Ruane at Columbia University in 1951. When Buffett closed his Buffett Partnership in 1969, he advised his clients to invest the money he would be returning them with Bill Ruane.

We came across this quarterly report from Bill Ruane's Sequoia Fund, published in 1978. It struck us that the note, with its references to inflation and problems in the Middle East, could just as easily have been written at any time over the last 24 months. We think this helps to put some perspective around short-term concerns in the market, inasmuch as there will always be something to worry about.

Sequoia Fund, Inc.

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QUARTERLY REPORT
For the Period Ended March 31, 1978

Dear Stockholder:

Sequoia's results for the quarter ended March 31 along with the comparable results of leading market indexes were as follows:

Sequoia Fund	+3.1%
Dow Jones Industrials	−7.5
Standard & Poor's 500	−5.1

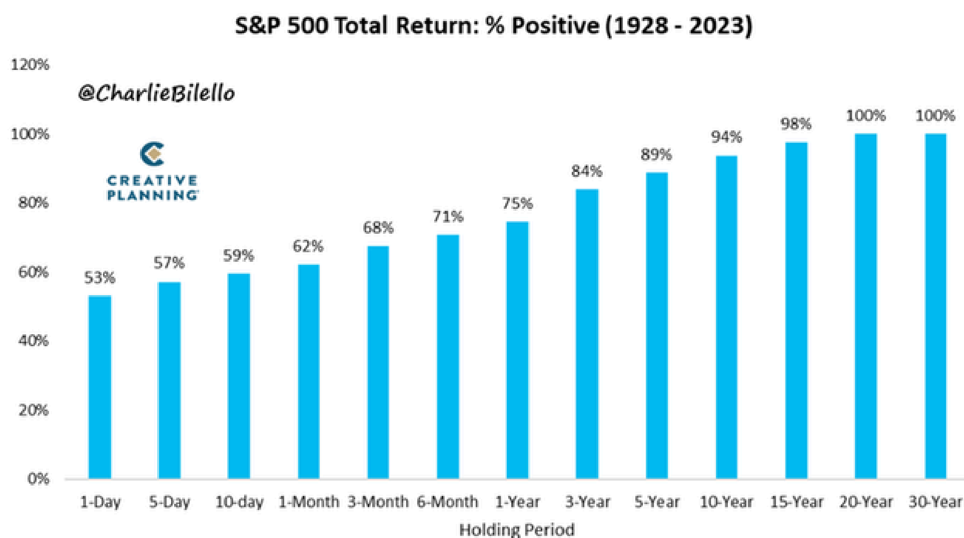
Out of curiosity we spent some time yesterday reading the stock market columns of the Wall Street Journal in the issues from March 17 to April 13 of this year. They were filled with hedged cautions on the effects of inflation, the Middle East problem and the fate of the dollar. Nary a clear-cut, positive prediction. Then — Boom! — on the next two trading days the market went up 35 points on a total volume of 116 million shares. Within two weeks, the market moved up a total of 69 points (or 9%) during a period when the dollar stabilized but inflation and the Middle East situation became anything but more hopeful.

We cite this brief history to explain once more why the management of the Sequoia Fund prefers to concentrate on specific values in the market and does not try to postpone the ownership of stocks which we consider attractive until we feel either the global outlook or the "market" looks good to us. If anyone had guaranteed us sixteen months ago that the Dow Jones Average would go down from 1005 in January of 1977 to 838 today (hitting 745 on the way), we certainly would have been concerned. Had we acted then on this guaranteed prediction and sold out it would have been very costly. We simply held our favorite companies and have seen the Sequoia Fund appreciate 38% (with dividends) since then. In short, if anyone offers you a new Mercedes for $2,500, take it and don't worry about the outcome of the Salt talks or the Middle East situation.

Source: coinvestorclub.com

Subject of course to the stage of life that each individual investor finds themselves, rather than getting too depressed (or too enthusiastic) by short-term events, it is much more beneficial to focus on the long-term benefits of investing. In regard to equities, Chart 12 shows that the longer one is invested in the share market, the chance of generating a positive return greatly improves.

Chart 12 – Play the Long Game



Source: Charlie Bilello

NB. Chart 12 shows the returns generated based on various investment timeframes. For instance, if you had invested for any 5-day period you would have achieved a positive return 57% of the time. If your investment timeframe was extended to 10yrs you would have generated a positive return 94% of the time.

Of course, remaining calm and rational in today's markets can be very difficult. Jason Zweig, Wall Street Journalist and editor of Benjamin Graham's investing bible *The Intelligent Investor* recently wrote "*Investing has been "gamblified" with pulsating brokerage apps, streaming market updates, screaming TV pundits, swarms of traders egging each other on over social media and TikTok videos bragging of big gains. Never before have the pull of technology and the madness of the crowd been so hard to resist.*

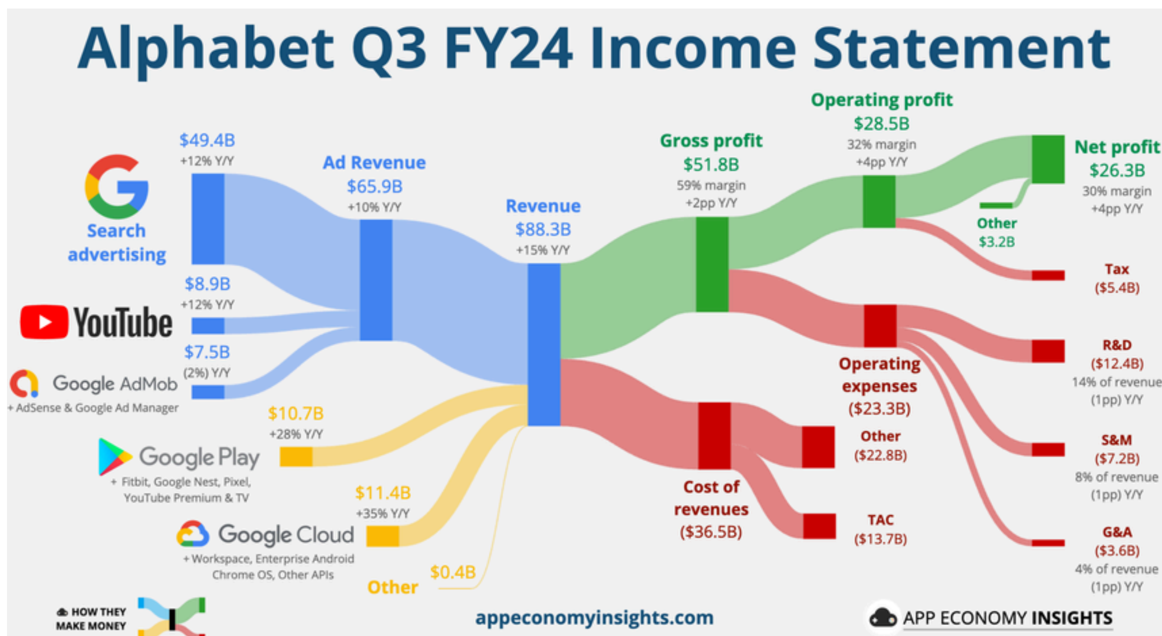
Yet resist them you must, if you are to have any hope of being an intelligent investor."

We believe that a very important part of our role in managing client portfolios is to remain calm and composed while resisting the madness of the crowd as we navigate toward delivery of our clients' goals.

Alphabet

Finally, just something we thought was an interesting graphical representation of how revenue eventually translates to bottom line profit. Chart 13 shows this stream for Alphabet, the parent company of Google, and how in the three-month period to end of September 2024, Alphabet converted revenue of US$88.3bn into a net profit of US$26.3bn (~A$41bn).

Chart 13 – How Alphabet Makes its Money



Source: appeconomyinsights.com
NB. TAC refers to “Traffic Acquisition Costs”

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