Australian Equity Strategy

2025 outlook part 1- expect further market 'melt-up' fueled by mid-cap outperformance

Equity Strategy

Australia

Richard Schellbach
Strategist
richard.schellbach@ubs.com
+61-2-9324 2277

Equity bull market a global phenomena, ASX200 end-25 target of 8850

The stock market 'melt-up' looks set to continue through 2025 on rate cuts / improving macro, Tech / AI themes, and leadership from the US market. We see equity prices headed further higher, although not at the breakneck speed which we have seen over the last 12 months. We target the ASX200 index reaching 8850 by the end of calender year 2025, which represents a +5% gain from today's closing price.

Trump and China shine (relatively) favourably on Australia as a 'safe haven'

The Australian economy (and its equity market) seems like a relative 'safe port' in a world abound of trade / geopolitical uncertainty. As global investors pointed out to us clearly when up in Asia last week, this is something which many other economies through the region do not enjoy. We expect that buying of Australian equities from regional investors would step up over the coming year, as any intensifying US and China rhetoric would prompt a rotation towards the relative 'safety' of Australian stocks.

Earnings growth should come in 2025… but will it be enough?

We expect mid-single-digit earnings growth from Aussie companies through 2025 given, 1) the exhaustion of the earnings downgrade cycle which began two year ago, 2) an RBA rate cutting cycle (which we expect to begin in May 2025), that should energise the consumer and feed through to a pick-up in economic activity, and 3) US earning Aussie listed companies enjoying the lift they get from their businesses exposure to the world's most dynamic economy plus a soft Aussie dollar.

Preferred sectors: TMT, Insurance and Industrials

Tech-related themes will likely continue to drive the market, and as long as these companies maintain their upward earnings momentum (which we believe will remain through 2025), the market seems to be comfortable with the high multiples which most of these stocks trade at. The Insurance sector also stands out on its strong pricing power and attractive relative valuation. Industrials we like on stock specific grounds, with many of its names favourably exposed to expected continued US economic strength.

More Mid Cap outperformance expected in 2025

We see the most energised part of the market remaining as the mid cap space. This segment of the market seems to be the 'sweet spot' right now, where an alignment of Tech, Online Classified and Healthcare stocks are benefiting from secular momentum in their industries. Many of these businesses are fast growing leaders in their fields, but unlike their top-50 counterparts, are operating in business lines which are 'growth focussed'.

Market 'melt up' to continue through 2025

The equity bull market is now a global phenomena, and one that seemingly should continue through 2025 on rate cuts, improving macro, and strong leadership from the US market.

Since we first laid out our 'market melt-up' thesis back in May, its foundations have only firmed. The most recent kicker to the 'risk on' sentiments has been the Trump US election victory, where an expected pro-growth, regulation-light approach has been received by equity market much like an early Christmas present.

Figure 1: Market 'melt-up' checklist

Ingredients	*Update for 2025*
Market rallying despite already high valuations	*Market has increasingly become more and more agnostic on valuations.*
Market rallying despite weak EPS growth profile	*EPS cycle is now transitioning from downgrades to upgrades.*
Market rallying despite subdued macro	*Soft landings are now accepted as reality for most economies.*
Hope of more liquidity / rate cuts	*Fed cutting cycle has begun... we expect RBA to begin in May.*
Money looking to be deployed (i.e. 'dry powder')	*Households now seeing real wage growth again, and spending the tax cuts.*
FOMO and speculative euphoria	*Equities up 20% last 12m… investors looking to gain more exposure.*
This time is different : 1. The rise of Artificial Intelligence (AI)	*The productivity boost to come from AI is increasingly believed real.*
This time is different 2. Demographics (big spending baby boomers)	*Positive wealth effects are allowing boomers spend like never before.*
This time is different 3. Policy makers do 'whatever it takes' to avoid recession	*Fiscal and monetary stimulus almost eliminates recessions risks.*

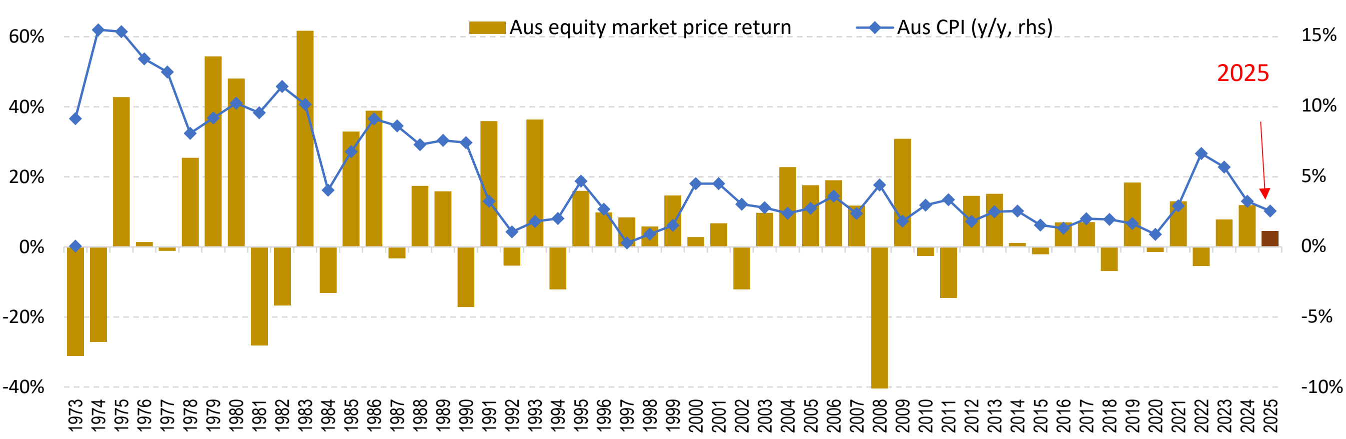
Source: UBS

ASX200 market target of 8850 by end-2025

We see equity prices headed further higher, although not at the breakneck speed which we have seen over the last 12 months. We target the ASX200 index reaching 8850 by the end of calender year 2025, which represents a +5% gain from today's closing price.

We acknowledge that this return does seem relatively pedestrian in the context of the 'bull market' euphoria many segments of the equity market are experiencing, and clear overshoot risks remain. But as fundamental analysts we need to temper our expectations around the reality for profits growth, which up to now has failed to match price gains, and thus earnings need to play catch up.

Figure 2: Annual price returns - Australian equity market



Source: UBS, Refinitiv

Trump and China shine (relatively) favourably on OZ

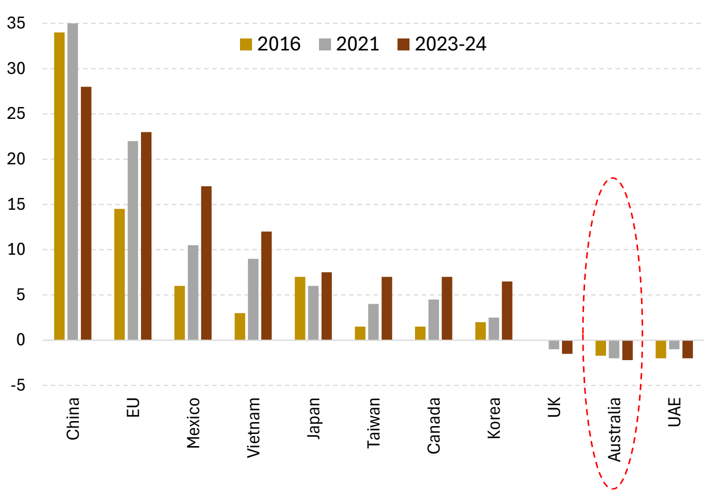
From our just completed roadshow talking to international investors through Asia, one thing that was resoundingly clear, was that the Australian economy (and its equity market) seems like a 'safe port' in a world abound of uncertainty.

Trump trade policies are viewed by investors as a reality which must be navigated, but Australia enjoys somewhat of a cushion against these risks due to a few key distinguishing factors. Firstly, the trade position between the US and Australian economies is one that would not seem to attract the ire of potential tariff policies of the incoming US administration. As global investors pointed out to us clearly when up in Asia last week, this is something which many other economies through the region do not enjoy.

In addition, we would highlight the long standing close relationship between the two countries. This held Australia in good stead through the first wave of Trump tariffs in 2018, and with the subsequent announcement of the Aukus security partnership between the Australia, the US and the UK, we expect this alignment to again be be helpful to Australia on trade policy risks.

We expect that buying of Australian equities from regional investors would step up over the coming year if US and China rhetoric intensifies, which would prompt a rotation towards the relative safety of Australian stocks.

Figure 3: US trade deficit (US$T)

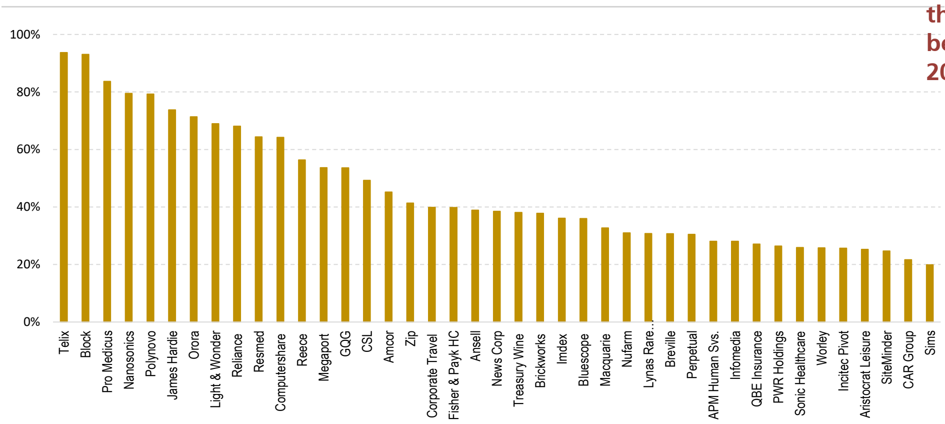


Source: UBS, S&P Global Market Intelligence

Finally, we continually point out that the Australian equity market is no longer the 'safe but boring' defensive market of the region. The index has never been more growthy and high quality than it is now, and is flushed with solid companies that generate earnings from the fast growing US economy. The below list of stocks do not just offer exposure to the robust top-line they will likely see from their US businesses over 2025, but will also see an additional kicker as those US profits are filtered back into a soft Australian-dollar.

US earning Aussie stocks (of which there are many), should continue to benefit from US exposure through 2025.

Figure 4: ASX companies with largest revenue exposure to the US economy



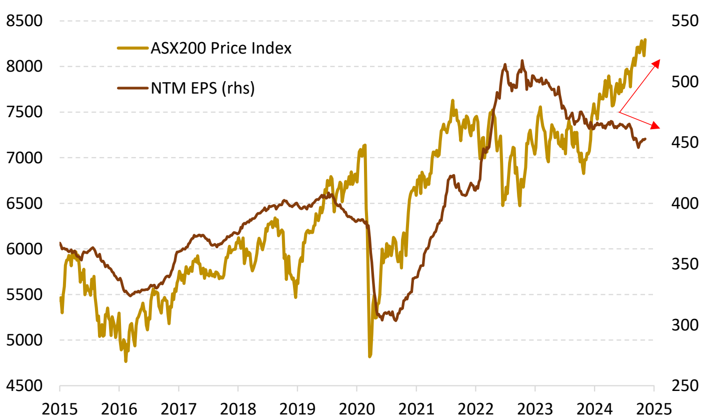
Source: UBS, Company reports

EPS growth should come in 2025, but will it be enough?

We expect earnings growth to resume through 2025 due to a combination of factors:

1. Firstly, earnings estimates for Aussie equities have now been in a downgrade cycle which began back at the start of 2023. Historically, downgrade cycles in Australia are finished after this duration, as analysts, investors and companies have all had time to 're-base' their estimates to the new macro realities. It would appear we have now reached this 'exhaustion point', and expect earnings can now grow off this floor level through 2025.
2. The RBA rate cutting cycle (which we expect to begin in May 2025), should energise the consumer, and stimulate a pick-up in economic activity. These tailwinds will feed through to improved company profits.
3. The US economy is strong and seemingly getting stronger. With the world's dominant economy on an expected upward trajectory, we believe that the overall earnings picture for equities in most jurisdictions (including Australia), look more rosy.

Figure 5: ASX200 price vs earnings

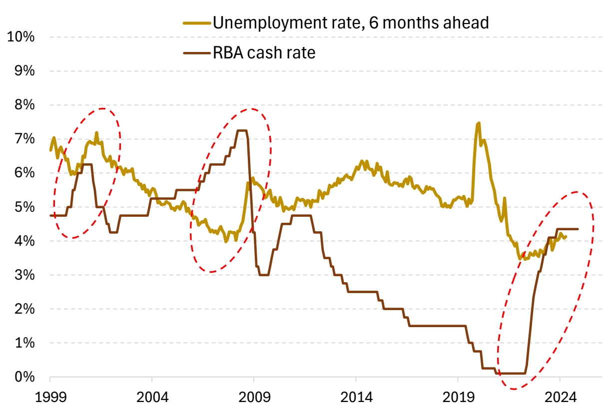


Source: UBS, Refinitiv

Through 2024 equity prices moved up even as the profits downgrade cycle continued. Over the coming year we expect a modest earnings recovery, which should provide a support to the stretched valuation multiples.

Despite the backdrop being conducive to earnings growth through 2025, we believe the eventual outcome will be modest, with profits likely to rise by only around 5% through the year. Tempering a more buoyant upswing in profits is the reality that the economic injection of activity, which we expect will come from the likely RBA rate cuts, will provide a less than usual kicker. Why?; well it comes down to just how non impactful the rate hiking cycle which we faced through 2022 and 2023, ultimately was to the labour market. The usual experience would be for unemployment to gradually increase as rates are tightened, and hence the subsequent rate cutting cycle facilitates an injection of activity as the jobs market recovers. But with the Aussie UE rate already sitting near its lowest on record, any such hopes for a V-shaped recovery seem unrealistic.

Figure 6: Australian unemployment rate vs RBA cash



Source: UBS, Refinitiv

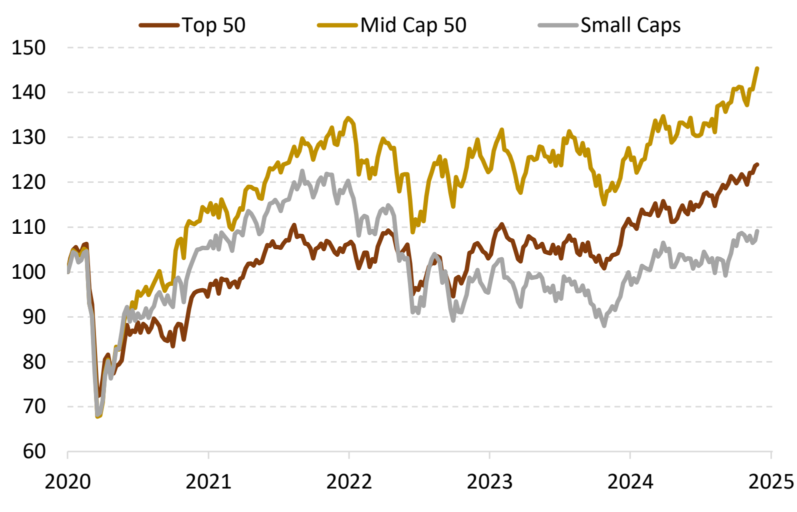
This cycle was unusual ... rate hikes were significant, but the labour market barely budged. The sting in the tail is that the 'usual employment' kicker which comes with rates cuts, will be absent through 2025.

Mid cap outperformance to lead the way

The path in which we get to our end 2025 market target seem to be largely driven by similar themes, sectors and styles to what we have seen through 2024.

Interestingly, we see the most energised part of the market remaining as the mid cap space. This segment of the market seems to be the 'sweet spot' right now, where an alignment of Tech, Online Classified and Healthcare stocks are benefiting from secular momentum in their industries. Many of these businesses are fast growing leaders in their fields, but unlike their top-50 counterparts, are operating in business lines which are 'growth focussed'.

Figure 7: Aus index price performance by size (Jan 2020 = 100)



Source: UBS, FactSet

The Aussie Mid-Cap universe captures a range of fast growing, capital light businesses, where the growth potential still has considerable upside potential.

In terms of equity sectors, there are three standouts where we expect the best performance coming from in 2025.

The **TMT** space captures key stocks in the Technology and Online Classified space. We have been overweight this sector for the last three years on the view that the dynamic changes occurring right now mean investors can not be underweight this space. As long as these companies maintain their upward earnings momentum (which we believe will remain through 2025), the market seems to be comfortable with the high multiples which most of these stocks trade at.

It helps that investor appetite for these companies should remain strong, as not only is sentiment on the theme strong, but the stocks can benefit as investors likely shy away from taking large active positions in the Banks and Miners (two sectors which frustrated investors through 2024).

Figure 8: Sector recommendations

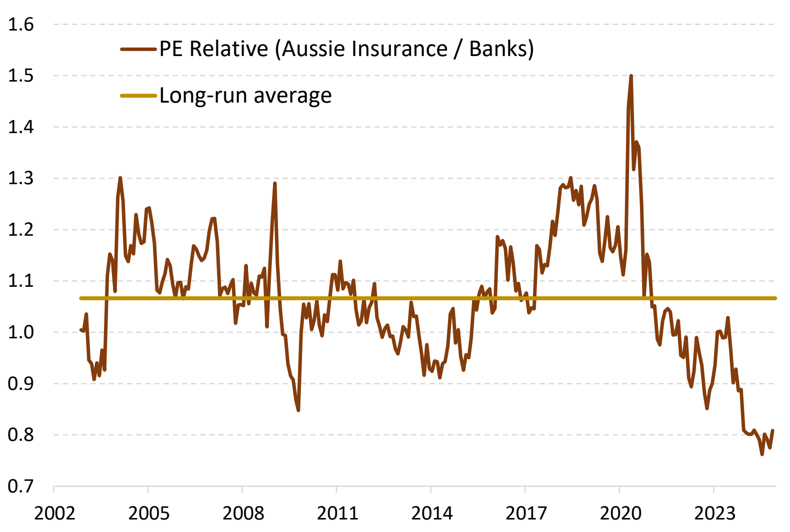
Overweight	Neutral	Underweight
Industrials	Consumer Disc	Banks
Insurance	Consumer Stap	Healthcare
TMT	Energy	Small Caps
	Infra / Utilities	
	Mining	
	Real Estate	

Source: UBS

We also remain optimistic on the prospects for **Insurance** stocks on the ASX. Our Consumer Survey work continues to show the strong pricing power still present through the industry, which makes us feel comfortable that margins can be maintained. In addition, the sector looks cheap (or at least relatively cheap), with its stocks now trading at a 20% PE discount to Australian Banks. This represents a significant relative discount versus the usual 10% premium they have historically traded at against the Banks.

Figure 9: PE relative - Aus Insurance / Banks

Aussie Insurance stocks show strong relative valuation and also keep impressing us on their pricing power dynamic



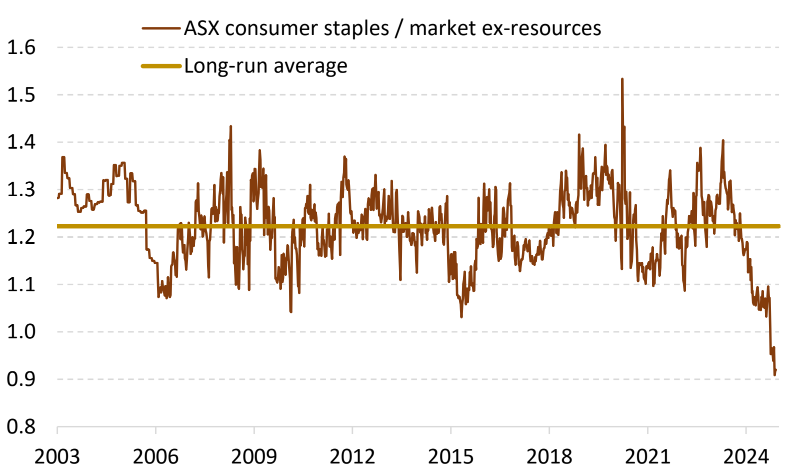
Source: UBS, Refinitiv

Aussie **Industrial** stocks also sit as one of our overweight sectors, although the reasons are often more stock specific. A common characteristic of many of the Industrial stocks we most prefer is their exposure to the US economy. Many of these stocks feature prominently on our list of 'US earners' which we show in Figure 4.

Finally a sector which we are neutral on, but which could pop upwards at some time through 2025, is the Consumer Staples space. We can't see any near-term catalyst for a move yet, but the combination of earnings disappointment and negative newsflow through 2024 have negatively affected share prices, such that valuations now look as cheap as they have ever been.

Figure 10: PE relative - Aus Consumer Stapes relative to market

Negative news has negatively affected the share prices of Aussie Consumer Staples with strong (relative) value



Source: UBS, Refinitiv

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Neutral	FSR is between -6% and 6% of the MRA.	40%	19%
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Buy	Stock price expected to rise within three months from the time the rating was assigned because of a specific catalyst or event.	<1%	<1%
Sell	Stock price expected to fall within three months from the time the rating was assigned because of a specific catalyst or event.	<1%	<1%

Source: UBS. Rating allocations are as of 30 September 2024.
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