



ANZ Investments 2025 Market Outlook

January 2025

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A recap of 2024 – another strong year for investors

Equity markets gain, but bonds lag behind

It was a very good 12 months for financial markets, with many international equity markets reaching record highs, while international bond markets also performed well as the world's central banks began to cut interest rates in response to signs of easing inflation.

US equity markets were some of the better performers, with the broad-based S&P 500 Index and the tech-heavy Nasdaq 100 Index enjoying returns of 25% and almost 30% respectively. Both were spurred by gains in the 'Magnificent 7' – a group of companies that have had a stellar run on the back of continued optimism surrounding the uptake of artificial intelligence (AI). Chip-maker Nvidia Corp was again the standout, as it gained over 170%.

Also supportive of equities was a US economy that showed resilience; it grew at an annual pace of 3.1%, created more jobs than expected, and consumer spending was supported by rising wages. Towards year end, equity markets enjoyed a final push higher, on renewed optimism that Donald Trump's return to the White House would bring lower taxes and looser regulation – even if the rally was later tempered following December's Federal Reserve (the Fed) meeting, where the central bank scaled back its expectations for further rate cuts in 2025.

Equity markets elsewhere largely took their lead from the US. Japan's Nikkei 225 Index gained 21%, as a weak yen made the country's exports super competitive – this despite its central bank being the only one to raise interest rates during the year. European indices also made gains, although their progress was hampered by pivotal elections in many of its key countries. The Euro Stoxx 50 Index and the UK's FTSE 100 Index were up 11% and 9% respectively.

At home, and against a backdrop of an economy that was suffering from growth that has stalled, New Zealand equities did well. The interest rate-sensitive NZX 50 Index was up 11%, buoyed by aggressive rate cuts from the Reserve Bank of New Zealand (RBNZ) – as it brought interest rates down from a peak of 5.50%, to 4.25%. Across the Tasman, the ASX 200 Index also gained 11%, despite the Reserve Bank of Australia's reluctance to lower interest rates given persistent inflation and jobs growth.

Other growth assets also enjoyed strong gains in 2024. Listed property and listed infrastructure investments tend to perform well when interest rates are falling, and so we saw solid returns from these asset classes during the year – especially Australian listed property and international listed infrastructure, which enjoyed double-digit gains.

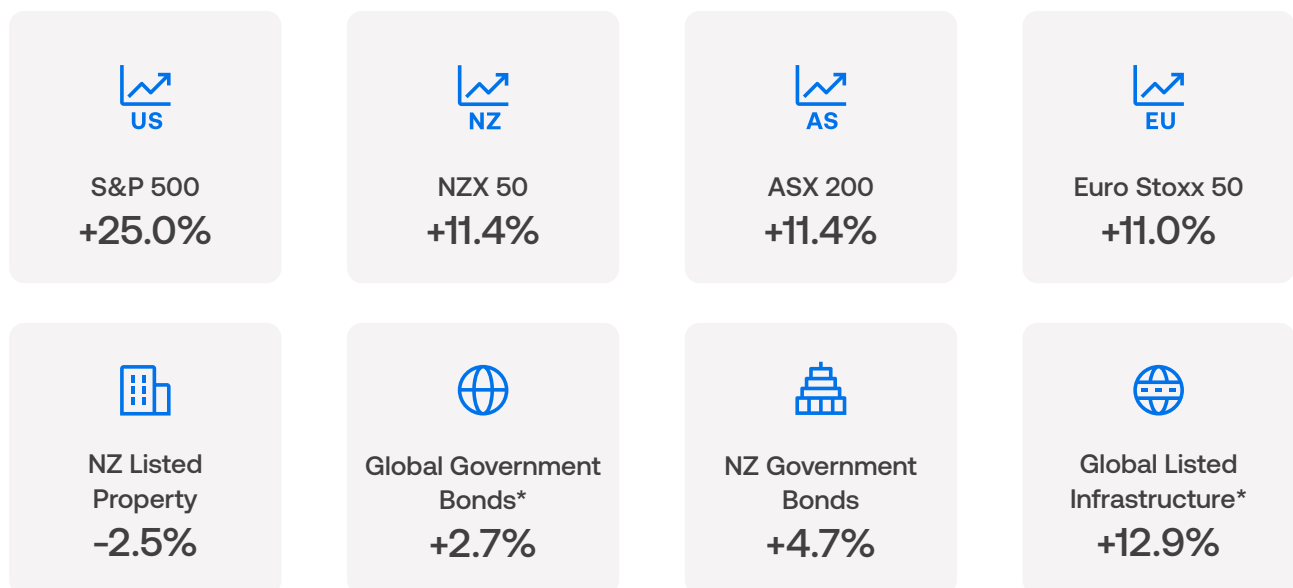
Meanwhile, after two challenging years, international fixed interest (bond) markets initially had a good run as central banks began to bring interest rates lower. In fact, we saw rate cuts in most major developed economies, including the US, Canada, Europe, Switzerland and the UK. Bonds tend to perform well when interest rates decline.

However, the rally stalled later in the year, as the US central bank signalled it was not in a hurry to cut rates further, given the resilience of recent economic data. It meant that international bonds gave back most of their gains to round out the year only 2% higher. New Zealand bonds fared better, supported by the RBNZ cuts, allowing them to finish over 4% higher.

As we look ahead to 2025, the good news is that economic data suggests the US – and many of the world’s other major economies – should avoid a recession. Further cuts in interest rates (albeit not as rapid as earlier hoped) and continued strong earnings should also be supportive of financial markets. That said, geopolitical tensions in Europe and the Middle East have been, and continue to be, a risk for markets. There’s also uncertainty around the policy implications of the incoming US political administration – which have the potential to create some market volatility.

With all that in mind, here’s ANZ Investments’ 2025 Market Outlook.

Most major asset classes deliver gains in 2024



* Hedged to NZD.

Source: Bloomberg, 31 December 2024

US exceptionalism to continue, but equity market valuations appear stretched

Optimism amidst market caution

In many ways, 2024 was another winning year for the United States economy and financial markets. Among developed nations, its economy and productivity outperformed, while its share markets continued to lead the way. Additionally, the US dollar surged to multi-year highs against many of its major trading partners.

The recent outperformance of the US economy began after the COVID-induced recession. Following an initial recovery, most countries and regions saw growth rates slow in 2021 and 2022, with many falling into recession. However, the US economy continued to expand, growing at a pace of 6.1% in 2021, 2.5% in 2022, and 2.9% in 2023, according to data from the US Bureau of Economic Analysis. Against this backdrop of US exceptionalism, it was little surprise that the S&P 500 Index delivered double-digit returns in 2020, 2021, 2023, and 2024.

As we look to 2025, we believe the US economy will continue to be the shining light for global investors. Deregulation should be a net-positive for economic activity, while company fundamentals look sound, which should support earnings. Meanwhile, consumer spending, which makes up two-thirds of the US economy, remains robust.

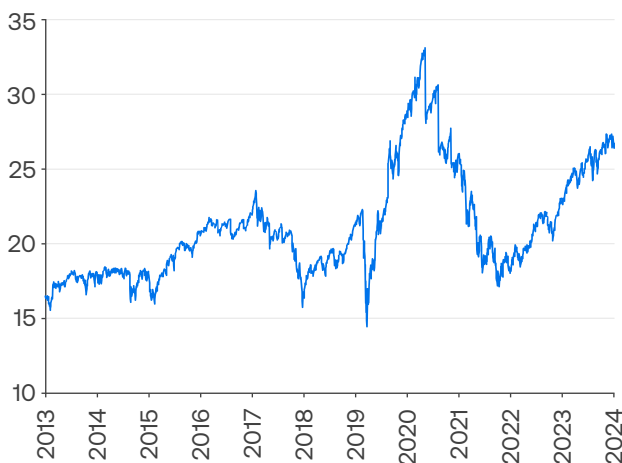
Global economic contrasts

In contrast, European growth will face headwinds amid trade pressures from potential US tariffs and growing competition from Asia, while energy prices, although well off their recent highs, are still elevated. Elsewhere, China's economy can expect ongoing government support, but consumption could be dampened as locals remain cautious after a challenging period.

Equity market valuations

However, in terms of equity market pricing, we are cautious at current levels. With US equity markets ending 2024 at or near all-time highs, valuations—the price investors pay relative to the profits of the company—are at multi-year highs. The price-to-earnings ratio (P/E ratio) of the S&P 500 Index closed 2024 at 26, close to its highest level in more than two-and-a-half years.

P/E ratio of the S&P 500 Index at multi-year highs



Source: Bloomberg

Looking back on 2024, it may have been a perfect storm for US equities: inflation fell, the economy boomed, and the Fed began to cut interest rates. Moreover, the rise of the “Magnificent 7” was truly remarkable.

Mindful of elevated equity market valuations and extremely positive market sentiment, we are heading into 2025 with a neutral positioning to international equities, but we continue to monitor equity markets closely as a correction could present an opportunity to move to an overweight position.

Inflation reacceleration risk

When assessing risks to US outperformance, a reacceleration of inflation is top of mind. Several of President-elect Trump’s policies, including tariffs, immigration, and tax cuts, pose upside risks to prices, while further escalation in the Middle East could see a spike in the price of oil. Meanwhile, wage growth, a major source of inflation over the past few years, remains above pre-COVID levels.

“Very few years unfold as expected, and markets are no different. Yet, the resilience of the US economy—driven by strong consumer confidence, robust corporate earnings, and a pro-growth fiscal stance—sets the stage for upside to risk assets. Outside the US, global growth is likely to remain sluggish, with the biggest threat to recovery being a global trade war.”



Tina Gupta, Senior Investment Analyst



New Zealand set to recover

Economy appears to be bottoming, but a sharp bounce back is unlikely

The New Zealand economy was one of the weakest performing among developed nations in 2024, with consumer spending tumbling as households felt the pinch of higher mortgage rates. The property and construction sectors also faced significant challenges from elevated borrowing costs – even as interest rates have come down.

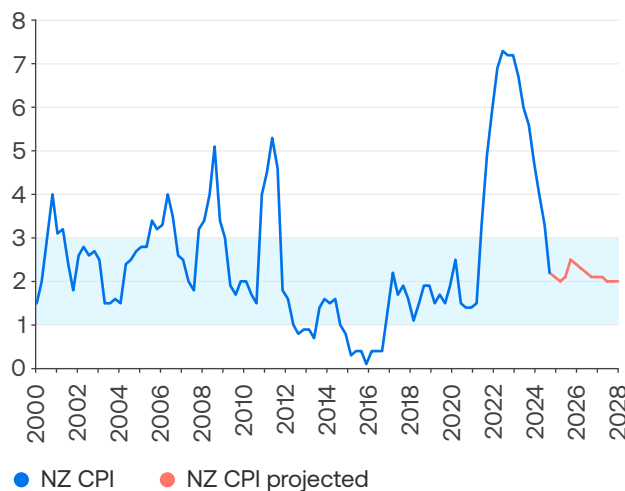
The struggles saw the local economy fall into a technical recession – defined as two consecutive quarters of negative economic growth. For the three months ending 30 September, the economy contracted by 1.0%, which came on the back of a 1.1% decline in the previous quarter. These were the biggest quarterly falls since late 2021, which was at the height of the Covid-19 pandemic and lockdowns. Furthermore, the country faced a productivity slump, with per-capita GDP (Gross Domestic Product) declining 1.2% in the third quarter.

Over the worst

As we head into 2025, we anticipate a moderate economic recovery. However, several challenges remain. Rising unemployment, projected to exceed 5% by mid-year, will be a significant headwind. Additionally, recent interest rate cuts by the Reserve Bank of New Zealand (RBNZ) will still take time to impact consumers and businesses, reducing the likelihood of a sharp economic rebound within the year.

Regarding monetary policy, we foresee the RBNZ implementing roughly 100 basis points of interest rate cuts, bringing the Official Cash Rate (OCR) to approximately 3% by mid-2025. Further reductions will only be considered if unemployment rises above 6%. Conversely, if inflation stabilizes above the central bank's target or begins to reaccelerate, the central bank may reconsider the extent of rate cuts planned for 2025. The good news is that headline inflation has declined close to the 2% target mid-point and is expected to remain there.

Headline inflation is within the 1-3% target band and is expected to remain near the 2% mid-point



Source: Stats NZ, RBNZ estimates (November 2024 MPS)

If there were to be an upwards surprise to the New Zealand economy in 2025, it would likely come from further stimulus from China – as its central bank looks to offer greater support to consumers. This could boost Chinese demand, potentially benefiting the New Zealand agriculture sector, while New Zealand could also see a pickup in tourism numbers.

“The New Zealand economy is showing signs of recovery, but challenges remain. Rising unemployment and the delayed impact of recent interest rate cuts will likely temper the pace of economic rebound in 2025. In terms of government spending, we expect cost-saving measures will continue with core services like roads, water infrastructure and waste collection prioritised over discretionary services.”



Ray Jack, Credit Analyst at ANZ Investments



Responsible investing

Investment Partnerships play a crucial role in implementing our responsible investment approach.

A key area of focus in 2024 was providing our investors with more detail about our approach to climate change, and stewardship for the companies we invest in.

Climate statements

In 2024, we published our first set of climate statements for four of our managed investment schemes, including our three KiwiSaver schemes. These highlight our commitment to responsible investing by helping investors and stakeholders understand the potential impact of climate change on our funds.

Our climate statements detail our approach to assessing the short, medium, and long-term effects of climate change on our investment funds and the actions we are taking to mitigate these impacts. Climate risks include physical risks, such as extreme weather events, and transition risks, such as policy changes towards a low-emission economy.

We report on the direct greenhouse gas emissions of the companies our funds invest in, enabling investors to compare emissions between funds and track changes over time.

We publish climate statements on the ANZ website – see Responsible investing.

Aotearoa New Zealand Stewardship Code

We are a Founding Signatory of the inaugural Aotearoa New Zealand Stewardship Code. This industry-led Code aims to create and preserve inter-generational value for investors, as well as efficiently direct capital where it is most needed for a resilient economy.

Stewardship involves using our influence as investment managers with a view to shaping the behaviour of the companies we invest in (investee companies). Working on behalf of investors, the aim is to encourage more sustainable business practices and improved corporate behaviour. We can do this in two ways:

- **Engagement** – Engaging with the companies we invest in, which could include boards, executives and management.
- **Proxy voting** – Voting on company and shareholder resolutions on our investors' behalf.

In December 2024, we published our inaugural report under the Aotearoa New Zealand Stewardship Code which contains information on the role of stewardship in our climate strategy, our engagement themes and demonstrates examples of stewardship for the companies we invest in.

You can read the report on the ANZ website – see Responsible investing.

Looking ahead to 2025

In addition to continuing to disclose our activities and outcomes through our climate and stewardship reporting, we will look to build on demonstrating how our investment partnerships are contributing to improved investment outcomes, and the implementation of our responsible investment approach.

“Our external investment partners play an important role in the implementation of our responsible investment approach. We look to leverage their scale and expertise and influence across the companies we invest in globally to both manage risk and capitalise on investment opportunities.”



Paul Gregory, Head of Investment Partnerships & Responsible Investment at ANZ Investments



An optimistic outlook amid ongoing geopolitical risks

As we look ahead to 2025, we are optimistic about financial markets, despite recognising the challenges posed by geopolitical risks. The global landscape is shaped by several key uncertainties. A major concern is potential policy shifts under a Trump presidency, notably renewed trade tensions and tariff threats, which could disrupt global supply chains and investor confidence. This could lead to higher inflation and a slower pace of monetary easing.

The ongoing war in Ukraine remains a source of instability, affecting energy markets, food security, and broader geopolitical alliances. Additionally, tensions in the Middle East remain a risk to economic stability, despite the recent ceasefire between conflicting parties. Further disruptions in the region could impact oil markets. These risks highlight the interconnectedness of today's financial markets, where localised events can have far-reaching consequences. We will be closely monitoring these developments this year.

Delivering strong and consistent returns

Despite the uncertainties, our priority is delivering strong investment returns for our clients while managing risks effectively. Since I joined the team in early 2024, we have been working to optimise our investment portfolios to ensure that selected assets can best meet our clients' needs. This has involved adjusting our manager line-up and introducing new investment partners to enhance outcomes.

Last year, we introduced a new international equity strategy from BlackRock Investment Management (Australia), replacing one of our previous managers. This change enhances diversification and strengthens our long-term return potential. We also changed our international equities benchmark, which will allow us to introduce dedicated emerging market managers into certain portfolios to further improve risk-adjusted returns. Watch out for more news about this soon.

Partnering with new specialists

In addition to changes in our manager line-up, we have started working with other carefully chosen investment partners, including a broader relationship with BlackRock (Australia) – which will provide ANZ Investments with risk management and support services, as well as access to their global team of investment and risk experts. BlackRock will assist with foreign currency hedging, rebalancing, and liquidity management, while decision-making, oversight, and accountability remain with ANZ Investments. Access to BlackRock's global team adds another layer of investment experience and insights to better inform our decisions.

Our commitment to active management

Despite these changes and the evolving investment landscape, ANZ Investments remains committed to active investment management. We will continue making thoughtful decisions to help our investors achieve their financial goals. As we move into 2025, we are confident that our updated portfolio structure and strategic partnerships position us well for the future. Our continued focus on responsible investing should help us deliver strong and sustainable outcomes for our clients.

“The global economy is undergoing significant change, given varied economic growth rates and persistent inflation. Navigating these complexities requires understanding both the risks and opportunities. In times of heightened uncertainty, a comprehensive investment approach is crucial. Diversifying across asset classes and regions, while focusing on long-term goals, is key to managing risks and achieving sustainable returns.”



George Crosby, Chief Investment Officer
at ANZ Investments





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