

Market Insight – Stay the course in growth assets

Recently there has been some commentary highlighting concerns with the future direction of equity markets, given some leading indicators suggesting heightened downside risk. One recent news article even noted an ex-RBA economist having moved all his super investments into cash due to concerns around a significant market correction of 30% to 40%. Such a potential outcome is understandably scary and gives most of us cause for concern. Of course, it might also be worth noting that economists are not renowned as great investors; regardless the headline gets your attention.

There appears to have been an increase in commentary noting heightened risks of a market correction, and these calls will be correct at some point in time, maybe next week or maybe in five years. Nevertheless, such commentators will be able to claim they were right, even if they were too early and markets rose in the interim to higher levels than the fall!

In fairness, we can point to some of the data suggestive of increasing risks. In the US recent job numbers were weaker than expected, raising concerns of a slowing US economy, although unemployment remains at 4.3%. Headline inflation in the US has risen since the announcement of tariffs in early April 2025, from 2.3% to 2.9%, annualised, while core inflation, which excludes volatile items like food and energy has increased from 2.8% to 3.1% over the same period.

Furthermore, the Fed's preferred measure for inflation is the core Personal Consumption Expenditure (PCE) price index, which has also increased from 2.6% to 2.9%, annually over the same period. However, looking at the monthly data for the above inflation measures, the period is still too short to identify any clear trends, but so far, monthly core PCE price data has ranged between 0.1% and 0.3% since tariffs commenced, and headline inflation between 0.1% and 0.4%, which are standard readings.

In coming months, more clarity will be gained on the inflation trend, but our current view is that inflation will work its way up towards the higher end of the Fed's range, to marginally above, where we believe it is likely to stabilise (i.e. around 3.5%). We also believe economic growth and the amount of rate cuts from the Fed will play a pivotal role in future inflation readings. Also, the level of tariff pass-through by companies, to maintain margins, will be dependent upon the level of economic growth. Therefore, we need to be vigilant in monitoring data as it becomes available to drive any shifts in our expectations.

Investors need to be mindful there are always some negative signals that can be highlighted in any market. Only over the 2025 financial year, markets delivered solid gains on a wall of worry; and rose through the Israel Iran crisis, the ongoing Ukrainian crisis, the April tariffs announcement, threats of deglobalisation, and so on. Markets do not always follow the path that may appear the most obvious at the time.

There are potential positives too, with likely interest rate cuts from the Fed, and the rise of artificial intelligence and its impact on equity markets, future company earnings and productivity. The impact of artificial intelligence into the future is an unknown, however it could be significant like the impact of railways in the 19th century and industrialisation from the midst of the 18th century.

The one certainty is the short-term future direction of equity markets is unknown and to move away from growth assets (i.e. equities) at this current point in time carries some risk, despite where valuations are. For now, we maintain a slight overweight in equities, however we continue to closely monitor data and events to ensure we are ready to act should the need arise.

The impact of artificial intelligence on markets to date has driven us to adopt more of a core satellite approach in our portfolios. The "magnificent seven" has been one result of the markets responding to the impact of the opportunity created by artificial intelligence. A select few companies have been significant beneficiaries with their valuations driven up considerably. These seven companies now represent over 30% of the S&P 500 Index.

This is astonishing in itself; however, these companies' earnings have been growing to justify the valuations, which is even more impressive. This can be seen for 2025 in the chart overleaf where valuations for IT and Communication Services focused stocks have fallen, while earnings have been growing. It is the rest of the market, where valuations can be more readily questioned with respect to support from underlying earnings.

Adopting a core satellite approach has allowed our clients to benefit from solid exposures to magnificent seven companies where some active managers have struggled to hold these stocks, let alone hold them overweight, during an unprecedented run up as artificial intelligence makes its mark.



Source: Livewire

Furthermore, our clients would have suffered considerably if we had recently reduced our equities exposures due to over-reactions to some data points. These data points suggest some caution is warranted, but they are not inherently indicative of impending market turmoil.

Tariffs have caused uncertainty and are a tax on consumption, which softens growth. However, this does not mean the destruction of an economy, as some commentators have implied. The famous Smoot-Hawley Tariff Act, implemented during the great depression, led to retaliatory tariffs that were detrimental to economies, further exacerbating the great depression. But even in that extreme period, the US economy was not destroyed, and the share market had collapsed in 1929, prior to the Smoot-Hawley Tariff Act's introduction.

Trump's tariffs may well soften the US economy (although real GDP is currently forecast to grow by around 1.5% to 2.0% this calendar year), but it is not the only factor to consider, such as the impact of artificial intelligence on productivity, profit margins and growth, increased tax benefits for consumers and corporates, lower interest rates, increased manufacturing investment, deregulation and lower energy costs, for example.

We need to always exercise caution as investors in markets, but we do not want to be jumping at shadows all the time either. Investing requires constant monitoring and reacting appropriately to evidence, without jumping at each new piece of data.

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