Monthly Market Commentary

November was an exceptional month for almost all major global equity indices with US stocks recording their seventh-best monthly return in 30 years. Fuelling this broad-based rally has been a notable shift in the narrative around interest rates. A series of benign inflation prints and weaker than expected economic updates has moved the market on from "higher for longer" and brought forward the prospects of an interest rate cut. Futures are pricing in a roughly 1.25 percentage point rate cut next year. The effect of this change is evident also at the long end, with yields on 10yr US treasuries, for example, falling by ~60bps during the month.

Arguably there is a growing disconnect between the strength in equity markets, which has been entirely driven by multiples, and the state of the economy. It appears that until they roll over, equity investors seem prepared to ignore the growing risks to earnings. And if equity investors are prepared to ignore the risk, analysts seem to see only upside. Forecasts for the S&P500 EPS next year are +10%. We find this hard to reconcile with history and the data.

US markets led the way, with the NASDAQ and S&P500 up 10.7% and 8.9%, respectively. US small caps also delivered strong returns during the month with the S&P600 Small Cap Index rising 8% in November. Major European bourses mostly participated in the strong rally, with the French CAC and German DAX, both up 6.5% and 9.2%, respectively. However, the UK FTSE was a noticeable laggard up only 1.8% for the month. In Asia, performance was mixed. While Japan's Nikkei225 rose strongly, up 8.5%, China's Shanghai Composite was largely flat as news flow continues to suggest the economy is rapidly cooling (e.g. China recorded its first ever quarterly deficit in foreign direct investment).

Except for Energy which fell 0.2%, all other sectors rose significantly with Tech the key standout, up 13.6%. Finance, Industrial, and Consumer Discretionary were also notable winners, all up over 10%. Defensives lagged in a relative sense however, they still managed to deliver good absolute performance with Healthcare and Utilities both up more than 5%, while Staples finished up 4.1%.

The AUD rose strongly against the USD, up 4.2%, while commodities were broadly weaker with the Bloomberg Commodity Index falling 2.7% and WTI Oil down 6.2%. Against this backdrop of strong equity market performance, VIX fell materially by 5.2 points to finish at 12.9.

In terms of new positions, the Fund gained exposure to US-based WEC Energy which owns a collection of regulated electricity and natural gas distribution and transmission assets across several US states. WEC has a solid track record of growing dividends (approx. 7% per year over the last five years) as it has consistently been able to expand its regulated asset base (RAB), a key driver of value for regulated businesses. Prior consensus expectations of rates to remain higher for longer weighed on WEC's share price. This created an opportunity for us to gain exposure to the stock on a prospective dividend yield of ~4%, when we think it can continue growing the dividend at mid-single digit levels. We were also attracted to the stock's defensive qualities with earnings largely unaffected by the business cycle.

Chinese technology group, Alibaba was the Fund's biggest detractor in November. Shares fell sharply after the company dropped plans to IPO its Cloud business and flagged that expanded US trade restrictions would affect its "ability to upgrade technological capabilities". While this is clearly disappointing, current business momentum is holding up well (all units contributed to Q2 24 EBIT growth), and a strong balance sheet affords management time to reposition the company accordingly. Should they execute on this, we think there is material upside on offer with the stock currently trading on a prospective P/E of less than 8x, noting it is sitting on ~USD$85bn in net cash. That said, given the stock's many challenges, we are prepared for it to take some time for any upside to materialise.

The Fund's holding in Canadian metals streaming business, Wheaton Precious Metals (WPM) was the biggest contributor to performance in November. The stock benefitted from a strong rebound in both gold and silver prices, as the weakness in the USD and longer-term rates helped the broader precious metal space. WPM also announced the completion of an important milestone associated with VALE's Salobo III expansion project, a mine with which WPM has a royalty agreement in place. Once completed, mine throughput will increase from 24Mtpa to 36Mtpa, helping further underpin WPM's medium term growth outlook.

Mexican beverages and retail group, FEMSA was also a meaningful contributor to Fund performance. The stock continued to rally through November following a solid Q3 23 result with highlights including strong user growth in digital, ~15% same-store sales across the Oxxo network, and high single digit organic growth and margin expansion in the Coke Femsa franchise. Following the divestment of all non-core assets, the balance sheet is now flush with optionality (~$3bn net cash) allowing management to focus on both investing more in these growth assets (Digital, Oxxo store roll-out) while also increasing returns to shareholders.

Talaria Asset Management
330 Collins Street
Melbourne, VIC, Australia 3000
info@talariacapital.com.au
talariacapital.com.au