

Growth Slowing at the margin

INFORMATION CONTAINED IN THIS REPORT CURRENT AS AT 10 OCTOBER 2025

The Australian share market (S&P/ASX 200) declined by 0.80% in September whilst international shares as measured by the Morgan Stanley Capital Index (MSCI) increased by 1.99% and emerging market shares 5.82% driven by China's share market. International shares were driven higher led by the US after the Federal Reserve delivered its first rate cut of the year, citing signs of a cooling labour market. U.S. equities went on to record their strongest September in over 10 years. Fears of higher inflation kept bond markets on edge over the month with the Australian bond market underperforming cash. Australian bonds performed in line with cash over the year with a return of circa 4%. Global bonds outperformed Australian bonds over the month thanks to data suggesting a slowdown in employment growth in the US. However international bonds continue to lag Australian bonds over the year.

In the US, consumer confidence, has a high correlation with consumer spending. The current level of confidence is consistent with real consumer spending growth of around 1.5%. It isn't a disaster however given consumer spending is over two thirds of US economic activity and averages closer to 3-4%, it is noticeable. The softness in spending may be due to concerns about inflation, incomes and wealth. While tariffs have been slow to impact inflation, there remains some nervousness that tariff-induced price hikes will come and will squeeze spending power, leading to a lower standard of living. Furthermore, there are concerns about job market prospects and lastly,

while equity markets are at all-time highs, the largest store of wealth for most Americans is in the value of their home. On this front, after five consecutive drops in monthly house prices, this may be more of a worry for homeowners.

On the employment front, a weak non-farm payrolls number in the US which was well below July's gain and analyst's expectations. The data suggested that the Fed Funds rate in the US will continue to be lowered. We will not get an employment report this month due to the government shutdown. Consequently, other data points which have some signals as to the health of the jobs market in the US have taken on greater significance. The ISM Services index employment component, the ADP national employment report and regional fed surveys pointed to falling employment while the Challenger data showed a continued "low hiring, low firing" regime which was outlined in last month's update. Overall, the picture of the US economy has not changed. Inflation remains elevated and whilst further interest rate reductions are expected, the pace of the reductions may slow. Slow GDP growth is needed to preserve the easing cycle and asset markets.



Emmanuel Calligeris

Chairman of the Investment Committee

In China, deflationary pressures persist and export growth has slowed. The World Bank forecasts China's GDP growth to ease to 4.2% in 2026 due to slower export growth. The housing market remains dire with residential floor space supply down 72% from its peak in 2021. The labour market remains weak and recruitment surveys point to a slowing hiring trend. China's factory activity improved slightly after a growth spurt at the start of the year but extended its decline for a sixth month. Both the housing and labour markets are weighing on consumption with durable goods spending lower again in September.

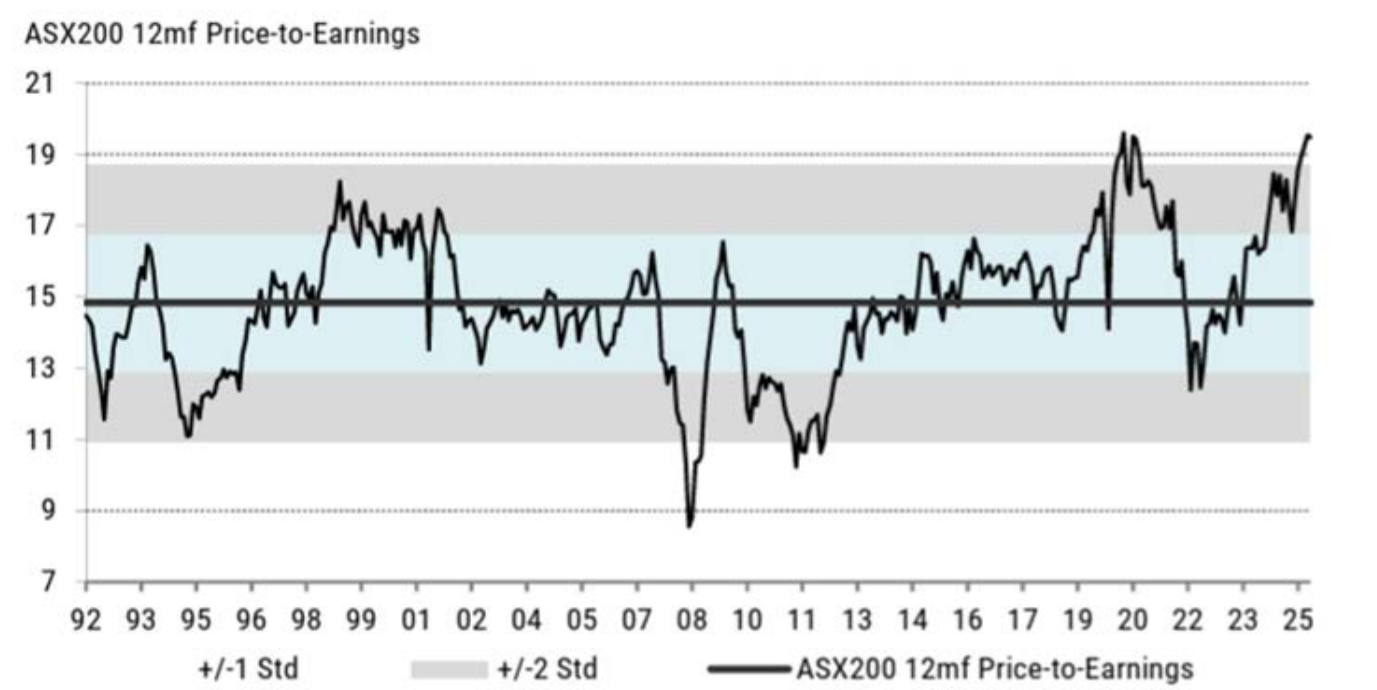
China's central bank cut interest rates and bank reserve requirements. It also enabled companies to buy back their shares and institutional investors to leverage their balance-sheets more easily. The stock market jumped. The Shanghai stock index is 40% higher over the year with the rally drawing its strength from the promise of fiscal stimulus and AI driving the gains. More recently it has gained momentum from the government's efforts to discourage price wars. The index exceeded 3,800 for the first time in ten years, however, the government's ultimate goal was not merely to revive the market. It hoped the market would help revive the economy by building confidence through the wealth effect. Unfortunately, the economy has refused to take the hint.

In Australia the RBA left the cash rate unchanged at 3.60% with the commentary sounding cautious to us. Governor Bullock expressed a degree of concern over the inflation outlook. Rental disinflation has stalled, running at around 3.5% annualised rate. Analysts expected this to decelerate however that has failed to materialise because population growth remains strong while new dwelling completions have failed to keep abreast of rising housing demand.

A surprising development is that new dwelling construction costs increased by 0.4% for the second consecutive month thanks to a pick-up in housing demand and still-elevated labour costs. This has led developers to offer less discounts. Together, rents and new dwelling construction cost make up 14.2% of the inflation basket. With house prices accelerating, labour market still tight, and high construction costs housing is expected to underpin higher inflation. Headline and trimmed-mean inflation is expected to be 3.0% and 2.7%, respectively, in the third quarter. As mentioned last month, there is a risk that the interest rate easing cycle could end after the next cut as a result.

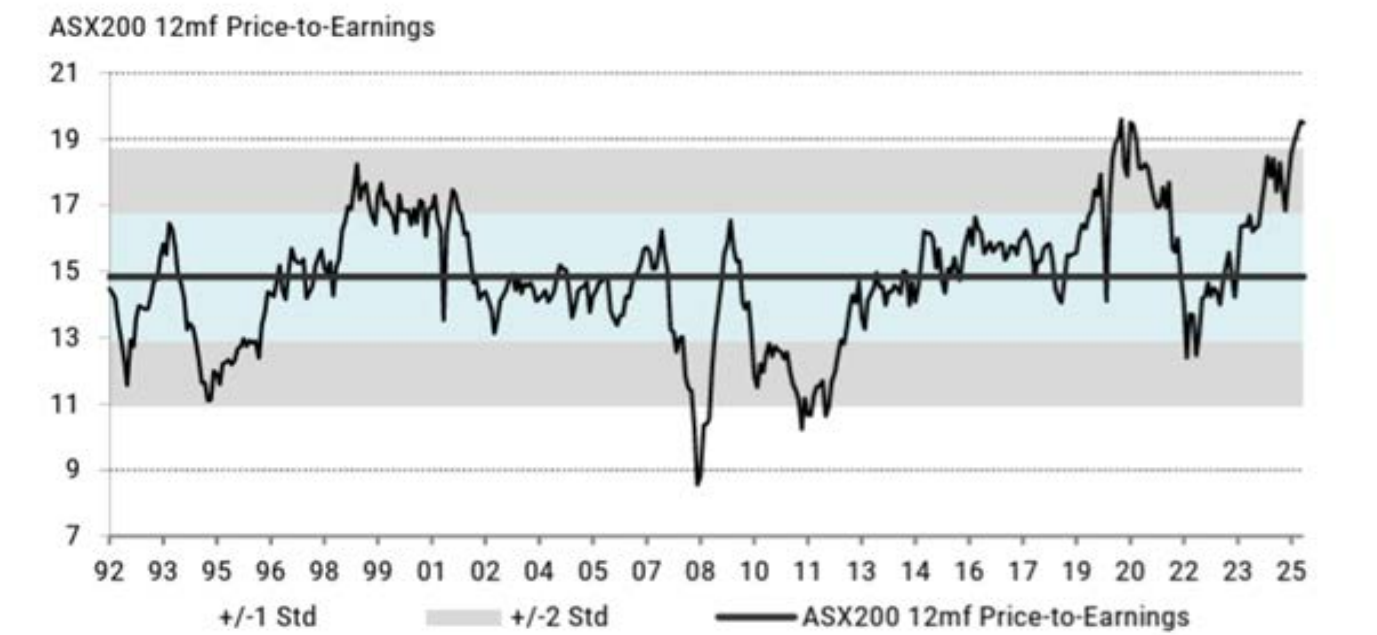
Consumer spending has also proved to be stronger than expected although temporary factors including insurance payouts, holidays and discounting boosted the outcome. The recovery in consumer spending is a key part of the rotation of growth from public to private demand. Much of Australia's growth was held up by government spending. The federal budget outcome for 2024/25 showed a better-than-expected cash deficit of \$10bn (0.4% of nominal GDP) off the back of elevated commodity prices and stronger company and income tax receipts. Although growth in public spending has slowed recently, the higher level of public spending will see the budget remain in deficit over the next decade. The combination of lower mortgage rates and the Australian Government's 5% home deposit scheme for first home buyers, has seen an uplift in house prices. The latest Cotality (formerly CoreLogic) data recorded a 0.90% pickup in house price growth in September again suggesting a reduced likelihood of a series of interest rate reductions.

We remain concerned that the Australian (and US) share market remains expensive. The following chart by IBESS/ Morgan Stanley highlights poor valuation as illustrated by the forward price to earnings ratio (P/E).



The S&P 500 currently trades at 22.7-times forward earnings. The forward P/E ratio today is similar to what it was in 2021. Relative to bond yields, the earnings yield on stocks has never been so low outside of the dotcom bubble. We remain concerned that the fiscal situation in the US has not improved and the slowing in growth coupled with sticky inflation may deliver a stagflationary environment in 2026.

Exhibit 8: ASX 200 forward multiple at historical highs, 19.5x



Source: RIMES, IBES, Morgan Stanley Research

ASSET CLASS RETURNS ARE BASED ON

Australian Cash

RBA Bank accepted Bills 90 Days

Australian Listed Property

S&P/ASX 200 A-REIT TR

International Shares

MSCI World Ex Australia NR AUD

Australian Bonds

Bloomberg AusBond Composite 0+ Yr TR
AUD

International Property Hedged

FTSE EPRA/NAREIT Dv REITS TR Hdg
AUD

Emerging Market Shares

MSCI EM GR AUD

International Bonds Hedged

BarCap Global Aggregate TR Hdg AUD

Australian Shares

S&P/ASX 200 TR

RETURNS TO THE 30TH SEPTEMBER 2025

| | 1 Month | 3 Months | 6 Months | 1 Year | 3 Years | 5 Years | 10 Years |
|-------------------------------|---------|----------|----------|--------|---------|---------|----------|
| Australian Cash | 0.29 | 0.90 | 1.85 | 4.02 | 4.02 | 2.58 | 2.07 |
| Australian Bonds | 0.10 | 0.40 | 3.04 | 4.09 | 4.25 | -0.23 | 2.12 |
| International Bonds Hedged | 0.68 | 1.02 | 2.53 | 2.44 | 3.96 | -0.57 | 1.94 |
| Australian Listed Property | -3.10 | 4.56 | 18.90 | 4.10 | 19.85 | 11.91 | 8.69 |
| International Property Hedged | 0.81 | 4.39 | 5.88 | -0.79 | 8.04 | 6.62 | 4.44 |
| Australian Shares | -0.78 | 4.71 | 14.66 | 10.56 | 15.17 | 12.98 | 10.11 |
| Emerging Market Shares | 5.82 | 9.41 | 16.50 | 22.81 | 17.02 | 8.71 | 8.62 |
| International Shares | 1.99 | 6.14 | 12.44 | 23.03 | 22.63 | 16.27 | 13.14 |

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