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Risky Business

September 2024



“The job of the Central Bank is to worry.” – Alice Rivlin, 16th Vice Chair of the Federal Reserve

If central banks worry, what is an investor to do? In its last monetary policy decision statement, the Reserve Bank of Australia (RBA) stated, “Sustainably returning inflation to target within a reasonable timeframe remains the Board’s highest priority.” The RBA is worried about inflation. Earlier in the month the Federal Reserve (Fed) issued its policy statement, noting “The economic outlook is uncertain”, before proclaiming, “In light of the progress on inflation and the balance of risks, the Committee decided to lower the target range for the federal funds rate by 1/2 percentage point”.

So while the RBA frets about inflation risks, the Fed now frets about the slowing economy, a different risk of their dual mandate. The result is a divergence of policy. The European Central Bank (ECB) appears to have shifted to the Fed’s thinking too. The manoeuvrings of Central Banks are driving markets. Irrespective of their focus, all central bankers will be doing all they can to pilot a ‘soft landing’, and we think for the most part they will.

In the meantime, rather than react to data releases, markets overreact as they tend to do. Volatility spiked and slowed as quickly as ever during the quarter. China started the last week of September among the worst performing equity markets, then rallied to finish the quarter as the best performing asset class, following an unexpected easing onslaught by authorities. Gold also bucked the trend as investors sought a hiding place from uncertainty and economic weakness, it surpassed US\$2,600 per ounce. As rates fell globally, long-duration assets such as infrastructure did well. Likewise, REITs were the best-performing equity sector.

Central banks’ actions, and inactions, are driving markets. No one knows which direction inflation will move next, no one knows what the next employment print will show. Each geography has unique issues. Central bank divergence is happening and could continue well into 2025.

The other show in town is the US Presidential Election, again, difficult to predict. The result will have implications for markets, but it seems no matter who wins, US debt will rise and there will be tariffs on China. It’s just the scale that differs between the two parties.

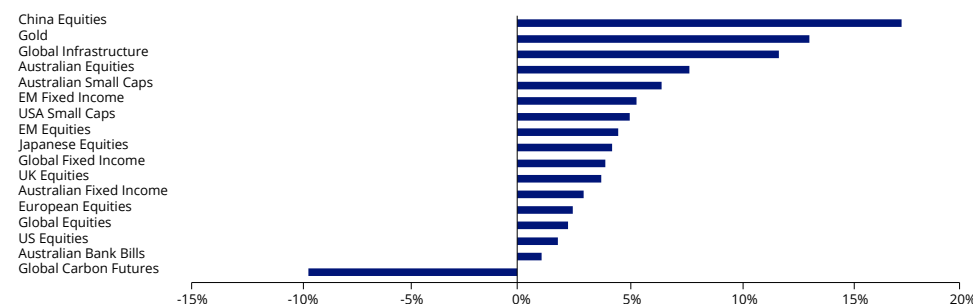
We are optimistic for investors and think opportunities exist into the next cycle. Investors should continue to approach risk assets selectively. Now is not the time to be brave for over-owned risk assets. While Australia may appear cheap relative to global equities, its composition skews to ‘cheaper’ sectors. We would caution to be mindful of concentration risks. Small companies, locally and globally, also present an opportunity, again selectivity is paramount. Emerging markets, both debt and equity complexes, offer a greater risk premia and past structural reforms have resulted in strong relative fundamentals coming

to the fore now. We could still see the US dollar come off and gold climbing to new heights. Gold miners are still undervalued relative to the price of gold, and we think with strong cash flows they could outperform the yellow metal into the backend of 2024.

Investors must navigate more risks than central bankers, who choose to either focus on inflation or growth. It’s a risky business. As a noted former hedge fund manager once observed:

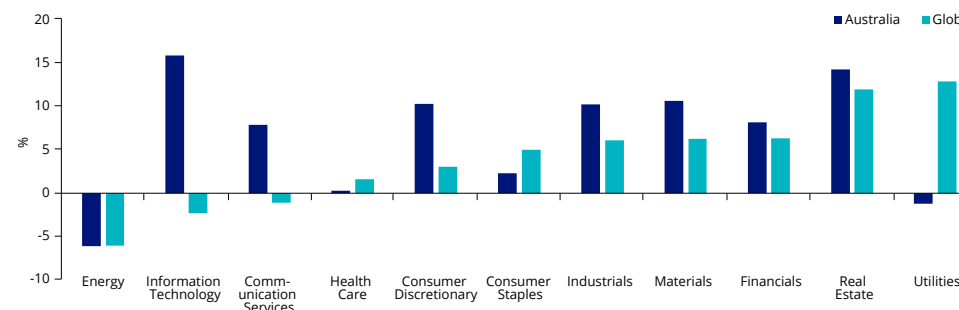
“The single greatest edge an investor can have is a long-term orientation.” – Seth Klarman

Chart 1: Mainstream asset class returns for the quarter



Source: 1 July 2024 to 30 September 2024, returns in Australian dollars. Global Carbon Futures is ICE Global Carbon Futures Index, US Equities is S&P 500 Index, International Equities is MSCI World ex Australia Index, European Equities is MSCI Europe Index, UK Equities is FTSE 100 Index, Australian Equities is S&P/ASX 200 Accumulation Index, Australian Small Caps is S&P/ASX Small Ordinaries Index, Gold is Gold Spot US\$/oz, US Small Caps is Russell 2000 Index, China Equities is CSI 300 Index, Global Fixed Income is Bloomberg Global Aggregate Bond Hedged AUD Index, Australian Bank Bills is Bloomberg AusBond Bank Bill Index, Australian Fixed Income is Bloomberg AusBond Composite 0+ yrs Index, EM Fixed Income is 50% J.P. Morgan Emerging Market Bond Index Global Diversified Hedged AUD and 50% J.P. Morgan Government Bond-Emerging Market Index Global Diversified, EM Equities is MSCI Emerging Markets Index, Japanese Equities is Nikkei 225 Index. Past performance is not a reliable indicator of future performance.

Chart 2: Global and Australian equity sectors quarterly performance



Source: 1 July 2024 to 30 September 2024, returns in Australian dollars. Utilities is MSCI World Utilities Index / S&P/ASX 200 Utilities Index, Industrials is MSCI World Industrials Index / S&P/ASX 200 Industrials Index, Materials is MSCI World Materials Index / S&P/ASX 200 Materials Index, Consumer Staples is MSCI World Consumer Staples Index / S&P/ASX 200 Consumer Staples Index, Consumer Discretionary is MSCI World Consumer Discretionary Index / S&P/ASX 200 Consumer Discretionary Index, Financials is MSCI World Financials Index / S&P/ASX 200 Financials Index, Energy is MSCI World Energy Index / S&P/ASX 200 Energy Index, Healthcare is MSCI World Health care Index / S&P/ASX200 Health care Index, Telecommunications is MSCI World Telecommunications Index / S&P/ASX 200 Telecommunications Index, Information Technology is MSCI World Information Technology Index / S&P/ASX 200 Information Technology Index, Real Estate is MSCI World REIT Index / S&P/ASX 200 AREIT Index. Past performance is not a reliable indicator of future performance.

A tale of two central banks

As COVID supply and demand shocks unravel, alongside global growth that could be best described as modest-to-anaemic, central banks find themselves on different timetables. In one notable case, Japan, is moving in a different direction.

Most central banks have either commenced easing or are edging towards it. The three biggest economic blocs, China, Europe and the US are cutting.

Monetary policy is a trade-off between different goals, made in the face of uncertainty.

Polymakers don't have up-to-the-minute data. As we have seen, as recently as the last quarter, the past (data) is also subject to revisions. As Niels Bohr, the father of quantum physics, said: "prediction is very difficult, especially if it's about the future."

Some of the variation between central banks noted above is due to differing current and expected macro performance.

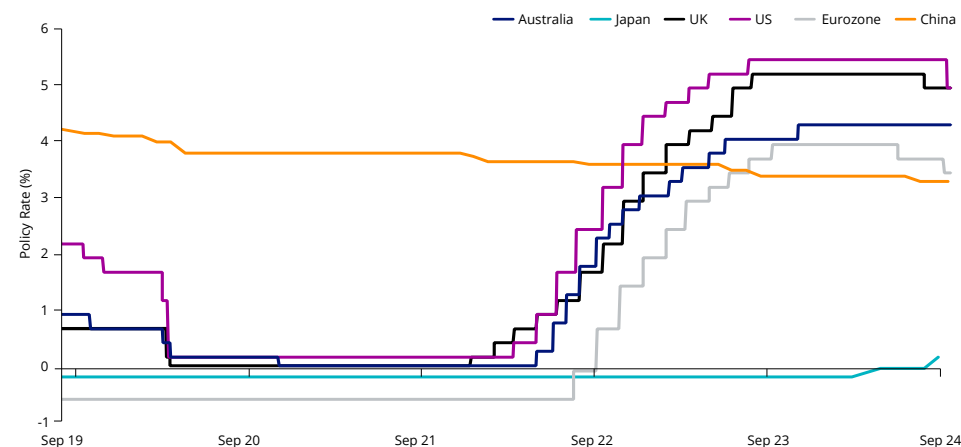
There are also other factors at play. For example, the gap in the policy setting between the Fed and the RBA is looking more like a chasm.

With its 50 basis point cut (bps), the Fed has gone full 'dove', with the RBA appearing to out 'hawk' the long-time title holders at the ECB.

For the jargon illiterate, doves seek an expansionary monetary policy, lowering interest rates while pursuing a policy of quantitative easing. On the other hand, hawks seek a contractionary monetary policy, hiking rates, or keeping them high and avoiding quantitative easing.

Chart 3: Policy rates around the world

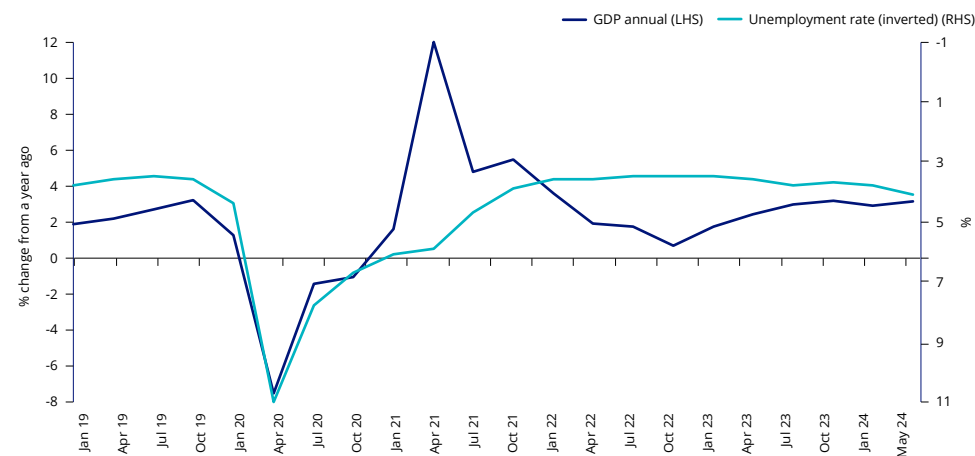
The last few months have seen policy divergence



Source: Bloomberg

Chart 4: US growth and unemployment

It's on repeat, still much ado about nothing



Source: Federal Reserve Bank of St. Louis.

Crisis? What crisis?

For the umpteenth time since the US economy escaped the clutches of COVID, we've been through another round of "oh no, here comes the recession". A lot of survey data has, once again, turned 'softish'. And yet, the hard data suggests the US is about to deliver another above-trend growth quarter.

The difference this time is the Fed has joined in, delivering a jumbo 50 bps cut at its most recent meeting, and forecasting another 50 bps by year-end.

It's difficult to say what changed the Fed's mind. Not a lot appears to have changed in its economic forecasts since its June projections, with the notable exception of the interest rate projections, which have been slashed.

One explanation could simply be a change in the risk they're now most focused on, growth. Since the commencement of its hiking cycle the Fed has been steadfast in its commitment to fighting inflation. Now it seems the Fed has declared victory on inflation, after data flipflops through the last quarter of 2023 and the start of 2024. The rate cut signals that the Fed has decided inflation is now on the path back to target.

That has allowed them to swing their focus back to unemployment, now a whisker above their estimates of non-accelerating inflation rate of unemployment (NAIRU).

A bit of Sahm rule hysteria mid-quarter and a downward benchmark revision (see, the past is subject to revisions) to payrolls may have unnecessarily added to angst.

Both have question marks over them.

Chart 5: Fed economic projections, June 2024

Only Fed funds rate has dropped

Variable	Median ¹				
	2024	2025	2026	2027	Longer run
Change in real GDP	2.0	2.0	2.0	2.0	1.8
June projection	2.1	2.0	2.0		1.8
Unemployment rate	4.4	4.0	4.3	4.2	4.2
June projection	4.0	4.2	4.1		4.2
PCE inflation	2.3	2.1	2.0	2.0	2.0
June projection	2.6	2.3	2.0		2.0
Core PCE inflation ²	2.6	2.2	2.0	2.0	
June projection	2.8	2.3	2.0		
Federal funds rate	4.4	3.4	2.9	2.9	2.9
June projection	5.1	4.1	3.1		2.8

Source: US Federal Reserve. Note: Projections of change in real gross domestic product (GDP) and projections for both measures of inflation are percent changes from the second quarter of the previous year to the second quarter of the year indicated. PCE inflation and core PCE inflation are the percentage rates of change in, respectively, the price index for personal consumption expenditures (PCE) and the price index for PCE excluding food and energy. Projections for the unemployment rate are for the average civilian unemployment rate in the second quarter of the year indicated. Each participant's projections are based on his or her assessment of appropriate monetary policy. Longer-run projections represent each participant's assessment of the rate to which each variable would be expected to converge under appropriate monetary policy and in the absence of further shocks to the economy. The projections for the federal funds rate are the value of the midpoint of the projected appropriate target range for the federal funds rate or the projected appropriate target level for the federal funds rate at the end of the specified calendar year or over the longer run. The projections were made in conjunction with the meeting of the Federal Open Market Committee on June 11–12, 2024. 1. For each period, the median is the middle projection when the projections are arranged from lowest to highest. When the number of projections is even, the median is the average of the two middle projections. 2. Longer-run projections for core PCE inflation are not collected.

Chart 6: Gold and real 10 year treasury yield

The dollar losing its lustre



Source: Bloomberg, National Bureau of Economic Research.

*Generic 10 year real bond.

We should all be sceptics

The Sahm rule, when the 3 month average unemployment rate increases by 0.5 percentage points from the prior 12 month low, signals a US recession. It has correctly marked the previous 12 recessions. This time might be different.

Fed-trained economist, Claudia Sahm, inventor of the Sahm rule, doubts it is correct this time, thanks to COVID distortions. Consumer expenditure is higher than in previous recessions.

And there are reasons to be sceptical over the scale of re-benchmarking downward revisions of non-farm payrolls – most notably due to employers under-reporting the hiring of illegal immigrants to avoid legal problems.

Even with the revisions, payrolls seem to be running at levels that should, more or less, soak up labour market growth.

Another, broader issue is what interest rate the economy needs to keep cruising around trend. This is a variant on model instability questioned above.

Through its projections, the Fed appears to think the neutral Fed Funds rate is just under 3 per cent, with inflation at 2 per cent, so a real neutral rate around 1 per cent. This is higher than in the post-GFC, pre-COVID era but sceptics should wonder if it is the appropriate, but unobservable, rate now.

There are reasons the neutral rate should be higher than the Fed thinks it is now: resurgent military spending, deglobalisation, decarbonisation, the return of fiscal spending. None of these appear to be going away.

Indeed, the fiscal outlook continues to darken.

Chart 7: The Sahm rule and cycle indicators when the rule is triggered

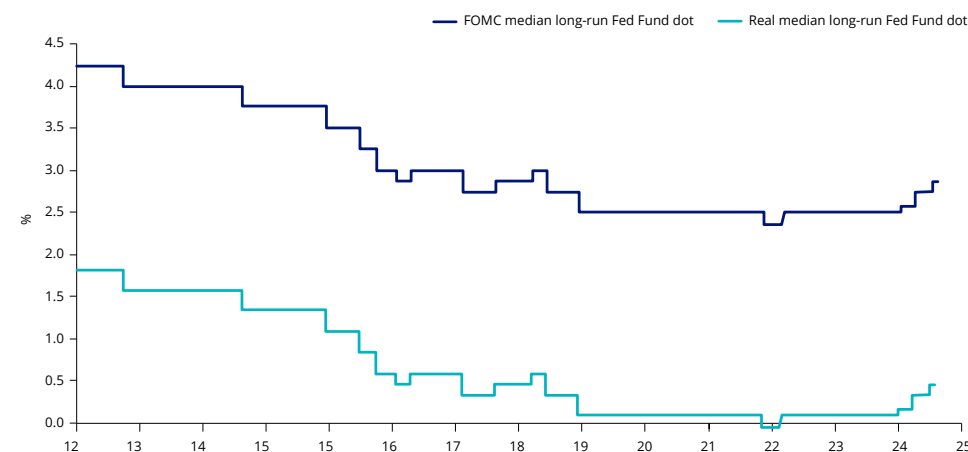
This time might be different

Date Sahm triggered	Months after recession start	Industrial production	Real personal income ex current transfer receipts	Real personal consumer expenditures	Manufacturing ISM	Consumer goods & materials new orders (real)
	No.	6M%	6M%	6M%	Level	6M%
Jan 1949	2	-3.5	n/a	n/a	32.9	n/a
Nov 1953	3	-4.9	n/a	n/a	36.9	n/a
Oct 1957	2	-1.8	n/a	n/a	41.1	n/a
Jul 1960	3	-4.2	1.0	1.5	43.7	-3.3
Feb 1970	2	-3.1	1.0	1.5	47.4	-7.0
Mar 1974	4	0.0	-1.6	-1.8	61.8	0.4
Feb 1980	1	1.2	0.1	0.2	50.2	-0.4
Nov 1981	4	-1.4	1.8	-0.3	36.1	10.3
Oct 1990	3	0.2	-1.4	-0.1	43.2	-0.4
Jun 2001	3	-2.8	0.1	0.4	43.2	-4.2
Feb 2008	2	0.1	0.4	-0.1	48.8	-3.9
Apr 2020	2	-16.6	-6.7	-16.0	41.8	-22.4
Jul 2024		1.4	0.5	1.7	46.8	2.3
Average (ex 2020)	2.6	-1.8	0.2	0.1	44.1	-3.6

Source: Bureau of Labor Statistics, Conference Board, National Bureau of Economic Research, Datastream

Chart 8: Expected long-run Fed fund rate

The Fed's neutral rate estimate is barely off its lows



Source: Federal Reserve, National Bureau of Economic Research

The impending fiscal clouds

Rather than a side of US politics seeking to correct runaway deficits, both parties' Presidential hopefuls are pushing forward with proposals that will worsen the situation.

The latest 2024 budget charts indicate a deficit outcome of 6.7% of GDP, which is unsustainably large, especially for an economy close to full employment. Rather than fiscal restraint, both sets of Presidential campaign promises will substantially worsen the budget outlook.

According to independent modelling from the Wharton Business School, nominee Trump's tax proposals would blow out the budget deficit by over \$600 billion a year over most of the next decade, equivalent to around an extra 2% of GDP a year. More modest proposals from nominee Harris worsen the fiscal position, by about 0.5% of GDP per year.

At the same time, nominee Trump's proposed tariffs, while revenue-positive, would worsen inflation, at least temporarily. They would also have a negative effect on lower- and mid-decile incomes, that is before factoring in any (inevitable) international retaliation. Likewise, stopping and even reversing immigration flows could crimp the supply side of the economy.

Either way, US equities are priced to perfection. Of course, equities bounce at the start of a rate-cut cycle. But normally equities are flat or down into the first cut, not surging beforehand.

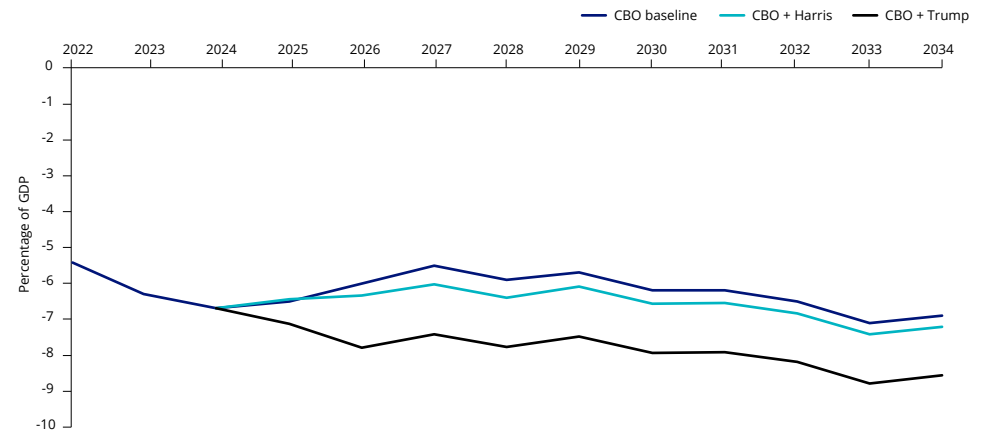
Current levels embody sustainably lower interest rates without a slowdown in growth or earnings. That may be wishful thinking if economic growth slows down more than expected.

Nor do current valuations appear to consider any risk that inflation resurges, which we think is a possibility with stronger fiscal impulse approaching and neutral rate uncertainty.

And then when you consider, beyond November, a choice between severe policy uncertainty or a higher corporate tax rate, we think navigating this environment, selection will be key.

Chart 9: Congressional Budget Office (CBO) projected deficits and the Presidential proposals

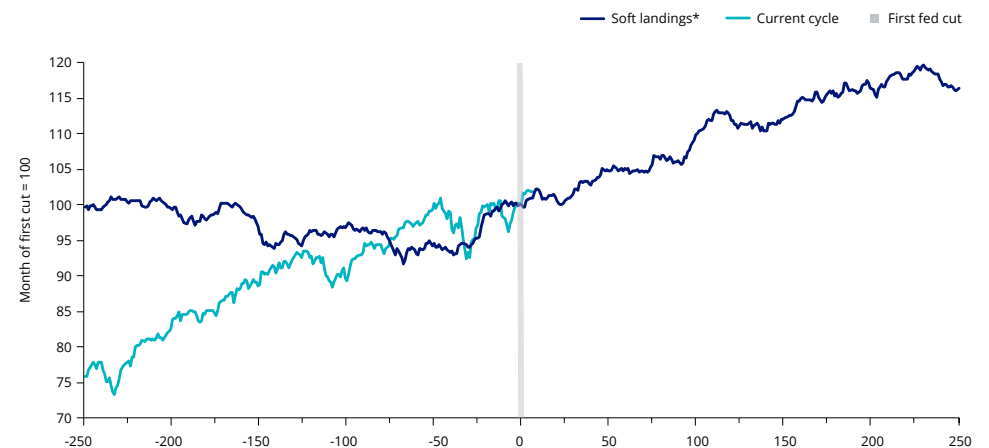
Deficits forever. Below zero = deficit



Source: VanEck based on Wharton School costings, Congressional Budget Office.

Chart 10: S&P 500 around the first rate cut

This cycle's unusual pre-easing equity rally



Source: Bloomberg.
*1966, 1984, 1995

China – growth blues, policy cues

It's not just the US navigating clouds to growth. China's economic surprise index spent the past 3 months in the sub-zero zone and analysts were busy downgrading their GDP forecasts after a stream of negative domestic activity surprises.

Exports remained a bright spot, but the housing sector is struggling and unresolved real estate issues, such as unsold houses, weigh on consumer sentiment. The only index still going up in the central bank's consumer survey is willingness to save, the opposite of the objective.

The traditional policy prescription to boost growth and stimulate domestic demand is to provide more stimulus. China's recent "Go Big!" policy blitz fits the definition, the long list of measures includes various rate cuts (both policy rate and reserve requirements), easing housing sector restrictions (mortgage rates and down payments), the use of the central bank funds for stock purchases, and more support to buy unsold homes.

The market's initial reaction was positive. But whether the sentiment uplift can be sustained, and, importantly, whether the growth momentum improves will depend on the actual use of the new rescue facilities.

A recent study by Bloomberg showed that the existing policy tools and facilities (even with zero interest rates) are not fully utilised, pointing to a lack of demand as the main reason rather than a lack of policy support.

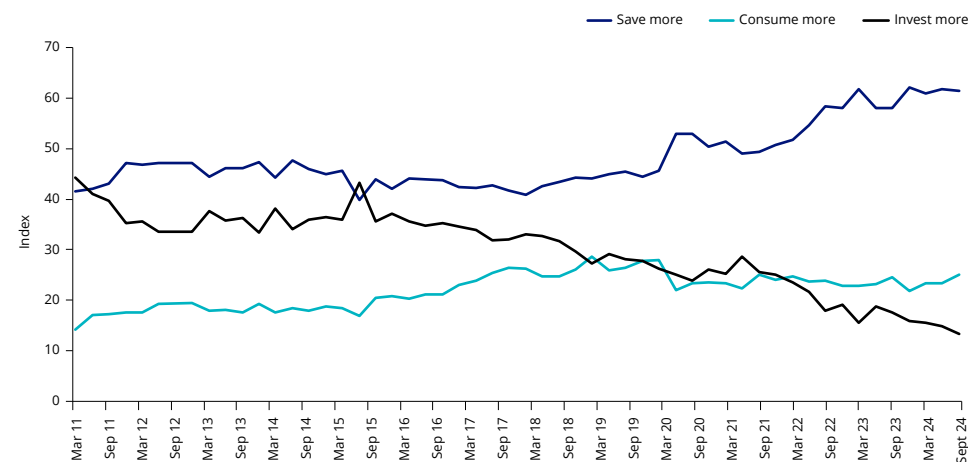
Calls to step up fiscal stimulus fall into the same category and such additional support will be useful (in the sense of giving a sustainable boost to growth) only if it addresses underlying structural issues. Using the central government's funds to deal with unfinished houses would be a step in the right direction and the logical extension of programs to buy inventories of unsold homes.

China's growth hiccups are yet to affect its geopolitical gravitas, and this dimension will become even more important after the presidential elections in the US, with higher tariffs topping the list of concerns. Higher tariffs are often growth-negative, but would they result in China's retaliation by weakening its currency?

The foreign currency question is back on the front-burner, especially with net exports becoming an important growth driver in China. However, it is important to make a distinction between nominal and real effective exchange rates here. The renminbi's nominal exchange rate has been helped by the improving interest rate differential between the two countries. However, the renminbi's real effective exchange rate is close to multi-year lows, supporting China's exports without damaging households' balance sheets in the process.

Chart 11: PBoC Consumer Willingness Survey

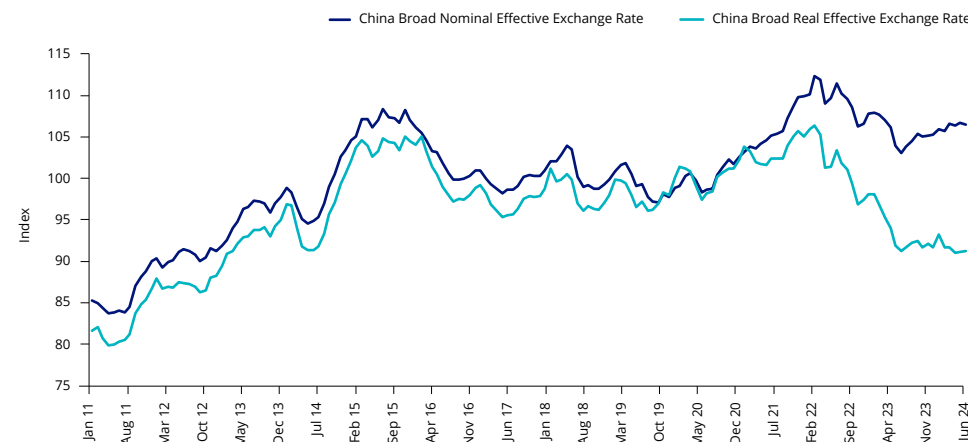
Chinese consumers are still saving



Source: Bloomberg.

Chart 12: China – Nominal and real effective exchange rates

Real effective exchange rate near multi-year lows



Source: Bank for International Settlements, Bloomberg.

Emerging markets continue to shine

As markets started pricing in a sharper decline in the US policy rate, global yields rallied across their curves. Treasuries were up around 6%, the Global Agg was up around 6.5%, while emerging markets (EM) sovereign bonds (local and hard-currency) were up around 7%.

This was the real story in EM, after years, arguably decades, of maintaining high real rates relative to the Fed, the markets rewarded EM as the Fed started its cutting cycle. Most importantly, when global rates were not experiencing a Fed cutting cycle and bonds were unpopular generally, EM bonds still outperformed developed market (DM) bonds, due to their higher premia and, in our opinion, steady or improving fundamentals relative to DM.

Indeed, EM now appears less correlated to US (see global) growth concerns and more linked to commodity prices and country-specific drivers. Over the recent past, the continued rates rally in the best of EM (Asia) during years of DM crises, coupled with the nascent rally in other EM rates, suggests EM continued strength.

A funny thing happened on the way to the rally in bonds, another over-indebted DM economy that experimented with their money (Japan) tried to blow up the world in the form of the JPY carry-trade unwind, and EM barely blinked. During the recent episode, China's currency remained rock-solid.

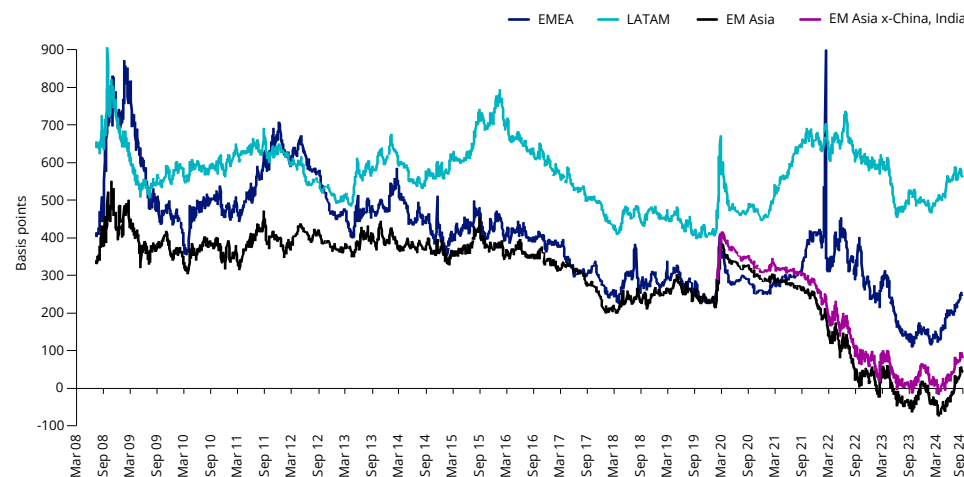
It is worthwhile to acknowledge DM politics, policy, and geopolitics, in the context of EM. We think it still helps EM. As US elections come into focus, our simple scenarios are that a Republican sweep is likely to be a challenge for EM due to the risk of a US dollar rally as tariffs and unfettered fiscal policy get priced. If the Democrats control either the House, the Senate seems out of reach, or the White House, then we see a more positive environment for EM. Fiscal will be fettered and policies behind a potential US dollar rally (such as tariffs) get watered or negotiated down.

Our main view is that it is still too early, given not just election uncertainty, including the post-election, but the risk surrounding the reality of policy changes, or that positions become negotiations. Tariffs are already somewhat old news, too. We suspect that a Trump Administration 2.0 would not repeat Trump 1.0, in which Mexico was the new and clear target. China is more in the crosshairs here, of course. But we think, China can handle it. Government debt is low. Reserves are high. Inflation is low compared to the US, meaning the Chinese currency keeps cheapening in real terms. Offshore "Chinese" US dollars may amount to US\$1 trillion, which could move onshore as US rates decline.

The world has changed and its not as simple as "risk-off equals sell EM" anymore. We think EM's relative strength could continue.

Chart 13: EM regions – GBI-EM/5Y US treasuries yield differentials

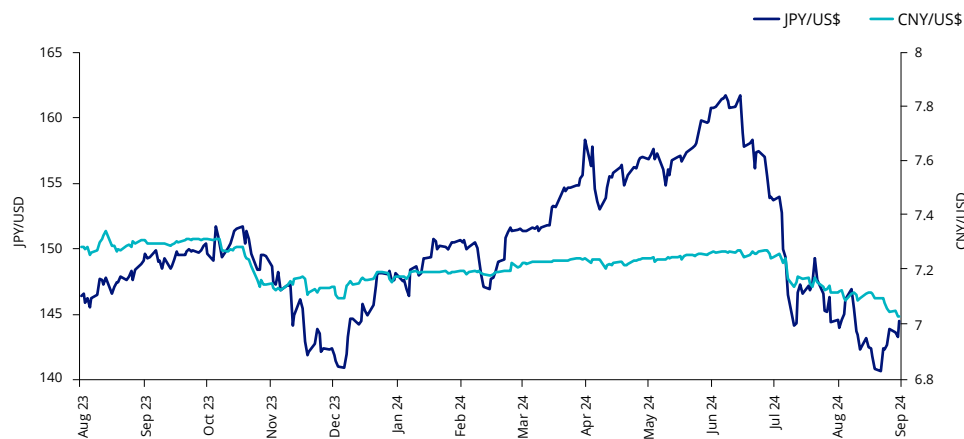
Asia EM rallied during the risky past 4 years



Source: Bloomberg.

Chart 14: US dollar/yen and US dollar/renminbi

The renminbi insulated EM from DM Japan's volatility



Source: Bloomberg.

Golden heights

With many of the world's developed economies struggling, gold has shone. Gold and gold equities were not immune from the recent equity market turmoil, but like the rest of the markets, it has managed to bounce back after the panic subsided.

Over the recent past one of the drivers of the gold price has been EM buying. EMs have been the driving force behind reserve gold's accumulation after the global financial crisis of 2008.

Western investors have not yet jumped into the gold market in full force. However, the World Gold Council reported estimated positive fund flows into the North American gold bullion ETF products during July and August and into the European products since May.

This is an important reversal in the persistent trend of outflows global gold bullion ETFs have experienced. This could be the initial stages of returning investment demand.

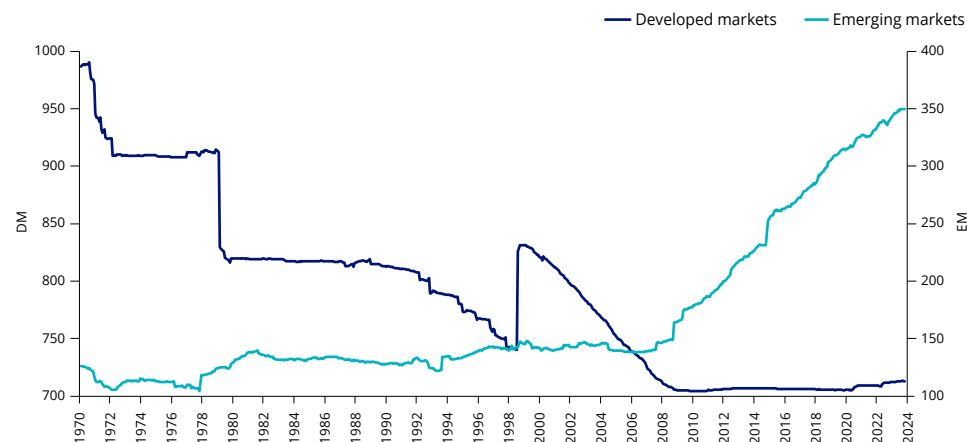
The early August, and early September, equity markets' weakness is signalling increasing concern about the health of the US economy and the risk of a recession.

Investors looking for more defensive, potentially recession resistant opportunities or a place to hide during periods of heightened uncertainty and volatility, may be finally turning to the gold sector. The historically cheap, financially strong gold mining equities should stand out as an attractive play to gain gold exposure. Margins continue to expand, as the gold price increases, but all-in-sustaining costs remain relatively stable.

We expect the gold price to remain supported around current levels with potential to go higher when Western investors decide it is time to search for the benefits gold has historically offered being a defensive opportunity, agnostic to economic conditions and a hedge against uncertainty. This should lead to more appetite for gold stocks and a re-rating of the sector to reflect valuation multiples more in-line with those observed in previous gold bull markets.

Chart 15: Reserve gold holdings (1970-2024), mln Troy oz

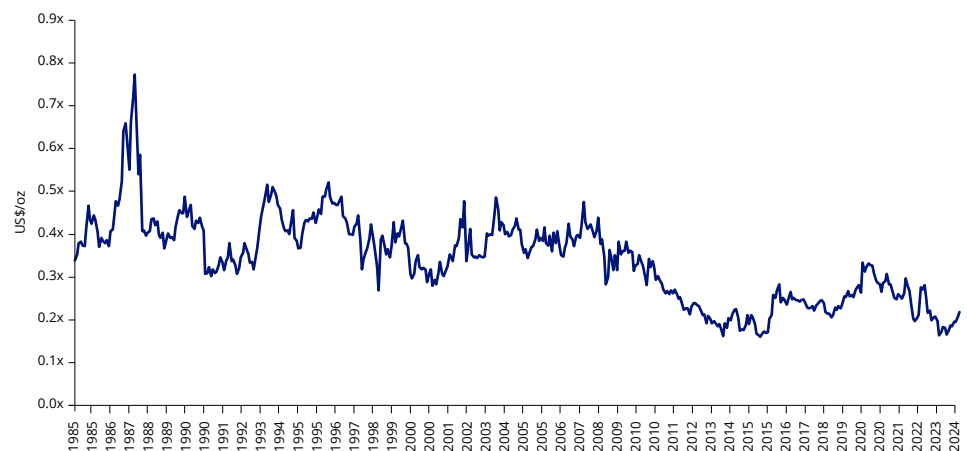
Emerging markets have been a driver of gold buying since the GFC



Source: Bloomberg.

Chart 16: Adjusted market capitalisation per oz of reserve (divided by gold price)

Valuation multiples are not in line with previous gold bull markets



Source: Scotiabank. Data as of August 2024. Figures represent the average of Scotiabank's North American coverage.

The hawk in the room

Central bank doves in the US, with growth at trend but moderate labour market softening, felt comfortable slashing rates, though inflation is not projected to be back to its target until the end of 2026. Likewise, the previous 'uber hawk', the ECB followed its 25 bps rate cut in June with a jumbo 60 bps, similarly based on a projection that inflation will be back to target by the end of 2026.

So far, the RBA Governor has remained hawkish. Despite the weakest growth performance since the 1991 recession, Australia isn't cutting its official interest rate yet because inflation won't be back to target until 2026.

While the other central banks have shifted their focus to growth, inflation remains the risk the RBA is focused on.

There are plenty of doves in Australia that fear the RBA may be driving the economy toward recession. Following post-COVID hiring difficulties, Australian businesses were hoarding labour. It's visible in the gap between headcount employment and much-weaker hours worked data, the latter tracking weak GDP. But, as RBA Chief Economist Sarah Hunter has explained, there's no room for rate cuts until the labour market substantially weakens.

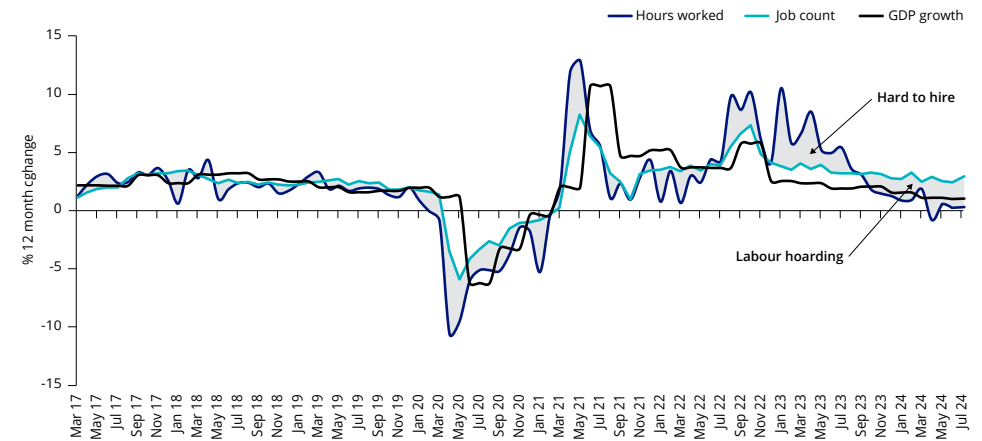
We mentioned above the hysteria in the US about the Sahm Rule. While it is based on US experience, Australia has also triggered the Sahm Rule.

Should the RBA maintain its inflation focus, it does warrant the question, what does a "substantial weakening" of the labour market look like to force it to consider the risk at the forefront of other central banks. Doves fear this is a recipe for a recession, if they move too late.

Right now, the Australian labour-market is still tight. While the wage price index data suggests private sector wage increases have already inflected down; at 0.7% last quarter and running at a rate that's conformable with the inflation target. Government spending in initiatives such as the National Disability Insurance (NDIS) supports the claims of the RBA that the unemployment rate indicates the economy is still running above capacity. It will be watching wage pressures and job cuts closely.

Chart 17: Hours worked versus headcount versus GDP

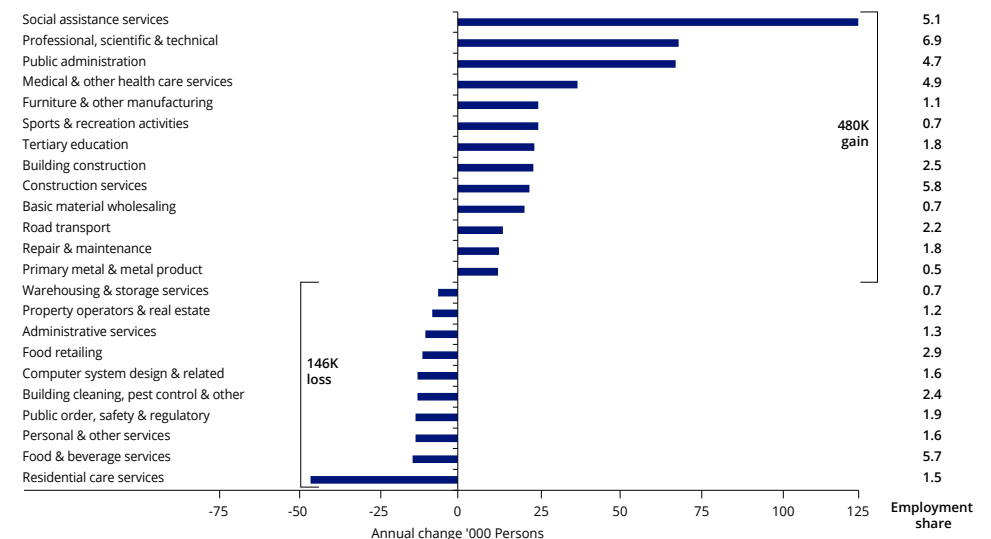
Jobs holding up as labour is being hoarded though hours worked slow with GDP



Source: Australian Bureau of Statistics.

Chart 18: Employment growth by industry

Sectors supported by government spending are growing



Source: Australian Bureau of Statistics, Change in employment over the year from 2023 to 2024. Not shown: industries with growth of less than 12K or falls of under 6K.

The waiting game

The RBA appears to be waiting for the tax cuts and other fiscal programs to run through the economy. While early spending and consumer sentiment data suggest a good chunk of tax cuts are going to savings, not spending, there are other factors the RBA is also weighing.

Markets are pricing in cuts to start by February 2025. Our view remains that it is unlikely that there will be any rate cuts until well into 2025. Although job ads, as measured by ANZ, have fallen 29.8 per cent from the peak in November 2022, they are still 11.4 per cent above pre-pandemic levels. The latest ABS immigration numbers also look robust, with net migration reaching a record 509,754 for that period.

The RBA may also be taking comfort that it started hiking rates a few months after the Fed and it did not go as steep.

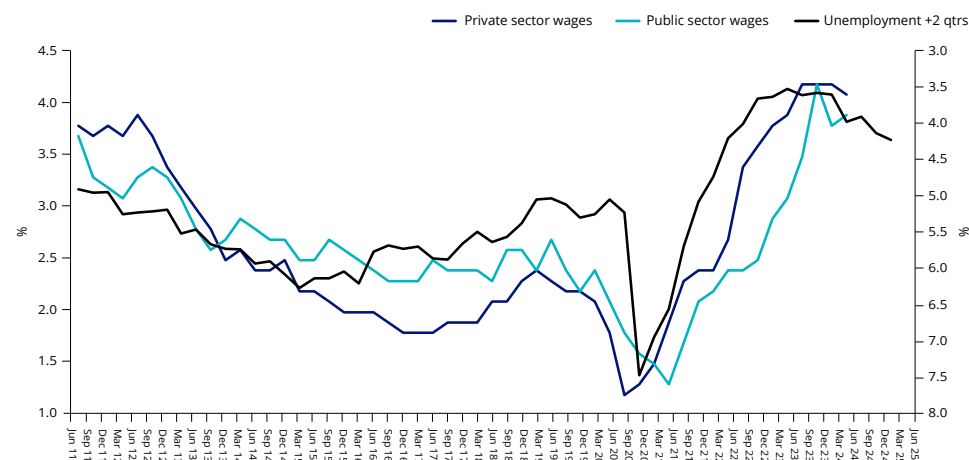
With such strong migration numbers and a lack of new housing, we expect house prices and rents will continue to put upward pressure on inflation as demand outstrips supply. While the RBA is focused on inflation risk, rates will stay where they are.

The Australian equity market also appears comfortable with the RBA's risk focus and is perhaps expensive. At a cursory glance, the local market's price to equity (P/E) isn't as high in the US. But, the ASX has a bigger share of "old economy" sectors and a far lower percentage of tech and forward-looking sectors.

The ASX is more expensive than the US, with US sector weights applied. And that's without considering US growth at trend, while Australia teeters near recession. The US also has a rate-cut cycle underway, while the RBA waits. On the other hand, Australia doesn't have an election to get through... well, until next year.

Chart 19: Annual wage growth by sector, seasonally adjusted

Private sector wages tracking jobs market



Source: Australian Bureau of Statistics.

Chart 20: Comparative price to earnings, S&P 500 and S&P/ASX 200

Australia may look cheap, but beware

	S&P 500		S&P/ASX 200		Premium/Discount
	Market Weight	Forecast P/E	Market Weight	Forecast P/E	
Financials	13.5%	15.9	35.5%	17.3	9.1%
Information technology	32.0%	28.4	2.0%	102.7	261.3%
Health care	12.5%	19.5	11.3%	31.0	58.8%
Consumer discretionary	9.8%	23.7	7.7%	24.3	2.4%
Industrials	8.6%	21.4	7.6%	19.4	-9.4%
Consumer staples	6.2%	21.4	4.5%	21.1	-1.4%
Energy	3.6%	12.2	4.6%	11.9	-2.8%
Communications	9.0%	18.2	4.2%	27.0	48.0%
Utilities	2.5%	17.7	1.6%	15.9	-9.7%
Materials	2.3%	20.0	20.8%	12.6	-37.1%
Overall market	100.0%	21.2	100.0%	17.9	-15.8%
P/E (US Weights)		21.2		27.7	30.6%

Source: IBES/DataStream, MSCI, S&P.

Going in a different direction

While the rest of the world ponders the pace and size of rate cuts, Japan remains the outlier, a mighty big one, at least where capital flows are concerned.

Active market players have ignored Japan for so long that they've largely lost their ability to understand the economy and the policymakers there. Hence, the first Bank of Japan (BoJ) rate hike was considered to be somewhere between symbolic and meaningless. It is worthwhile acknowledging, that interest rate differentials remained gulf-like, and markets have seen many recovery false starts over recent decades.

But as both the economy and BoJ rhetoric continued to stay on-path, markets had a panic: more hikes were coming. The yen soared and panicked Japanese equities crashed.

Japanese equities largely recovered from their swoon, with the yen also initially dropping back, both aided by a change in rhetoric.

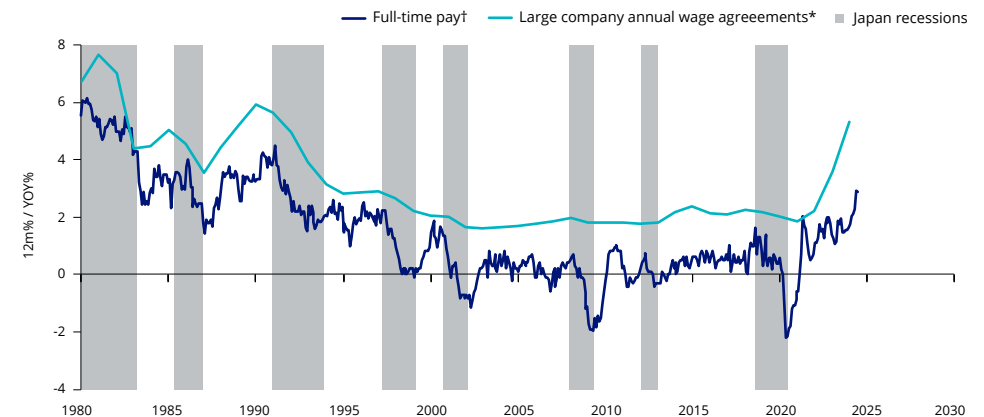
We would caution this is not over. This is not a change in path, it's just management of the pace of change. Wages growth remains robust, supporting domestic demand and sustainable inflation. Interest rates are not at levels compatible with 2% inflation, so they will continue to rise.

BoJ policymaker Tamura confirmed as much in a little-reported speech, pointing out the neutral rate was probably around 1%, a goal they needed to reach sometime next year. He also noted the longer it took to get rates up, the further it would heighten upward inflation risk.

In other words, assume higher rates and higher yen, but also expect policymakers to lean against sudden moves. Japanese equities remain cheap; but, unlike recent past years, currency translation could be your friend, not your enemy.

Chart 21: Japanese wage growth

The right sort of inflation

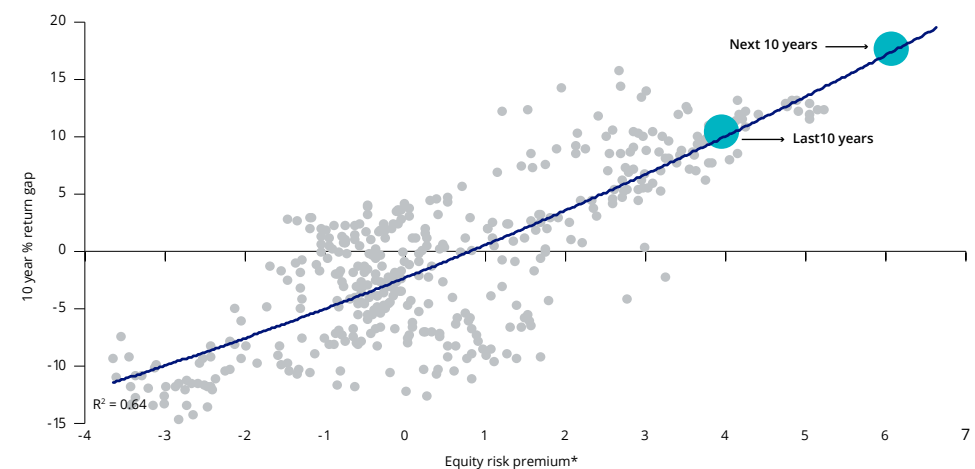


Source: Ministry of Internal Affairs and Communications, Ministry of Health, Labour and Welfares.

† Contracted cash pay, all industries, full-time workers. Pre-1994 all workers. * Shunto/rengo rounds.

Chart 22: Japan relative price and relative equity-bond return

Japan equities could be the wild ride



Source: MSCI, Cabinet Office, Bureau of Labor Statistics, Bloomberg.

*ERP is equity yield (CAPE inverted) minus real JGB yield (10-year yield deflated by 3-year trailing CPI). Data from 1980. The return gap is the gap between the average annual equity and bond return series over 10 years.

VanEck's range of Exchange Traded Funds on ASX

Equity opportunities

VanEck Fund	ASX code	Index	Management fees (p.a.)*
Australian Broad Based			
Australian Equal Weight ETF	MVW	MVIS Australia Equal Weight Index	0.35%
Geared Australian Equal Weight Fund (Hedge Fund)	GMVW	MVIS Australia Equal Weight Index	0.35%^
Australian Small and Mid Companies			
Small Companies Masters ETF	MVS	MarketGrader Australia Small Cap 60 Index	0.49%
S&P/ASX MidCap ETF	MVE	S&P/ASX MidCap 50 Index	0.45%
Australian Sector			
Australian Property ETF	MVA	MVIS Australia A-REITs Index	0.35%
Australian Banks ETF	MVB	MVIS Australia Banks Index	0.28%
Australian Resources ETF	MVR	MVIS Australia Resources Index	0.35%
Sustainable Funds			
MSCI Australian Sustainable Equity ETF	GRNV	MSCI Australia IMI Select SRI Screened Index	0.35%
MSCI International Sustainable Equity ETF	ESGI	MSCI World ex Australia ex Fossil Fuel Select SRI and Low Carbon Capped Index	0.55%
International			
MSCI International Quality ETF	QUAL	MSCI World ex Australia Quality Index	0.40%
MSCI International Quality (AUD Hedged) ETF	QHAL	MSCI World ex Australia Quality 100% Hedged to AUD Index	0.43%
MSCI International Small Companies Quality ETF	QSML	MSCI World ex Australia Small Cap Quality 150 Index	0.59%
MSCI International Small Companies Quality (AUD Hedged) ETF	QHSM	MSCI World ex Australia Small Cap Quality 150 100% Hedged to AUD Index	0.62%
Morningstar International Wide Moat ETF	GOAT	Morningstar® Developed Markets ex Australia Wide Moat Focus Select Index™	0.55%
Morningstar Wide Moat ETF	MOAT	Morningstar® Wide Moat Focus NR AUD Index™	0.49%
Morningstar Wide Moat (AUD Hedged) ETF	MHOT	Morningstar® Wide Moat Focus NR AUD Hedged Index™	0.52%
MSCI International Value ETF	VLUE	MSCI World ex Australia Enhanced Value Top 250 Select Index	0.40%
MSCI International Value (AUD Hedged) ETF	HVLU	MSCI World ex Australia Enhanced Value Top 250 Select 100% Hedged to AUD Index	0.43%
MSCI Multifactor Emerging Markets Equity ETF	EMKT	MSCI Emerging Markets Multi-Factor Select Index	0.69%
FTSE China A50 ETF	CETF	FTSE China A50 Index	0.60%
China New Economy ETF	CNEW	MarketGrader China New Economy Index	0.95%
Global Sector			
Gold Miners ETF	GDX	NYSE Arca Gold Miners Index® (AUD)	0.53%
Global Healthcare Leaders ETF	HLTH	MarketGrader Developed Markets (ex-Australia) Health Care AUD Index	0.45%
FTSE Global Infrastructure (AUD Hedged) ETF	IFRA	FTSE Developed Core Infrastructure 50/50 Index Hedged into AUD	0.20%
FTSE International Property (AUD Hedged) ETF	REIT	FTSE EPRA Nareit Developed ex Australia Rental Index AUD Hedged	0.20%
Global Defence ETF	DFND	MarketVector Global Defence Industry (AUD) Index	0.65%
Thematic			
Video Gaming and Esports ETF	ESPO	MVIS® Global Video Gaming and eSports Index (AUD)	0.55%
Global Clean Energy ETF	CLNE	S&P Global Clean Energy Select Index	0.65%

*Other fees and costs apply. Please see the respective PDS.

^The Fund charges a nil management fee. This is the indirect cost represented as a percentage of the gross asset value. If the average gearing level is 50%, the indirect cost will be 0.70% of the net asset value.

VanEck's range of Exchange Traded Funds on ASX

Income opportunities

VanEck Fund	ASX code	Index	Management fees (p.a.)*
Australian Equity Income			
Morningstar Australian Moat Income ETF	DVDY	Morningstar® Australia Dividend Yield Focus Equal Weighted Index™	0.35%
Australian Fixed Income			
Australian Corporate Bond Plus ETF	PLUS	iBoxx AUD Corporates Yield Plus Mid Price Index	0.32%
Australian Floating Rate ETF	FLOT	Bloomberg AusBond Credit FRN 0+Yr Index	0.22%
Australian Subordinated Debt ETF	SUBD	iBoxx AUD Investment Grade Subordinated Debt Mid Price Index	0.29%
1–5 Year Australian Government Bond ETF	1GOV	S&P/ASX Government Bond 1–5 Year Index	0.22%
5–10 Year Australian Government Bond ETF	5GOV	S&P/ASX Government Bond 5–10 Year Index	0.22%
10+ Year Australian Government Bond ETF	XGOV	S&P/ASX Government Bond 10–20 Year Index	0.22%
Global Fixed Income		Index/Performance Benchmark	
1-3 Month US Treasury Bond ETF	TBIL	Bloomberg U.S. Treasury Bills: 1-3 Months Unhedged AUD Index	0.22%
Emerging Income Opportunities Active ETF (Managed Fund)	EBND	50% JPM EMBI Global Diversified Hedged AUD and 50% JPM GBI-EM Global Diversified	0.95%
Capital Securities		Index/Benchmark	
Global Capital Securities Active ETF (Managed Fund)	GCAP	RBA Cash Rate + 3% per annum	0.59%

Alternative opportunities


VanEck Fund	ASX code	Index	Management fees (p.a.)*
Alternatives			
Global Listed Private Equity ETF	GPEQ	LPX50 Index	0.65%
Global Carbon Credits ETF (Synthetic)	XCO2	ICE Global Carbon Futures Index	0.45%
Gold Bullion ETF	NUGG	Tracks the price of gold	0.25%
Global Listed Private Credit (AUD Hedged) ETF	LEND	LPX Listed Private Credit AUD Hedged Index	0.65%
Bitcoin ETF	VBTC	Tracks the price of bitcoin	0.49%

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