yieldreport Daily

Your Income Advantage

31st May 2025

Overview of the US Market

A solid month for stocks is ending on a weak note as Trump said Beijing "totally violated" a tariff agreement, with the market briefly extending its slide after a news report the US plans to broaden restrictions on China's technology sector. Following a rally that put the **S&P 500** on track for its best May since 1990, the index fell as much as 1.2% before paring losses. By close and after a slight rally into the close, the **S&P 500** fell 0.1%. The **Nasdaq 100** fell 0.3%. The **Dow Jones Industrial Average** ended up gaining 0.2%. Big tech got hit, with Nvidia Corp. down 3.5%. Action was muted in bonds, though Treasuries were set for their first monthly drop this year. The dollar barely budged, while heading toward a fifth straight month of declines - the longest losing run since 2020.

On the economic front, US consumers hit the brakes in April while goods imports plummeted by a record as companies adjusted to higher tariffs. Inflation-adjusted personal spending rose 0.1% after rising 0.7% a month earlier. Separate data showed an almost 20% slump in imports, leading to a massive narrowing in the US merchandise-trade deficit in April. Meanwhile, the Federal Reserve's preferred price gauge remained tame. The **personal consumption expenditures (PCE) price index**, excluding food and energy, increased 0.1% from a month earlier. Compared with a year earlier, the **core inflation gauge rose 2.5% from April 2024** — the smallest annual advance in more than four years.

The figures reflect an undercurrent of anxiety among many American consumers about the economy after the weakest quarter for spending in nearly two years. Higher duties on imports had yet to show up more broadly in higher goods prices, as sentiment slumped and the outlook for personal finances stood at a record low. However, in April US businesses pulled back significantly on imports after months of pulling forward economic activity to avoid tariff policy. But here's the irony, because of the way GDP is calculated, the April slump in imports of goods after months of front loading will likely give a boost to GDP in the second quarter. The Atlanta Fed's GDPNow forecast pencilled in a 3.8% increase for the second quarter, which would mark a bounceback from the 0.2% drop last quarter.

Overview of the Australian Market

The Australian sharemarket rose for the second consecutive month after a US court blocked American President Donald Trump's tariffs, adding to hopes that global trade tensions will simmer down. The **S&P/ASX 200 Index** rose 0.3% on Friday with seven of 11 sectors in the green, led by utilities. The benchmark rallied 3.8% in May, recording its best month since January. The **All Ordinaries** rose 0.3% on Friday, notching its eighth consecutive weekly gain.

During the course of the day however, the S&P/ASX 200 swung between gains and losses before defensive consumer and utilities stocks helped lift the benchmark index. Bank stocks were broadly higher – CBA edged up 0.9% and NAB gained 1.3%. Technology stocks were heavily sold, with WiseTech off 1.5% and Megaport down 3.1%. Energy stocks were dragged lower by Woodside Energy and Santos, which both tracked a steep decline in oil prices. Woodside fell 2.1% and Santos retreated 0.9%.

A **surprise fall in retail sales**, down 0.1% in April, sent government bond yields plunging 10 bps and helped spur optimism that the RBA will step up interest rate cuts. Retail turnover ended its 2025 run of gains falling -0.1%mth in April to be 3.8%yr higher. The weakness was centred on clothing & footwear and department stores, which the ABS attributed to warmer weather delaying purchases. Retail trade rebounded in Qld (1.4%mth) following weather-related impacts last month. Excluding Qld would have resulted in a -0.5%mth fall in retail turnover. Meanwhile, NSW posted its sharpest decline in over a year. **The suspicion is the April read has also been impacted by holiday-related disruptions.** Supporting this, the weekly Westpac-DataX Card Tracker showed significant disruptions from the late timing of Easter and its proximity to the ANZAC Day public holiday, spending only stabilising in mid-May.

Meanwhile, the **ASX's quarterly rebalance** will be announced next Friday and take effect a fortnight later. Gold stocks have been identified as significant inclusions. For example, Evolution Mining is expected to headline a flurry of changes to the ASX's biggest indices as gold producer stocks soar amid investor interest in the precious metal as a haven from broader market turmoil. Evolution, which has mines around the country, is set to join the S&P/ASX 50 index in the quarterly rebalance.

Markets are now turning their attention to **Q1 GDP figures released next week**. Consensus is for growth to slow from 0.6% in Q4 2024 to 0.2% in Q1 2025, largely owing to slower household consumption

Overview of the US Bond Market

The **yield on the US 10-year Treasury note** swung around 4.4% on Friday, as traders assess the latest developments on the trade war and fresh economic data. President Trump claimed in a social media post that China had "totally violated" its agreement with the US, though he provided no further details. On Thursday, a federal appeals court temporarily reinstated Trump's tariffs, just one day after a trade court ruled he had overstepped his authority.

Meanwhile on the data front, the **PCE price index** came roughly in line with expectations, with both the headline and core readings edging up 0.1% month-over-month. On an annual basis, both measures slowed, offering some relief over inflation pressures. Personal spending growth also eased to 0.2%, in line with forecasts. The data reinforced expectations that the Federal Reserve may have room to cut interest rates later this year. **Considering the May month, the benchmark bond yield in the US is down more than 20 bps**.

US Treasuries are on track for their first monthly loss this year as President Donald Trump's abrupt policy shifts shake investor confidence. Worry about the budget deficit picked up in May tied to a tax-cut bill moving through Congress.

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The figures reflect an undercurrent of anxiety among many American consumers about the economy after the weakest quarter for spending in nearly two years. Higher duties on imports had yet to show up more broadly in higher goods prices, as sentiment slumped and the outlook for personal finances stood at a record low. However, in April US businesses pulled back significantly on imports after months of pulling forward economic activity to avoid tariff policy. But here's the irony, because of the way GDP is calculated, the April slump in imports of goods after months of front loading will likely give a boost to GDP in the second quarter. The Atlanta Fed's GDPNow forecast pencilled in a 3.8% increase for the second quarter, which would mark a bounceback from the 0.2% drop last quarter.

Meanwhile, **Jamie Dimon warned that a crack in the bond market is "going to happen"** after the US government and Federal Reserve "massively overdid" spending and quantitative easing. "I just don't know if it's going to be a crisis in six months or six years, and I'm hoping that we change both the trajectory of the debt and the ability of market makers to make markets," he said Friday at the Reagan National Economic Forum. Dimon has said repeatedly in recent years that he is concerned about global deficit spending, and when asked Friday if so-called bond vigilantes are back, he said "yeah."

On the topic of JPMorgan, a survey of traders released during the week spotlighted that **investors expect the sell-off in treasuries to worsen, keeping yields elevated**. The survey's all-client category for outright short positions — which includes central banks, sovereign wealth funds, real money and speculative traders — has climbed to the most since around mid-February. Traders rattled by the rout in long-dated Treasuries are turning more bearish as yields continue to oscillate around a key 5% psychological threshold.

The bearish sentiment comes on the tail of a decline in global long-dated bonds as investors grow concerned about widening government fiscal deficits. The US 30-year yield is lingering around 5% after soaring last week to 5.15%, the highest since October 2023, amid the US losing its top credit score, a steep selloff in Japan's super-long bonds and the passing of Trump's tax bill in the House.

While long-bonds got some relief this week, the 30-year yield still hovering around 5% signals **investors remain fickle**. That's being expressed in the options market too, where traders are paying higher premiums to hedge an extended selloff in long-bond futures versus a rally.

Overview of the Australian Bond Market

Australia's 10-year government bond yield fell a large 10 bps to around 4.26% on Friday, hitting its lowest level in over two weeks, as investors assessed the latest economic data. Retail sales unexpectedly declined in April, driven by unseasonably warm weather—which reduced demand for winter clothing—and fewer promotional events at department stores, **highlighting growing consumer caution. Or does it??**

Earlier this week, data also revealed that the monthly CPI came in slightly higher than expected in April, although it remained unchanged from the previous two months and marked the lowest level since November 2024. Despite lower borrowing costs and easing inflation, household spending remains subdued, with the April data suggesting a soft start to Q2. This persistent weakness prompted the RBA to cut interest rates by 25 bps to 3.85% earlier this month, after an initial rate cut in February. Markets are now pricing in at least three additional rate cuts this year, potentially bringing the cash rate down to 3.10%.

On retail sales, yes, it was a surprise and it sent government bond yields plunging 10 bps and helped spur optimism that the RBA will step up interest rate cuts. Retail turnover ended its 2025 run of gains falling -0.1%mth in April to be 3.8%yr higher. However, what needs to be borne in mind is two things. First, the weakness was centred on clothing & footwear and department stores, which the ABS attributed to warmer weather delaying purchases. Retail trade rebounded in Qld (1.4%mth) following weather-related impacts last month. Excluding Qld would have resulted in a -0.5%mth fall in retail turnover. Meanwhile, NSW posted its sharpest decline in over a year. Second, **the suspicion is the April read has also been impacted by holiday-related disruptions.** Supporting this, the weekly Westpac-DataX Card Tracker showed significant disruptions from the late timing of Easter and its proximity to the ANZAC Day public holiday, spending only stabilising in mid-May. Seems like the bond markets over reacted.

Figure 1: Australian Monthly CPI (YoY)

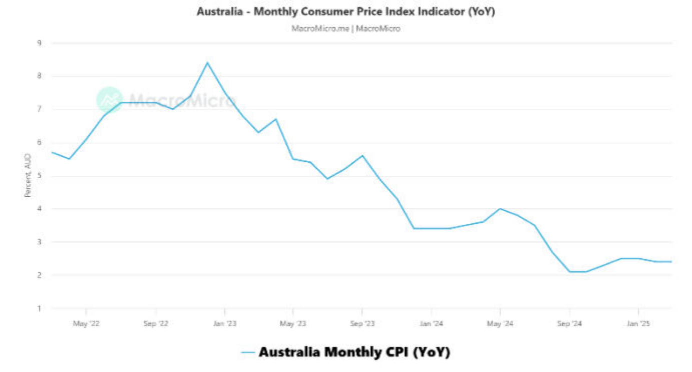
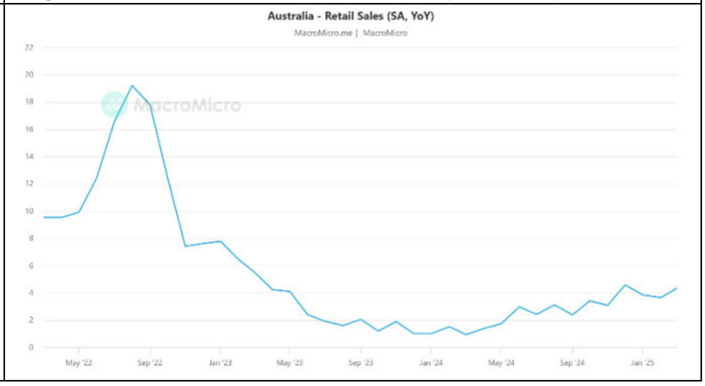


Figure 2: Australian Retail Sales (SA, YoY)



ETFs -Domestic & Global

Global Select ETF News

Wall Street's Rush to Launch Vanguard-Style Dual Listed Funds Draws Warnings

The US Securities and Exchange Commission is expected to approve applications for **dual-share-class structures**, allowing managers to add an ETF sleeve to an existing mutual fund, which could bring the two vehicles closer together. More than 50 firms, including BlackRock Inc. and State Street Corp., are waiting for the regulator's greenlight to deploy the hybrid structure — made possible after Vanguard Group Inc.'s exclusive patent expired two years ago.

The **two-in-one blueprint is a tantalizing prospect for asset managers looking to break into the ETF market at scale**, without having to launch a new strategy from scratch. It also offers a lifeline to firms battered by years of mutual-fund outflows, as investors fled for more tax-efficient alternatives and the convenience of daily liquidity. The hybrid structure famously helped Vanguard save its clients billions in taxes over two decades.

But there are two key concerns. First, some Wall Street experts caution the shake-up could erode key benefits of the wrapper, especially **if hybrid funds face significant withdrawals during market stress**. Second, At the heart of the concern is a tax dynamic that ETFs were built to avoid. These funds rarely pay capital-gains tax distributions, thanks to their in-kind redemption process, which allows the issuer to swap securities with authorized participants rather than sell them outright. By contrast, mutual funds redeem in cash, meaning managers may need to sell securities to meet outflows. **If those sales generate capital gains, they may distribute them to investors. In a hybrid vehicle, those taxable gains risk getting passed onto ETF shareholders too**.

Newly Minted ETFs Buck Vanguard Effect as Fees Hit Record High

The **average fee of an exchange-traded fund launched this year has surged to a record 65 bps**, with leveraged trades, cryptocurrency, and active management among the slew of nearly 350 new offerings. That said, despite the high fees of new ETFs, the average asset-weighted expense ratio across all funds is falling and hovering around its lowest level on record, at 17.5 bps.

Paradoxically, the all-time high costs can be linked back to the race toward lower fees among the highest ranks of the ETF league tables. Fund giants like the Vanguard Group, BlackRock Inc. and State Street Corp. have spent years slashing fees, or expense ratios, on their index-tracking, core portfolio funds to near zero, in an effort to attract new investors. But as the so-called Vanguard Effect has lowered fees for investors, it in turn has given them the resources to allocate a slice of their portfolios to more expensive, niche funds. The scale and efficiency of ultra-low-cost products have helped subsidize the expansion of higher-fee offerings elsewhere, supporting broader innovation and diversification across the ETF landscape.

The Deep Dive – How Flows Effect ETF Factor Performance

There is a host of factor related ETFs, and for good reason. Many investors think asset class, geographic, sector, market cap exposures or thematic exposures. Less so understanding market performance on a factor basis. For example, during the downturn between mid-February and the early part of April this year, outperformance was primarily driven by factors. And in particular, factors like lower beta, lower volatility, strength of balance sheet, stable profit margins, stable if not growing dividend yields outperformed. That is, a quality wrapper, but with that emphasis on the lower beta, lower volatility, those factors that tend not to do well when the market is ripping back on the upside.

Many investors know that the performance of factors like value or momentum declines if more investors put money at work in these factors. This is one of the key reasons why factor performance waxes and wanes over time. But thanks to a brilliant study by Nikolay Doskov, Thorsten Hens, and Klaus Reiner Schenk-Hoppé we can put some numbers to this effect. The paper is an absolute must read for every fund manager.

They looked at all the stocks traded on the 14 largest stock exchanges in the world and formed portfolios based on the different factors as well as passive portfolios that just replicate the market. They considered both long-short and long only factor portfolios, but I will only deal with long only portfolios here.

Then, in each month from 1995 to the end of 2020, they track the performance of each stock and check which stocks move in and out of the different factor portfolios. This way, they can simulate how investor flows change different factor portfolios over time and how in the medium- to long-term these flows change the returns of different factors.

Here is what they estimate happens to the returns of the four main factors - value, small cap or size, momentum, and quality - if 1% of the total market is shifted into these factor portfolios. Note that the total market cap of the stocks in their study is about $60 trillion, so 1% corresponds to net inflows from passive strategies to these factors of c.$600bn worldwide.

Figure 1: Impact of 1% of market cap inflow into factors

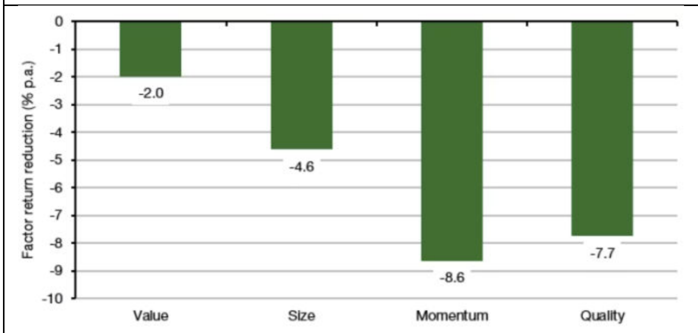
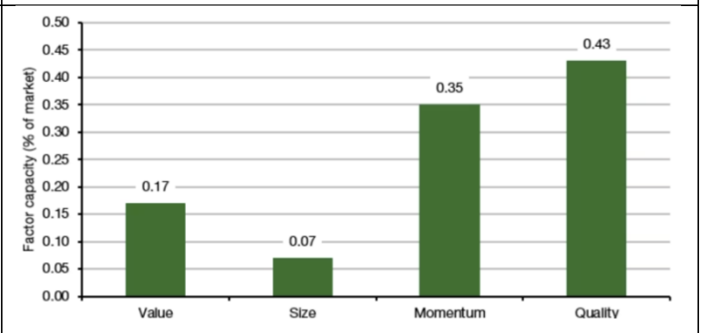


Figure 2: Capacity of different factors



Source: Doskov et al. (2024)

As evident in Figure 1, the returns of the value factor are reduced by only 2% p.a while momentum returns decline by about 8.6%. If investors chase the best performers of the past, they quickly reduce the returns of momentum strategies because they push the prices of expensive stocks even higher. Meanwhile, if investors move into cheap value stocks, they reduce the potential future return by much less because these stocks remain cheap – and thus poised for future outperformance – even after the inflows.

Intuitively, one could interpret this as value and small cap portfolios having higher capacity - meaning they can digest more inflows before their outperformance disappears. But this is not true because different factors have different long-term performance. If we turn the calculation around and ask what percentage of the total market needs to move into the factor portfolios before the outperformance disappears, we get the chart in Figure 2.

Because the average outperformance of value strategies vs, the market is much smaller than the average outperformance of momentum portfolios. In the end, value and small cap strategies have the least capacity and their outperformance tends to disappear if a mere 0.17% of the total market cap (c.$102bn) and 0.07% of market cap (c.$42bn) flow into these factors globally.

What is particularly interesting, though, is that the study also estimates cross-factor impacts. If more money flows into momentum stocks, the expensive stocks tend to get more expensive while the cheap stocks tend to get cheaper. This should increase the return potential for value investors.

US ETF Flows by Asset Class

The value of ETF flows data is relatively obvious – it highlights asset class inflows and outflows. As such, it illustrates investor asset class preferences at any given time. Relative to the ASX data, which is monthly, US data is available on both a more frequent and timely basis. The data below is as at 22 May 2025.

Figure 1: One Week US ETF Flows (as at 22 May)

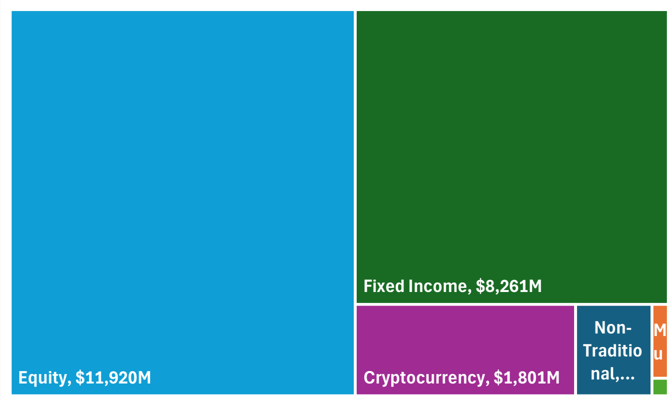


Figure 2: US ETF Flows by Asset Class (as at 22 May)

Asset Class	1-week	1-month	3-month	YTD	1-year
Non-Traditional	$624M	$4,577M	$37,857M	$51,805M	$103,931M
Multi-Asset	$109M	$262M	$1,238M	$1,238M	$3,468M
Fixed Income	$8,261M	$30,287M	$77,004M	$141,592M	$354,390M
Equity	$11,920M	$31,425M	$134,346M	$213,889M	$739,687M
Currency	-$52M	$17M	$968M	$1,042M	$950M
Cryptocurrency	$1,801M	$7,701M	$2,673M	$7,745M	$35,422M
Commodity	-$1,885M	-$4,178M	$8,950M	$13,300M	$18,093M
Alternative	$26M	$241M	-$79M	$654M	$1,731M

Global Select ETF Launches

New issue ETFs reflect 'real-time' investment theme investor sentiment. i.e, what's 'hot'. Additionally, the largest Australian ETF issues are all part of large international entities. And often what ETF is issued in their home markets and, to some degree, subsequently issued in Australia.
Regarding the table below, there are several distinct themes reflecting investor preferences currently:

- **German equities ETFs** – Germany has been running hot all of 2025. Initially it was a relative value play vs the US. Then it became a defense sector play as well as the major theme of a diversification away from the US.
- **Income related ETFs** – defensive, fixed income products, partly reflecting the more defensive or at least diversification of portfolios given a range of uncertainties, particularly in the US and in US equities.
- The Innovator Capital Management launched the Innovator Equity Managed 100 Buffer ETF is an interesting product. It is an actively managed solution that seeks to **provide 100% downside protection** through a one-year laddered options portfolio. It is reflective of many ETFs that have been issued over the circa last 4-6 weeks particularly in the US – equities exposure but with either downside preservation or downside protection.
- **Global / international equities ETFs**. Same theme – diversification away from the US.
- Franklin Templeton to **convert 10 Putnam Municipal Bond mutual funds to ETFs**. I wonder why. These is a very common dynamic these days.

Figure 25: Select ETF Launches, for May 8th to 22nd 2025
Select European ETF Launches
STOXX launches DAX Composite Indices
First Trust launches three ETFs on Deutsche Börse
Crédit Agricole and Solactive launch Solactive Constant Maturity Government Bond Index Family
Janus Henderson launches UCITS mortgage-backed securities ETF
Franklin Templeton to convert 10 Putnam Municipal Bond mutual funds to ETFs
Select US ETF Launches
Vontobel Asset Management, Inc. launched the Vontobel International Equity Active ETF
Lazard Asset Management converted the Lazard International Equity Advantage mutual fund into an ETF
Innovator Capital Management launched the Innovator Equity Managed 100 Buffer ETF
Russell Global Infrastructure Active ETF

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