



Commonwealth
Private



September 2025

Market Outlook.

Not the time for a blanket approach,
as market strength continues.

Foreword

Domestic equity markets continued their ascent throughout August, with the S&P/ASX 200 index breaching 9,000 points to fresh highs. The perception of manageable (albeit sticky) inflation, falling interest rates and “green shoots” among Australian consumers boosted market sentiment. US equity markets also continued to rebound from April-lows to record another month of solid returns. However, below the surface, there are several watchpoints, including ongoing market concentration, elevated valuations, low credit spreads and a cooling US labour market.

The Reserve Bank of Australia’s (RBA) August rate cut came prior to the release of slightly higher-than-expected inflation in July. Despite this, the RBA has so far managed to “thread the needle” and bring core inflation down to within their 2–3% target range, while keeping unemployment low at 4.2%. Several tailwinds for the Australian economy are now emerging. These include a tentative but persistent recovery among the consumer together with an easing monetary backdrop. This is despite some evidence of scarring from the high interest rates and inflation in the aftermath of the pandemic seeing some of the rate cuts being used to pay down debt. CommBank continues to expect another rate cut in November to take the cash rate to 3.35%.

The other focus point for markets remains the US economy, which is still growing but at a slower rate. A softening jobs market and sticky inflation have presented a challenging backdrop for the US Federal Reserve (Fed) even as the odds firm for a September rate cut. US consumer spending has also slowed in H1 2025, decelerating from the robust pace seen in 2024. One component of the US economy that has continued to exhibit strong growth is AI Capital expenditure (Capex). Such has been the investment by the public and private AI firms in Capex that spending has outpaced the US consumer as a driver of growth during the first six months of 2025. Our stance is that AI remains both an opportunity and a threat, with a disruptive element that will affect equity, credit and labour markets.

The most disrupted companies will become cheap for a reason (i.e. “value traps”) and therefore, poor candidates for mean reversion-based strategies. History is littered with examples of companies that appear cheap on traditional metrics amid structural change catalysed by tech-advancement. This underscores the importance of taking a forward-looking approach.

That doesn’t mean paying any price for the winners. The valuation assessment is particularly important at the current market juncture, with both US and Australian equities each trading at a premium to historical norms. The most recent Australian reporting season also demonstrated the unforgiving nature of markets when companies don’t meet expectations. The good news is that there is ample dispersion within and across markets – with very high expectations implied in some companies, and not others. This dispersion has been amplified by the narrow market leadership seen in recent years. Looking below the surface, we still see opportunity among small and mid-caps both locally and abroad. We also see reasonable valuations within yield generating growth assets such as Global REITs, which have lagged the broader equity markets in recent years.

Similar valuation considerations exist in fixed income markets as credit spreads have continued to tighten. During the month, the extra yield, or credit spread, over Treasuries for US investment-grade bonds fell to around 0.7% – the lowest level since 1998. However, there are parts of the credit spectrum (such as asset-backed securities and Australian investment grade credit) that are less overvalued. Having a flexible approach underpinned by the full spectrum of credit options (both public and private) is helpful in these situations. This means not being constrained to the largest markets and having the freedom to move across the various forms of fixed income. This concept also applies to equities, real assets and alternatives, where an expansive opportunity set can free up scope to find those assets with more favourable risk/return dynamics.

James Foot, Chief Investment Officer
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Global Economics:

Slowing growth

- Global economy is navigating a delicate transition from inflation management toward sustaining growth.

Global sentiment continued to reflect cautious optimism in August, tempered by continuing geopolitical uncertainty and persistent inflationary pressures in some key economies as the Fed's independence is challenged.

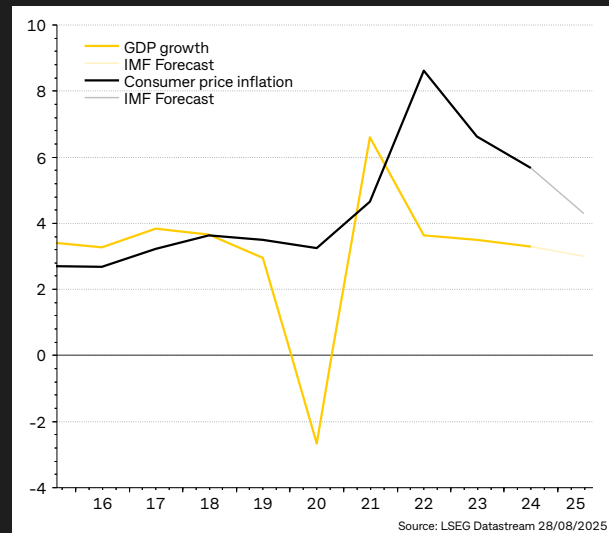
Policy signaling at Jackson Hole dominated August. Fed Chair, Jerome Powell, indicated that with policy 'in restrictive territory,' the balance of risks has shifted and conditions 'may warrant adjusting our policy stance'. Markets read this as a clear opening for a September cut with Fed-funds futures implying high odds of a 25 bp move. Powell also framed tariff effects as largely one-time price-level shocks rather than a source of sustained inflation pressure, even as he acknowledged uncertainty around trade, immigration and fiscal settings.

Inflation data for July showed headline CPI at 2.7% year-on-year and core CPI at 3.1%, with services costs continuing to drive stickiness. Labour market readings pointed to an unemployment rate of 4.2%, with hiring momentum slowing across most sectors. Taken together, the data reinforced the Fed's cautious but dovish lean, with markets pricing a September cut as the base case.

Euro area inflation held steady at 2.0% in July, keeping price pressures contained outside of services. Activity indicators were more encouraging: the August flash composite PMI rose to 51.1, its highest in over a year, as German manufacturing stabilised. Price pressures in services, however, suggest the European Central Bank will tread carefully in adjusting policy.

Global growth & inflation expectations

Annual % change



The UK experienced an unwelcome rebound in inflation, to its highest level in 18 months, with headline CPI accelerating to 3.8% in July and services inflation remaining near 5%. The re-acceleration complicates the Bank of England's path, with markets pushing back expectations for additional rate cuts. Meanwhile, retail indicators suggest renewed price stickiness, perhaps serving as a cautionary tale for other central banks with regards to cutting rates before inflation is firmly back under control.

China's data releases painted a mixed but stabilising picture. China's industrial production rose 5.7% year-on-year slowing from the month prior and missing expectation. It's a similar story for retail sales that saw growth of 3.7%, however, this was also down sharply from the month prior and missed expectation. Price pressures are limited, allowing policy to remain supportive but measured. Authorities continue to favour targeted stimulus rather than broad-based easing, signalling growth will likely remain range bound.

Australia Economics:

RBA easing to result in easier financial conditions

- The RBA resumed rate cuts joining other key central banks in late cycle easing.
- Rate cuts are having the desired effect on the broader economy with evidence of some “green shoots” for the consumer.
- Easier monetary conditions are a key support factor for risk assets amid several watchpoints.
- The Labor government confirmed its move to introduce new super tax rules and a tax on unrealised capital gains. If implemented, this may have key implications for super-based investors that are captured.

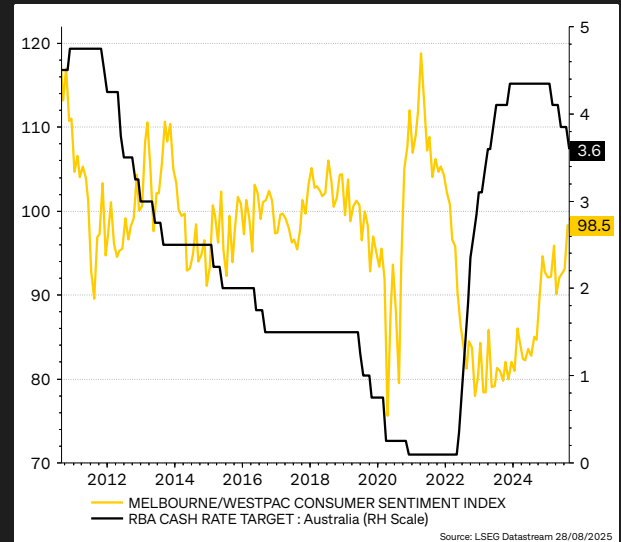
On cue, the RBA delivered its third rate cut in this cycle, taking the cash rate to 3.60%. Markets are now pricing in further easing from the Fed, underscoring the continuation of late-cycle global policy easing, and thus, easier monetary conditions.

The August RBA Board minutes showed the evolution of the RBA’s thinking with upside risks to inflation now superseded by potential downside risks to the domestic labour market. That said, the monthly CPI indicator released later in August showed a larger than expected rise in inflation. While the RBA is focused on the less volatile quarterly CPI data, in terms of future easing, this highlights that the RBA remains data dependent. Overall, CommBank still expects the RBA to cut the cash rate once more in November to 3.35%.

Rate cuts are having the desired effect on the broader economy with evidence of some “green shoots” for the consumer, a key driver of domestic economic activity. This was shown by the CommBank Household Spending Insights Index lifting by 0.8% in July, the tenth month of consecutive gains.

Consumer sentiment improves

WBC-MI Consumer sentiment index vs RBA Cash Rate



With the WBC-MI consumer sentiment also improving to a three and a half year high, there are rising signs that the consumer recovery is gaining some momentum. Solid employment conditions are assisting, with the unemployment rate retreating from 4.3% to 4.2% in July, a historically low level.

As we note in our Foreword above, easier monetary conditions are a key support factor for risk assets but come at a time of several watchpoints including elevated equity valuations and low credit spreads. We discuss this further in the Fixed Income section below.

The Treasury’s Economic Reform Roundtable aimed to build a consensus on reducing red tape and amending the construction code to improve productivity. Our focus, however, was centred on the Treasurer’s desire to proceed with the tax rules on earnings on superannuation balances over \$3m which includes a new tax on unrealised capital gains. If implemented, for cashflow management reasons, those impacted may consider changing their investment vehicle.

Equities:

Mixed reporting season

- Both the US and Australian equity markets set new highs on positive momentum.
- While the US reporting season drove earnings upgrades, the domestic index saw aggregate earnings falling.

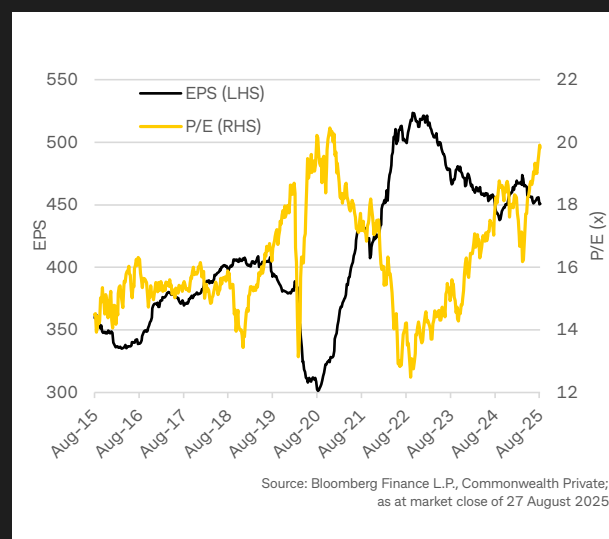
Major equity indices continued marching higher throughout August. New records were set in a number of markets, including the US and Australia, primarily driven by the positive sentiment stemmed from easing monetary policies and fear of tariffs temporarily fading away.

With nearly 90% of S&P 500 companies having reported, the US reporting season has so far been better than expected, according to the data compiled by JP Morgan Research in mid-August. The Mag7 have delivered positive earnings surprises well ahead of S&P 493 (13.1% vs 6.8%), and also led in the earnings growth (21.8% vs 8.1%). On this backdrop, the CY25 Earnings Per Share (EPS) forecast for the S&P 500 index has been revised up by approximately 1.6% since July, according to FactSet. The year-on-year EPS growth for CY26 and CY27 are both expected to be around 13%. The S&P 500 Index rose 4.2% from 30 June to 26 August, and the 12-month forward Price to Earnings (x) ratio only edged up slightly from 22.1x to 22.4x, implying two thirds of the index price gain was attributed to earnings growth.

However, our domestic market didn't enjoy the same positive earnings outlook as the US market. Instead, the aggregate EPS for S&P/ASX 200 Index has been revised down by 1% and 2% respectively for CY25 and CY26 since July, with the soft earnings sentiment continuing amid a mixed reporting season. At the time of writing, the majority of the domestic listed companies have reported financial results. While it may take a bit longer for the analysts and investors to digest the information and recut the forecast numbers, the trend of earnings downgrade hasn't shown any sign of turning

S&P/ASX 200 Index 12-month forward P/E vs EPS

Elevated multiples on soft earnings



around. The index-level 12-month forward EPS now sits approximately 14% below where it peaked in October 2022. And yet, the P/E multiple expansion has driven strong equity market returns over the last three years. The 12-month forward P/E of the S&P/ASX 200 Index is just below 20x, a touch below the previous high of 20.6x seen in late-2020.

The share price reaction during the reporting season has been very volatile. One in six companies that have released results (24 out of 145) saw greater than 10% one-day share price moves, either up or down, and slightly skewed to the downside (13 down vs 11 up). The worst-performing stock was James Hardie Industries, down 27.8%, and Tabcorp Holdings was the best, up 23.9%. While some moves may look like overreaction, we see almost all the companies in this oversized share price move list have carried the momentum on the same direction for the following trading sessions. The very bifurcated share price performances have highlighted how unforgiving the market can be when facing surprises. But at the same time, we think it could provide opportunities for long-term returns if any mismatch in fundamentals and valuation could be identified.

Wholesale validated clients can expect to receive a further update on our key takeaways from the Australian reporting season in September.

Fixed Income:

Late cycle easing drives search for yield.

- Last month's fall in short-dated interest rates reflects revised rate cut forecasts for the Fed.
- Lower policy rates provide impetus for many deposit investors to seek yield enhancement solutions, while also providing some support for globally narrow credit spreads.
- Long-dated (30-year) US bond rates remain elevated and there are key factors that could continue to pressure this yield.

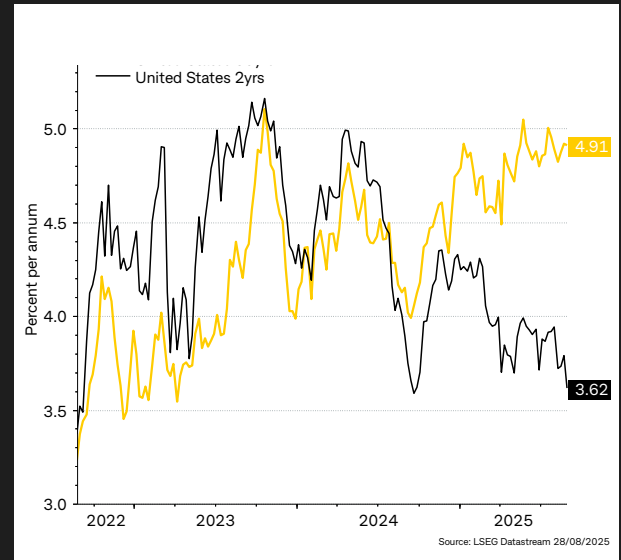
Shorter-dated government bond yields declined in August as investors raised expectations for further late cycle rate cuts from the Fed. Mild support for short-dated US bond (treasury) yields was also extended via S&P's affirmation of the US rating at AA+ and the rating agency's expectation of some moderate fiscal repair over the next three years.

There are two broad impacts from lower policy rates in fixed income: Firstly, it gives added impetus for many deposit-based investors to seek alternative yield enhancement solutions. Secondly, easier financial conditions are also one support factor for credit spreads. As we noted in the Foreword, credit margins for investment-grade-based (IG) US corporate bonds are now at 27-year lows and are vulnerable to widening pressure should fundamentals and/or risk sentiment weaken.

While AUD credit markets hold some better relative value, historically low global credit spreads highlight the importance of sector and issuer selection. Within the broad IG credit domain, we favour securitised assets, notably quality, seasoned, higher coupon asset-backed exposures as we believe these offer defensive attributes as well as reasonable spread compensation for liquidity. All of the diversified, multi-sector fixed income funds in our core and yield managed accounts hold material allocations to securitised assets.

Long-dated US Treasury yields rise again

US 2-year and 30-year Treasury yields



While shorter-dated bond yields have declined, the US 30-year treasury yield has remained elevated and there are key factors that could pressure this yield higher: a more dovish Fed that prioritises the US labour market over its inflation mandate could lead to higher growth and inflation outcomes in the future. In addition, the future composition of the Fed Board of Governors may look more dovish later this year, which could also increase inflation expectations.

Meanwhile, the RBA confirmed the challenge facing term deposit (TD) holders with six-month retail TD rates now falling below 3%. While high net worth investors are typically able to source higher deposit rates, wholesale TD rates are materially below the 5%-plus rates previously available.

Given this, and with the elevated fixed income portfolio yields still on offer, we see merit in moving from short-term cash products into fixed income investments that are moderately higher yielding, but liquid and IG-based, as noted above. We discussed in our special report *"Navigating the Shifting Tides: Australia's Fixed Income Investment Landscape"*, published on 28 August.

Real Assets:

Real Assets build on solid foundations

- Real Assets such as Property and Infrastructure can provide long-term investment stability.
- It can also provide a hedge against the inflationary-based erosion of asset value.

In our August Market Outlook, we focussed on Australian commercial property markets, noting that: (a) valuations of Industrial and Retail sector assets have already experienced two consecutive quarters of capital growth, and (b) the near-term supply-demand balance has held back Office sector valuations from achieving the same outcome. However, the medium-term outlook for prime CBD office assets is cautiously positive, as recently completed office space continues to be absorbed by the market, and new supply looks to be constrained by high construction costs.

Similar dynamics are seen globally, albeit noting that some Office locations still face significant headwinds from high vacancy rates, for example, major US Cities.

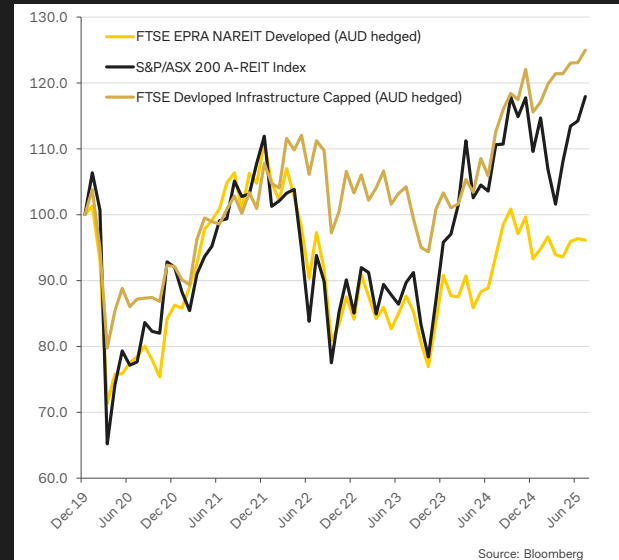
Meanwhile, commercial real estate transaction activity is still subdued, held back by the gap in price expectations between reluctant sellers and cautious buyers. We expect this activity to increase over the next 12 months, as base interest rates fall and competition between real estate private credit providers combine to reduce financing costs. Valuations will also be underpinned by ongoing contracted rental increases, adding to the improvements in net revenues gained by falling financing rates.

In listed real estate markets, prices continue to reflect implied discounts to underlying asset values. Overall discounts to net asset value are estimated to be circa -14% globally, and circa -12% in Australia. By sector, globally, the largest discounts are in Hotels, Industrial, Office and Residential. (Source, CBRE, as at 30 June 2025.)

At the same time, listed Australian REITS reported increased earnings in the June quarter

Real Asset investment returns

AUD Hedged (Indexed to 100 at 31/12/2019)



(in total, noting that there is a significant divergence of results between constituents). While Australian REITS have performed relatively well in recent months, the performance of global REITS has lagged, as shown in the chart above.

In consideration, we expect global REITs to continue to deliver sound income, as well as provide the potential for capital growth. This potential for capital growth can be driven by the increase in underlying asset valuations and/or the narrowing of the trading discount to underlying asset values. Improved investor sentiment remains key to unlocking this potential.

Similarly, we maintain a positive outlook for Infrastructure which continues to evolve, with new opportunities in sectors such as energy transition, digital infrastructure, and waste recycling adding to underlying core sectors such as utilities (energy generation, gas, and water), and transportation (airports, road, rail, and shipping). It also encompasses the necessary refreshment and upgrade to electricity infrastructure (such as electricity grids and energy storage), which will provide a base for infrastructure investment and returns in the decade to come.

Alternatives:

Demand for alternatives remains strong

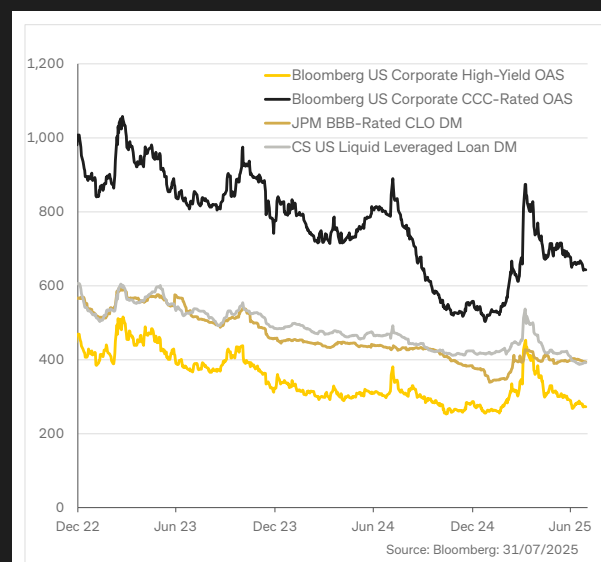
- Hedge Funds aim to provide absolute returns with low correlation to traditional asset classes.
- Alternative Credit offers enhanced yields.
- Private Equity offers access to value-added opportunities and participation in developing businesses and technologies.

In August 2025, credit spreads of more-liquid high-yield and lower IG alternative credit instruments continued to trade at relatively tight spreads compared to their historical levels. This return to current levels, since the spike in April 2025, reflects market confidence in the US economy, including that the increase in US import tariffs won't have a persistent negative impact. More broadly, it reflects ongoing investor demand for higher-yielding investments in an environment where major central bank interest rates are expected to continue to fall over the remainder of 2025 and into 2026. While higher-yielding investments present higher risk than investment grade bonds, the sector's continued growth indicates that investors are comfortable with the given risk exposures.

Investors also continue to search for structural yield enhancement in private credit and structured credit. For example, in structured credit, Collateralised Loan Obligations (CLO) provide a key role in facilitating access to credit by non-investment grade corporates. These structures allow lenders to target the risk and return profiles that suit their investment objectives: the larger portion of these structures consist of senior investment grade tranches, while mezzanine financiers can achieve higher yields while taking measured credit risk across a diversified portfolio of borrowers. Noting that many investors have limitations on investing in such structures for mandate or prudential capital reasons, or do not have the specialist expertise to conduct the necessary fundamental analysis, this results in CLO's being able to offer higher yields compared to similarly rated corporate bonds.


High-Yield spreads and discount margins

Basis points



Overall, we maintain our preference for experienced specialist credit managers which: (a) actively manage a diversified portfolio of investments across multiple credit strategies (such as high yield bonds, corporate loans, and structured credit), and (b) have a strong focus on risk assessment and can demonstrate ongoing below-system asset downgrades and default rates. In the current market context this includes preferencing companies that have high-quality stable cashflows, and consideration of the additional risks posed by sectors that are more exposed to changing economic and policy drivers.

Meanwhile, we continue to see healthy levels of Private Equity (PE) transactions. While IPO activity has been subdued since 2022, according to EY, in H1 2025 the number of IPOs in the US increased by 16%, building on progressive increases in 2023 and 2024. Together, we expect the ongoing increases in IPOs and PE secondary market transactions to free up capital and satisfy demands for increased distributions from investors in older PE vintage funds that have experienced longer than expected investment time frames.



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