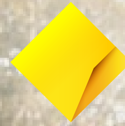

Commonwealth Private

April 2026

Market Outlook.

Discipline, not reaction, remains the strongest investment edge.

CIO Foreword

Markets shifted decisively in late-February. 2026 began as a period of equity broadening, with capital rotating beyond mega cap AI leaders into a wider opportunity set but has been overtaken by a narrative centred on geopolitical escalation, energy disruption, and a renewed inflation shock.

The coordinated strikes in the Persian Gulf and subsequent disruption of the Strait of Hormuz prompted a rapid reassessment of both the macroeconomic outlook and investor positioning, reinforcing the sensitivity of global markets to supply-chains. The Strait of Hormuz remains one of the most critical supply arteries in the global economy, facilitating approximately 20% of global oil and Liquid Natural Gas (LNG) flows. Disruption at this scale placed strong upward pressure on energy prices at a time when growth momentum was already moderating. This combination contributed to a more complex macro environment, where inflation risks re-emerged even as activity softened, complicating the monetary policy response for key central banks and reducing visibility on the path forward.

At the start of the year, markets expected the US Federal Reserve (Fed) to continue easing policy as inflation showed signs of moderation. However, as at the end of March, that trajectory has become less certain, with markets repricing toward a higher-for-longer environment. Global bond yields moved higher to reflect elevated inflation expectations and reduced confidence in near term rate cuts in the US. In Australia, the Reserve Bank of Australia (RBA) again lifted rates and 10-year government bond yields moved to their highest level since 2011, mirroring this global adjustment. While higher yields created near term headwinds for bond prices, they also improved forward looking return potential by enhancing income and reinforcing the defensive role of fixed income within portfolios.

Equity markets underwent a similar repricing. The speculative excess that characterised much of 2025, supported by rate cuts and abundant liquidity, began to unwind through March. As macro uncertainty increased, market leadership shifted toward companies with strong balance sheets, durable earnings, and pricing power. The dispersion between high quality assets and more speculative equity segments widened, reflecting a more selective allocation of capital.

Where to from here?

In environments such as this, increased volatility can be interpreted as a prompt for action. However, effective investing is not defined by activity alone, but by the quality of decisions made. With information widely accessible and analytical tools increasingly commoditised, behavioural discipline remains a meaningful source of differentiation. The ability to remain measured and selective, particularly when conditions are unsettled, is central to achieving consistent long-term investment outcomes.

The “Goalkeeper’s Dilemma” offers a useful parallel. Research shows that goalkeepers are more likely to save penalties when they remain in the centre of the goal, yet they still tend to dive, influenced by the perception that inaction reflects a lack of effort. This illustrates action bias, the tendency to favour movement under pressure even when restraint may be more effective. Investors can encounter a similar dynamic. Periods of heightened volatility often leads to adjustments in positioning, such as rotating into defensive sectors or reducing risk exposure. While appropriate in some cases, when defensive assets are already priced at elevated levels, such decisions can reduce future return potential, ultimately detracting from long-term outcomes.

Thus far, the events of early 2026 reinforce a familiar principle: the primary risk to long-term outcomes is often not market volatility itself, but the behavioural responses it provokes. We remain prepared to adjust positioning as conditions evolve, but only where valuation and risk-reward considerations provide a clear basis for doing so.

James Foot,
Chief Investment Officer
Commonwealth Private

Supply Shock to Demand Destruction

Key insights:

- Disruption in the Strait of Hormuz removes spare capacity, driving non-linear price moves and a higher risk premium.
- Sequencing matters; inflation now, demand destruction later.
- The shock is initially inflationary, particularly over six to 12 months erodes real incomes and demand, ultimately becoming disinflationary and increasing downside risks to growth if disruption persists.

The closure of the Strait of Hormuz on 28 February 2026 has delivered what the International Energy Agency is calling the largest supply disruption in the history of global oil markets, a sobering designation in a century that includes the Arab embargo of 1973, the Iranian Revolution, and the Gulf War.

Escalating disruption in the Strait has re-emerged as a first-order macro concern. The Strait carries roughly 20 million barrels per day, equivalent to 20% of global oil consumption. Crucially, it's not just a transit choke point it's the conduit for the majority of the world's effective spare capacity, largely concentrated in the Gulf. Any sustained disruption therefore constrains both current supply and the system's ability to respond.

This distinction matters. Markets aren't simply repricing lost barrels, they're repricing the absence of any spare capacity, which introduces a materially higher risk premium into oil prices. As history has shown, price sensitivity increases sharply when spare capacity is impaired, even if realised supply losses remain modest.

Brent crude climbed more than 50%, trading toward $120 per barrel at recent peaks as markets priced both disruption and risk premium.

The macro transmission is both immediate and measurable. A commonly cited rule of thumb is that a 10% increase in oil prices adds 30-40 basis points to headline inflation in advanced economies over the subsequent year, while reducing global growth by 0.1-0.2 percentage points. Given the scale of recent price moves, the implied inflation impulse is non-trivial, particularly in economies where energy remains a large component of consumption.

For policymakers, the challenge is that higher inflation coincides with weakening real activity, limiting the scope to ease policy without risking a de-anchoring of expectations. The more consequential dynamic lies beyond the initial inflation impulse. Energy shocks function as a tax on real incomes, disproportionately impacting lower-income cohorts with higher energy and food expenditure shares. As this shock spreads, it compresses discretionary consumption and weighs on industrial demand.

This sets up a familiar but often underappreciated sequence. In the near term, higher oil prices are unequivocally inflationary and can reinforce expectations of restrictive policy settings. Over a six to 12-month horizon, however, the same shock becomes disinflationary, as weaker demand, tighter financial conditions, and declining consumption begin to offset the initial price impulse. Historically, sustained oil price spikes have been associated with subsequent slowdowns in both inflation and growth, not because the supply shock resolves quickly, but because demand adjusts downward to meet constrained supply.

The ultimate macro impact is highly sensitive to duration. Short-lived disruptions tend to generate price spikes without lasting demand impairment, while prolonged dislocations increase the probability of a transition from an inflation shock to a broader growth shock. For investors, this creates a sequencing challenge. Early-stage dynamics favour energy exposure and inflation hedges, alongside caution on duration. If disruption persists, positioning typically rotates toward quality, defensiveness, and duration, as growth risks begin to dominate and demand destruction takes hold.

The resolution path matters as much as the disruption itself. A negotiated reopening that allows oil to retrace could limit lasting damage as consumer confidence would recover, financial conditions would ease, and central banks would regain optionality. A protracted closure, however, risks converting a supply shock into a fully-fledged growth shock, as demand destruction sets in and investment confidence deteriorates. We're monitoring both the geopolitical signalling and the market closely.

Equities: Shock without panic

Key insights:

- Valuations have adjusted; earnings risk is next. Markets have repriced via multiples, not profits. That holds only if the conflict in Iran is short-lived.
- Energy exposure is driving winners and losers with energy and defence outperforming.
- Duration will determine the outcome; the longer the conflict in Iran persists, the deeper the equity drawdown.

The Iran conflict has become a key driver of equity market performance through March. Markets have followed a consistent pattern: selling off where there's escalation, recovering on signs of de-escalation, and reversing as those hopes fade. This reflects a market that is repricing risk in real time, rather than capitulating, with outcomes increasingly dependent on how far, how long, and how disruptive the conflict becomes.

US equities have shown relative resilience: the S&P 500 has experienced a pullback, with the adjustment driven primarily by valuation compression rather than a deterioration in earnings expectations. This is an important distinction as equity markets, for now, are treating the conflict as a headwind to multiples rather than to profits. Performance has been increasingly concentrated in large-cap companies with pricing power, while sectors more sensitive to rates and input costs are under pressure. The key shift has been the influence of higher energy prices feeding into bond yields, tightening financial conditions and weighing on equity valuations.

Global equities have been more directly impacted: performance has increasingly tracked exposure to energy costs, with Germany and Japan each being affected by their reliance on imported oil and LNG. This translated into weaker equity returns in cyclically exposed sectors over March, as higher input costs and softer demand expectations weigh on earnings outlooks. In contrast, energy producers and defence-related stocks were beneficiaries, highlighting the growing dispersion within equity markets. The result is a more fragmented landscape, where sector and regional exposures are driving returns more than broad market direction.

Australian equities have also seen this dynamic: the ASX has corrected sharply from early March highs, with materials and mining stocks leading the decline. At the same time, energy was the standout performer, supported by higher commodity prices. This divergence underscores the bifurcation within equity markets between sectors benefiting from higher prices and those exposed to slowing demand.

The outlook can be framed through three variables: depth, duration, and disruption. Depth refers to the severity of escalation. Markets currently appear to be pricing a contained conflict, but a shift toward sustained infrastructure damage or broader regional involvement would likely trigger a more pronounced equity selloff, particularly in globally exposed cyclicals. Prolonged disruption to the Strait of Hormuz remains a risk as it would significantly tighten energy supply and isn't fully reflected in current equity valuations.

Duration is the most critical variable for equities. Short-lived geopolitical shocks are typically absorbed quickly, with limited lasting impact on earnings. However, a prolonged conflict would mean higher energy prices, increasing input costs and margin compression across a range of sectors. There are already early signs that equity markets are becoming more sensitive to these second-order effects, with performance increasingly driven by rate expectations and cost pressures rather than headline events alone.

A swift and sustained resolution would likely support a recovery in equities, particularly in cyclically exposed markets, such as Asia and Australia, as energy prices retrace and pressure on margins ease. Conversely, a longer conflict raises the risk of a more sustained earnings headwind, favouring defensive sectors and companies with pricing power.

For now, equity markets remain highly sensitive to headlines. Until there's greater clarity on the duration, volatility is likely to remain a defining feature of equity markets.

We see smoke, but is there fire?

Key insights:

- The fundamental credit outlook appears reasonable, however, implications from private credit fund redemptions and traded prices indicate that investors are wary.
- The mismatch of investment fund liquidity terms with underlying asset liquidity can be problematic.
- Investors need to be risk aware, have a long-term investment horizon, and invest with experienced managers who give proper consideration to individual and portfolio risks.

Since Q4 2025, there's been significant debate regarding valuations in private markets. Firstly, the question has been raised whether several high-profile corporate failures in the US are an indication that default rates are set to accelerate. In Q1 2026, these concerns focussed on the potential for artificial intelligence (AI) to disrupt and ultimately cause the failure of certain businesses. Software companies are firmly in the spotlight here, as generative AI is proving extremely capable of writing computer code. This has already resulted in the widening of credit spreads, and lower prices, of high-yield bonds and broadly syndicated loans across the software sector.

It's also started to test the resolve of some investors in direct corporate loans, which aren't easily traded. Credit fund managers have been quick to communicate that they believe that their portfolios are, overall, fundamentally sound. We note that some small level of default is expected in private credit portfolios, with the risk of those defaults being compensated for by higher yields compared to IG loans. Ratings agencies are also monitoring closely. S&P's 2026 credit outlook base case indicates a relatively stable environment, however, FitchRatings observed an uptick in private credit defaults across 2025 in its US privately monitored ratings.

With this context, multiple listed US direct lending funds have experienced selloffs and are trading at discounts to their last-published net asset values of 10% to 25% (or more in isolated cases), thereby offering yields to new buyers in the low-to-mid-teens.

In Q1 2025, multiple large (unlisted) US private credit funds received increased levels of redemption requests. These funds usually offer quarterly redemptions, with those redemptions being limited in size, often being capped at 5% of each fund's net asset value. Funds that received redemption requests exceeding their caps have scaled back redemptions, meaning that investors will take longer to have their capital returned. It doesn't mean that defaults in the portfolio have risen significantly, or will necessarily do so. Does this mean that these "semi-liquid" funds are bad for investors? Not necessarily. These redemption limits are designed to protect long-term investors from the potential impact of too much money being withdrawn in the short term, and obviate the need for managers to try to sell their illiquid assets (which may require trading at a discount and incurring losses in the process).

Our main learning point from these situations is that investors who wish to participate in this asset class have to accept that they may not be able to withdraw their capital as quickly as they would like. In comparison, the exit timeframes from such funds are still lower than the long-term commitments of up to 10 years or more required by closed end funds.

While there will be impact from AI, we believe it necessary to look through the headline noise to the underlying business models and financial situation of each company, rather than expect widespread and near-term failures.

High quality credit managers have been doing this, considering the risks and opportunities posed by AI for some time, and curated their portfolios accordingly. This can be seen in the reduction of risk exposures to businesses that are most vulnerable to AI disruption, such as content creation and information synthesis. Managers may also take advantage of price declines in companies that will be less negatively impacted by AI, or those that will benefit, by increasing exposures to established companies with competitive moats, and those which provide business critical infrastructure.

Such fundamental investment rigour, considering opportunities, weakness, and threats, from financial and credit perspectives is crucial when making investment decisions for all companies, not just in relation to AI. In this regard, we favour managers who can demonstrate such skills over multiple investment cycles. In addition to investment selection, we look for managers with sound valuation policies that require the regular re-valuation of loans when corporate financial circumstances deteriorate, and according to changing market conditions (such as tightening or widening market spreads).

Why is an active style to stand alone fixed income investing important in difficult markets?

Key insights:

- Despite difficult market conditions from October, returns for key domestic absolute return fixed income funds remained solidly positive to end-February and performed notably better compared to the indices in March amid the Iran war.
- These conditions, especially in March, and the relative performance gap, has underscored the importance of investing via unconstrained, absolute return-based fixed income funds which have return and capital-based objectives.
- While the conflict is fluid and key risks remain, given the hefty rise in rates, the forward-looking total return potential for fixed income is sound.

The importance of taking an active and absolute return approach in standalone fixed income investing has been highlighted in recent months and especially given the escalating Iran conflict throughout March.

Since early-2023, the "goldilocks" conditions for fixed income were generally in place, characterised by low growth, moderating inflation, falling – but historically low – credit spreads and rangebound AUD interest rates. However, in October 2025, consensus pivoted from an RBA easing to hiking bias, and government bond (AGB) yields rose sharply. Despite these conditions, net returns for key domestic absolute return-based fixed income funds were solidly positive to end February. With the Iran conflict and the energy and inflation shock, market conditions weakened sharply in March, with the AUD three-year AGB yield peaking at 4.8% in late-March (a rise of 1.5% since October to a 13-year high), and global credit spreads bouncing further off their historical lows.

Absolute return-based fixed income funds ostensibly have dual aims: to deliver a cash-plus return target over the medium-term, as well as a capital-related objective. As a result, depending on the prevailing market conditions and/or views of the portfolio managers, their priority will shift from placing the portfolio in a position to deliver on the medium-term return target, to capital and mitigating the downside (and vice versa). Clearly, the latter scenario has presided recently where a focus on capital, not short-term return generation, is the priority.

The relative performance outcomes highlight the difference between passive/index-based and active fixed income funds - in the period 1 to 28 March 2026, the total returns for a key domestic AGB index[1] and a key global fixed income index (in AUD)[2] were -2.05% and -2.40% respectively. In comparison, key Australian absolute return funds performed notably better with small positive returns or moderate negative returns recorded over the same period. In February's Market Outlook, we discussed the impact of higher bond yields on long-dated fixed rate bonds. These 10- and 20-year AUD bonds, issued by several financials and corporates in 2025, have fallen by around $3-4 in capital price and are trading materially below par at ~$96-97 as at late-March.

It's important to note, however, in context of the funds' through the cycle return targets, that given the testing market environment and the active managers' resultant focus on capital, during these periods, the performance for these funds will track below the run rate for their medium-term return target.

As at end March, with the Middle East situation highly fluid, key risks remain, notably the duration and outcome of the conflict, and the impact on oil, inflation and rates, given the transmission has mainly been via interest rate markets. Meanwhile, if the recent US private credit sector headlines gather steam, so too does the risk of contagion to the liquid public credit markets. Given this, for standalone fixed investments that aren't part of a diversified portfolio strategy the need to remain active, unconstrained (and thus, run moderate interest rate and credit exposures) is important in our view.

Given the sharp rise in AUD rates, the forward-looking medium-term total return potential for the investment-grade (IG)-based fixed income sector is solid. With these rate rises, depending on funds' floating rate exposures, elevated portfolio yields that are now obtainable of ~6%+ will likely reset higher in months to come - that is, if AUD credit spreads remain broadly steady, funds with exposure to floating rate bonds (whose coupons reset every 90 days) will see their portfolio yields rise further given the 90-day bank bill swap rate is higher by ~0.8% since October.

[1]Bloomberg AusBond Treasury 0+ YR AUD index. Source: Morningstar.
[2]Bloomberg Global Aggregate TR index AUD hedged. Source: Morningstar.

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