Commonwealth Private

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Market Outlook.

Opportunity can build where the market has stopped looking.

CIO Foreword

Markets recently provided a timely reminder that what is priced often matters more than what is delivered. Samsung Electronics' preliminary second-quarter guidance indicated operating profit of approximately KRW 89.4tn (AUD$89bn), around 19x higher than the same prior period. Having already risen roughly 150% YTD, much of the good news was reflected in the share price. This demonstrates that investment returns are not driven by fundamentals alone, but by the gap between expectations and reality. Companies can deliver exceptional results and still disappoint if those results fall short of what is already embedded in its share price. Being correct about the fundamentals is not the same as being rewarded for them. In markets where expectations have become elevated, outcomes matter less than whether they exceed what investors have already assumed.

From Infrastructure Spend to End Demand

Samsung may represent an early indication that investors are beginning to look beyond Artificial Intelligence (AI) infrastructure spending and focus on a more important question: whether end-user demand for AI services will ultimately justify the scale of capital being deployed across the technology stack. The question is not whether AI will be transformative. The question is whether the economic returns ultimately generated by AI adoption will be sufficient to support the scale of investment currently underway. Samsung's announced KRW 400tn (approx AUD$400bn) investment plan for a new semiconductor manufacturing hub, with flexible deployment timelines, is a textbook response to strong pricing and high returns. It serves as a reminder that the capital drawn in at the top of a cycle is often what ultimately competes those returns away.

The links across the AI ecosystem are becoming increasingly important. Hyperscalers fund the infrastructure. Model developers consume it. Semiconductor companies supply the hardware. For the cycle to remain self-reinforcing, end users must ultimately generate enough value from AI applications to justify investment at every stage of the chain. Demand today is strong. The question is whether adoption, productivity gains and commercial use cases can scale quickly enough to support the capital being committed.

Narrow Leadership and Outsized Positioning

For much of this year, global equity market leadership has been unusually narrow, with returns concentrated in the semiconductor value chain. That is not to say the rest of the market lacks merit: parts of the software sector, for instance, have sound fundamentals despite being overlooked, though not all software companies are equally attractive. Within the leadership itself, the concentration has been striking. In South Korea, enthusiasm for semiconductor stocks became so intense that regulators tightened rules around newly launched single-stock leveraged ETFs tied to Samsung Electronics and SK Hynix. For investors, it's a useful reminder that when positioning and leverage become concentrated in a narrow part of the market, prices can become increasingly vulnerable to shifts in expectations.

Expectations versus reality

Recent weakness in semiconductor share prices demonstrates that even the market's strongest themes are not immune to changing expectations. While the correction reduced some of the excess, it's also reinforced an important point: as capital continues to flow into AI-related infrastructure, equity markets are becoming increasingly selective.

The key distinction is no longer whether a company is exposed to AI, but whether it can convert that investment into sustainable earnings and attractive returns on capital. For long-term investors, the opportunity may increasingly lie in identifying businesses where expectations remain modest relative to improving fundamentals.

James Foot,
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Australia's data-centre boom: investment, imports & constraints

What's going on here:

- Business investment will lift, but heavy reliance on imported equipment means the direct GDP benefit will be more modest.
- The strongest opportunities may sit in power, grid-connected land and infrastructure rather than data-centre operators alone.

Australia is entering one of its most significant non-mining investment cycles since the mining boom thanks to the rapid build-out of data centres required for cloud computing and artificial intelligence. The scale is now large enough to lift business investment and influence the national accounts. However, the benefit to the domestic economy will be smaller than the headline spending figures suggest.

CBA Economics[1] estimates that Australia has around six gigawatts of potential data-centre capacity in the pipeline, with development concentrated primarily in New South Wales and Victoria. Public project announcements imply a nominal build of around A$150bn, while industry cost benchmarks suggest the full pipeline could cost more. Delivery is likely to be phased, as projects compete for electricity, water, planning approvals and construction capacity.

The effect is already visible in the investment data. Information, media and telecommunications capital expenditure reached approximately A$8.7bn in the March quarter, almost three times its level a year earlier. Much of the increase was related to data centres and AI infrastructure, contributing around five to seven percentage points to annual business-investment growth. The sharp rise in commercial-building approvals suggests construction activity is likely to increase further over the next one to two years.

The key qualification is import intensity. The largest components of a modern data centre include servers, processors, networking equipment and specialised cooling systems, most of which are manufactured offshore. CBA estimates that around two-thirds of total data-centre capital expenditure may ultimately flow into imports.

[1] CBA Economics, Forecast update – Australian economy still set to slow, but drivers shifting, 6 July 2026.

As a result, the sector could make a substantial contribution to business-investment growth while adding only around 0.2% to real GDP growth in both 2026 and 2027.

What does this mean?

The domestic benefit will instead be concentrated in construction, engineering, electrical work, transport, commissioning and grid infrastructure. This should support activity and employment during the build-out, particularly in Sydney and Melbourne. However, it will also add to existing capacity pressures. Data-centre developers are competing for specialist trades at the same time as Australia is attempting to expand housing supply, renewable-energy infrastructure, defence capacity and public investment.

The implication is nuanced. Stronger investment supports growth, but it can also raise construction costs and crowd out activity elsewhere. Large technology-backed developers are well placed to compete for labour, equipment and grid connections. Other projects may therefore face higher costs or longer delivery times, keeping domestic capacity pressures elevated even if household demand remains subdued. This could also reinforce the case for monetary policy to remain restrictive for longer.

Power is the clearest constraint. Australian data centres consumed an estimated 3.9 terawatt hours of electricity in 2024–25, or around 2% of electricity supplied through the National Electricity Market. Australian Energy Market Operator's (AEMO) forecasts suggest consumption could rise to more than 6% of the market by 2030–31. This creates significant demand for new generation, transmission, storage and firming capacity, and increases the value of industrial land with reliable grid access.

Why should I care?

The opportunity therefore extends beyond data-centre operators. Infrastructure, generation and transmission assets, grid-connected industrial property, specialist engineering providers and private credit may all benefit from the investment cycle.

The key question is whether the infrastructure ultimately produces a broader productivity dividend. If businesses use the additional computing capacity to improve output and efficiency, the build-out could increase Australia's productive capacity over time. In the near term, however, its clearest effects are likely to be stronger investment, higher imports and increased competition for already-scarce economic resources.

Fiscal 2027: The Year of the Credit Analyst?

What's going on here:

- With more difficult domestic operating conditions ahead, credit fundamentals are coming into focus.
- The larger domestic bank and corporate AUD issuers are generally better placed to negotiate this operating environment in FY27.
- Our focus is on smaller corporates and banks and why it's vital to invest via experienced, active managers.

What a difference a year makes. This time last year, domestic credit investors were benefiting from continued Reserve Bank of Australia (RBA) easing and property price rises, amid positive but below par growth and low credit spreads.

Since then, the RBA has pivoted and raised the cash rate three times (taking AUD market rates with it), war has broken out in the Gulf with the well-reported impact on oil prices and inflation, and the "most significant tax reform package for more than a quarter of a century"[2] was passed in Parliament.

As it stands now, real gross domestic product (GDP) grew at just 0.3% in the March quarter, housing is weakening more than expected (especially in Sydney and Melbourne), and Australia exhibits one of the highest cash rates in the developed world.

While last week's quarterly core inflation data has taken the pressure off the RBA to act in the shorter-term, core inflation remains above the RBA's target. Meanwhile, offshore, CBA economists believe the Federal Reserve (Fed) will raise rates this year, while the central banks in Europe, NZ and Norway have all increased their policy rates in the last three months. Higher offshore market rates have ensued as a result.

As we have highlighted in our July *Market Outlook* publication, a higher rates complex translates, positively, into higher for longer fixed income portfolio yields and solid fixed income return potential in investment-grade (IG) fixed income. However, with more challenging conditions anticipated later this year, credit fundamentals are now coming into focus.

What does this mean?

The domestic company issuers in the AUD credit markets are generally better placed to negotiate more challenging operating conditions, reflecting their status as larger players in concentrated (often oligopolistic or monopolistic) industries. This aspect of their business profiles is a key driver of their solid investment-grade ratings.

General insurers IAG and Suncorp, and the four major banks are prime financial examples. As the latest APRA data[3] highlights, the housing loan market shares for the major banks ranged from 14% to 25%. The majors' market shares across housing and business loans and deposits are one key driver of their AA band ratings.

As such, in this upcoming period of potentially weak growth, we are less concerned on these larger issuers. Rather, our domestic focus is on the smaller corporates and the less diversified banks and financials, and their mortgage and asset-backed pools, that haven't maintained strong loan underwriting standards, capital and liquidity measures. In a downturn, size typically matters.

As one recent example - and there will be others –Judo Bank[4] announced a profit warning in late June driven by impairments on three unrelated business exposures. Higher loan impairments may well have a larger proportionate impact on the bank's earnings and capital compared that for the larger banks, noting that the Common Equity Tier 1 for Judo Bank totalled $1.5bn as of end-2025 compared to $56bn for Westpac. The major banks, which are viewed as systemically important, also boast diversified earnings streams and funding flexibility that are important levers in weaker conditions of lower credit growth and higher impairments.

Moreover, in this age of digital banking, the Silicon Valley and Signature Bank events in the US in 2023, demonstrated that: (1) if some depositors become anxious with a bank's fundamentals and health, deposit funds can be easily withdrawn via an app, and (2) analysis on banks' liquidity measures are also very important (notwithstanding that deposit accounts up to $250,000 with ADIs[5] in Australia are effectively government guaranteed).

[2] Media release from The Federal Treasurer on 12 May.

[3] Quarterly authorised deposit-taking institution statistics | APRA
[4] Judo Bank ASX 25 Jun 26 announcement
[5] APRA Deposit checker: Are your deposits protected?

For bank creditors, it is not just about reducing the risk of rating downgrades (or worst case, defaults), it is about ensuring that bank credit investors continue to receive adequate credit spread compensation for the credit and liquidity risks being taken, amid low credit spreads. Back to the example above – Judo Bank's equity price slumped by over 40% on 25 June, while credit spreads on its AUD Tier 2 bonds[6] widened by around 45bps with material implications for credit portfolio returns.

Why Should I Care?

For Commonwealth Private, this is where credit investing through fixed income managers that maintain diversified, actively managed portfolios is vital and frankly, a "must have" in our manager selection process. Through their due diligence and analytical work on single name issuers and sectors, these investment teams and credit analysts that hold sound experience across multiple market cycles, identify issuers and securities that exhibit satisfactory credit fundamentals through the market cycle.

Together with their portfolio managers, these managers then decide if the credit spreads on offer provide sufficient compensation, and if so, from a risk management viewpoint, size the individual positions accordingly in the portfolio. Given bumpier conditions ahead, we raised this topic in our recent round of due diligence meetings with our managers and sought confirmation that they remain satisfied with the risk reward of their smaller financial exposures and that these positions are appropriately sized in the fund.

This is yet another reason why we prefer and have onboarded these managers and why we believe fiscal 2027 will be the "Year of the Credit Analyst".

[6] Judo Bank's AUD Tier 2 maturing Oct 2035, callable Oct 2030. Source: Bloomberg

Private Markets: Opportunity amid a slower exit cycle

What's going on here:

- Private markets remain active, with exits remaining the key challenge.
- Private equity deal activity has been skewed to larger transactions in established companies.
- Manager selection and operational value creation are increasingly important.

What does this mean?

The first half of 2026 has reinforced the themes that has dominated private markets since interest rates began rising in 2022: capital is available, but liquidity and exits remain the industry's defining challenge. Across private equity (PE) and private credit (PC), investors continue to commit capital to established managers, deal activity remains healthy, and deployment has accelerated. However, the pace of exits and distributions to investors continues to lag historical norms.

PE activity entered 2026 with good momentum, despite the prevailing geopolitical and market volatility, with KPMG reporting[7] that global PE deal value reached US$436bn across 4,168 transactions in Q1 2026 alone. On a rolling 12-month basis, total deal value declined slightly, from $2.2tn in Q4 2025 to $2.1tn in Q1 2026, however this remained high compared to 2023-2024 levels. In contrast, the number of deals per quarter continues to be below levels last seen in early-2021, as cautious and selective deal makers look to the higher certainty provided by larger companies that are less susceptible to disruption.

In-line with the more-than-substantial current and expected future spend on AI enabling infrastructure, sectors such as energy and digital infrastructure were among the most active sectors. In contrast, the transaction activity in the technology sector was relatively subdued compared to prior years.

PE exits over the past few years, and the consequential return of capital to investors, have been noticeably below long-term averages. While the total value of IPO exits increased substantially in 2025 compared to 2023-2024, the number of exits declined, thereby mirroring the growing median transaction size. This trend continued in Q1 2026, with the total quarterly exit value increasing significantly due to the outsized USD$250bn sale of interests in X.AI to SpaceX by multiple PE firms. However, both the total number of completed exits, and the number of public listings (IPOs) in Q1 were well below historical averages. In contrast, trade sales or exits to other PE firms continue to provide the majority of exit pathways. PE firms are also expanding the use of GP-led secondaries or continuation funds to create liquidity for investors and close-out older closed-end fund vintages.

Nevertheless, the prevailing slow exit environment has resulted in extended holding periods, and lower returns of both capital and profits (together distributions) to investors in closed-end PE funds. While it may be construed that PE firms are simply waiting for improved exit conditions, PE firms continue to focus on adding value to their companies by providing strategic advice, improving operational efficiency, and being ready with any additional capital necessary to accelerate growth. Ultimately, returns to investors can also be satisfied by ongoing uplifts in underlying financial performance over time, not just regular exits.

This exit backlog has also contributed to relatively slow fundraising conditions for many managers, as well as investors concentrating commitments with larger well-resourced managers that have demonstrated strong investment performance and the ability to return capital.

Why should I care?

Overall, the first half of 2026 suggests private markets have moved beyond the post-rate-shock slowdown and are evolving positively. Deals are returning, fundraising remains substantial, and capital continues to flow to leading managers. However, stronger exit activity and higher distributions will be required before private markets ecosystem can fully normalise.

Importantly, we believe that capital deployment should be underpinned by operational value creation rather than the multiple expansion and leverage-driven returns that characterised the previous decade. The potential for high-quality managers to deliver such value creation over the medium term remains intact.

[7] KPMG, Pulse of Private Equity Q1'26, April 2026.

The search for next market leaders – Australian equity reporting season preview

Key insights:

- Domestic equity market has become increasingly concentrated in Financials and Materials, masking divergent sector and company-level trends beneath the S&P/ASX 200 Index's resilient returns.
- Earnings momentum softening amid a tougher business backdrop.
- Share price reactions are likely to remain volatile this reporting season, driven more by forward-looking commentary than by reported-period results. Company guidance on demand, pricing, costs, cash flow and capital allocation should help identify where market leadership may broaden next.

A concentrated market masks divergent performance

Index composition is critical when interpreting market returns and earnings headlines. As at 30 June 2026, Financials accounted for 33.3% of the S&P/ASX 200 Index and Materials 25.6%, together representing around 59%. The ten largest stocks made up 48.6% of the Index, with BHP and Commonwealth Bank alone accounting for more than one-fifth. As a result, Index-level earnings and performance metrics may provide a less representative picture of underlying market conditions than in previous cycles.

This concentration has become more apparent as market leadership has rotated between the largest index constituents. By our estimate, banks generated around 60% of the Index's total return over the two years to June 2025. In FY26, leadership shifted to Materials, which returned 52.1% and contributed more than the Index's entire 6.1% annual gain. This implies that, in aggregate, the remainder of the market detracted from Index performance over the year, with Health Care and Information Technology (IT) the main laggards, falling 37.0% and 36.1%, respectively.

The Index can therefore appear resilient even when underlying conditions are uneven, as a small group of banks and miners dominate performance while divergent earnings trends across consumer, health care, technology and industrial companies are less visible.

~1/3	~60%	~1/4	>100%
Index weight in Financials	Index total return from Banks over FY24 & FY25	Index weight in Materials	Index total return driven by Materials in FY26

Source: Bloomberg Finance L.P., Commonwealth Private Investment Research Team

Macroeconomic conditions pose uncertainties

Australia enters reporting season against a challenging backdrop of slowing activity, persistent inflation and elevated geopolitical uncertainty. The RBA has raised the cash rate by 75 basis points in 2026 to 4.35% and paused in June, while leaving the door open to further tightening. Although headline inflation eased to 3.8% in June from 4.0% in May, trimmed mean inflation, the preferred measure by the RBA, remained at 3.6%, with higher energy prices linked to the Middle East conflict gradually flowing through the economy. Employment growth exceeded market expectations in June and the unemployment rate held at 4.4%, suggesting labour demand remains resilient. Until inflation and labour market conditions cool more clearly, the hurdle for rate relief is likely to remain high.

At the same time, growth indicators are softening, with business and consumer sentiment both in pessimistic territory. March-quarter GDP growth slowed to 0.3%, and markets expect a further moderation in the June quarter. Housing has also lost momentum, with national home prices falling for three consecutive months since April amid higher borrowing costs, weaker sentiment and uncertainty surrounding proposed tax changes affecting the sector.

These macro crosscurrents will affect sectors differently. Higher rates can support bank lending margins, but may also intensify deposit competition and mortgage stress, while lifting refinancing costs for property and infrastructure and further constraining household budgets. Softer housing momentum could also weigh on credit growth and asset quality, while the negative wealth effect may dampen household spending, particularly on discretionary items.

Earnings sentiment softening, with focus on cost discipline and cash conversion

Following the strong earnings momentum that supported sentiment ahead of the February reporting season, analysts have become increasingly cautious in recent months. Index-level 12-month forward earnings per share forecasts have remained largely range-bound since April, while the price-to-earnings ratio has hovered around 17x, slightly above its 10-year average in the mid-16x range.

ASX 200 Index 12-m Forward EPS and P/E

Source: Bloomberg Finance L.P., Commonwealth Private Investment Research Team

Cost pressure remains a key challenge for corporate Australia. Pricing power that was effective when demand was stronger is now harder to exercise without risking volume loss, customer trade-down or heavier promotional activity.

Margin commentary should help distinguish genuine productivity from short-term restraint. We'll look for repeatable cost savings from procurement, automation, simplification, network design and better asset utilisation, rather than temporary benefits from hiring freezes, lower marketing spend, deferred maintenance or delayed investment. This distinction is important because temporary restraint can support near-term margins while weakening future growth.

Cash conversion will be an important cross-check. Higher inventories, slower receivables, restructuring costs, remediation, interest expense and capital expenditure can all widen the gap between reported earnings and free cash flow.

Companies with stronger balance sheets can continue investing while returning excess capital. Those with less flexibility may need to refinance at higher rates, preserve cash or temper dividend growth.

In a market with high expectations, cash-backed earnings are likely to matter more than accounting growth alone.

Watch outlook statements for clues to future market leadership

FY26 results will show where companies finished the year, but investors are likely to focus more on the bridge into FY27. The next market leaders may not be those with the strongest near-term EPS growth, but businesses where earnings revisions are improving, margins are stabilising and cash generation is recovering from a reset base.

We'll be cautious on guidance that depends on rapid rate cuts, stable commodity prices or aggressive price increases without clear volume support. In an uncertain environment, scenario ranges, leading indicators and operating milestones may be more useful than a single point forecast.

Where leadership could broaden

Resources can remain leaders if production, unit costs, project execution and capital discipline translate commodity tailwinds into sustainable free cash flow. Banks can also contribute if margins are more resilient than expected without a meaningful deterioration in credit quality.

The larger opportunity for broader leadership may lie in sectors where expectations have already reset: health care and technology if execution stabilises, consumer businesses if volumes hold as pricing normalises, and rate-sensitive real assets if funding risks are contained.

Leadership may also emerge at the company level rather than the sector level. Businesses with structural growth, self-help initiatives, market-share gains or disciplined capital allocation can outperform even when their broader sector remains subdued. By contrast, companies trading at high valuation multiples have little room for cautious guidance.

Further detail on key sector set-ups and watchpoints is provided in the "Sector watchpoints" table on the next page.

Conclusion

The August reporting season will test the themes outlined above: a concentrated market where banks and resources dominate index-level returns, and a tougher operating backdrop that leaves less room to absorb cost pressures. Against this uncertain backdrop, we remain focused on quality businesses with durable earnings, strong cash generation and disciplined capital allocation – attributes we believe will define the next generation of market leaders. We remain selective and ready to take advantage of market divergence and volatility as long-term opportunities emerge. Please also look out for our post-reporting season review next month.

Sector watchpoints

Sector	Set-up	What we will be watching
Materials & Energy	The current earnings growth driver. Elevated commodity prices should support FY26 profits, but much of this benefit appears reflected in market expectations.	Production cost trend, such as labour, fuel and freight, capex and project execution, China demand and commodity assumptions in FY27 guidance, and capital allocation, for example, surplus cash is directed to debt, dividends, buybacks or growth.
Financials	Financials remain the largest part of the index. Higher rates can support net interest margins, but deposit competition, wholesale funding costs, softer housing momentum and the lagged effect on borrowers are important offsets.	Net interest margin, loan and deposit growth, deposit pricing, arrears and provisioning, operating expenses, technology and compliance spend, and capital returns. Strong execution will be needed to justify premium valuations.
Consumer	Nominal spending remains positive, but confidence and major-purchase intentions are weak. Outcomes are likely to diverge across market players rather than a uniform consumer downturn, subject to categories and execution.	Like-for-like sales growth, price versus mix, cost drivers, such as wages, rent, utilities and freight, promotion and customer acquisition, and inventory moves. The key test is whether margins can be protected without sacrificing volume or market share.
Health Care	After a weak FY26, expectations and valuations are significantly lower than prior periods. That creates scope for a re-rating if execution stabilises, but investors will require evidence that recent operational, regulatory and cost headwinds are genuinely easing.	Revenue and volume trends, margin recovery amid persistent cost pressures, research and development investment, pipeline progress, capital expenditure, foreign exchange impacts, regulatory developments and FY27 guidance. Stable guidance could rebuild confidence, but another downgrade would keep the sector under pressure.
Technology	Sharp de-ratings have reduced valuation risk, but not execution risk. Concerns about AI disruption mean growth companies still need to prove that revenue quality and cash generation support their multiples.	Recurring revenue, retention and churn, sales cycles, cash conversion and capitalised development, the cost and monetisation of AI investment, and whether AI improves products and productivity without eroding pricing power or increasing competition.
Real estate & infrastructure	Higher bond yields and funding costs have reintroduced valuation and refinancing pressure. Contracted, regulated or inflation-linked revenue can still provide resilience where balance sheets and debt maturity profiles are conservatively positioned.	Occupancy, leasing spreads, capitalisation rates and asset valuation, hedging, refinancing costs and debt maturities, development pipelines and asset sales, and whether distributions are covered by recurring cash flow rather than additional leverage.