Commonwealth Private

February 2026

Market Outlook.

Moving from AI promise to performance.

CIO Foreword

Global equity markets enter 2026 following a third consecutive year of gains, supported by resilient macroeconomic fundamentals and corporate earnings, enthusiasm for artificial intelligence (AI), and expectations of a more accommodative monetary environment for the US. Since the much-heralded release of ChatGPT in late 2022, AI has been a central driver of global equity performance, and investor sensitivity to AI-related developments is unlikely to diminish in the year ahead. What is evolving, however, is the nature of investor expectations. 2025 was characterised by unprecedented investment in AI infrastructure, but the next phase is likely to place greater emphasis on outcomes. Although elevated capital expenditure may persist in the near term, markets are increasingly shifting from a "build it" mindset to a "prove it" framework. Investors will seek tangible evidence that AI investment can generate sustainable improvements in productivity, earnings quality, and free cash flow.

Technological transformations are rarely linear. Technology-related sectors now represent around half of the S&P 500's market capitalisation. While we retain conviction in the long-term AI theme, we remain firm advocates of diversification. Should AI-driven productivity gains fail to materialise, and returns on investment disappoint, companies may moderate AI-related capex spending. While this could support free cash flow for large US platforms that have been investing heavily in AI infrastructure, such as Alphabet and Meta, it would likely weigh on earnings across the AI supply chain, particularly semiconductor manufacturers and infrastructure providers. This risk is most relevant over the next one to two years, though it does not represent our long-term base case.

A more constructive scenario sees AI adoption continuing to scale effectively. As productivity benefits become measurable, deployment broadens beyond pilot programs and companies demonstrate genuine operational leverage. Firms that successfully integrate AI into core business processes stand to benefit the most. This progression would be consistent with prior technology cycles, where early scepticism gave way to proven use cases, and the competitive advantage of pure infrastructure providers gradually became commoditised.

Beyond technology, independence of the US Federal Reserve (Fed) remains a key watchpoint. A degradation of that independence, through increased political influence, could raise the risk of policy rates being set inconsistently with the Fed's inflation-fighting mandate. Should investors begin to price in sustained political interference, greater tolerance for inflation, or fiscal dominance, the US risk premium would increase, eroding one of the country's core structural advantages. Recent experience illustrates the market pressure that would be likely to apply. In early-April 2025, US bond yields rose sharply in response to tariff announcements. Shortly after, the Trump Administration announced a pause in tariff measures - underscoring the role of financial markets as a check on policy credibility. In this context, market discipline acts as a constraint, with higher yields and tighter financial conditions likely to penalise perceived policy missteps.

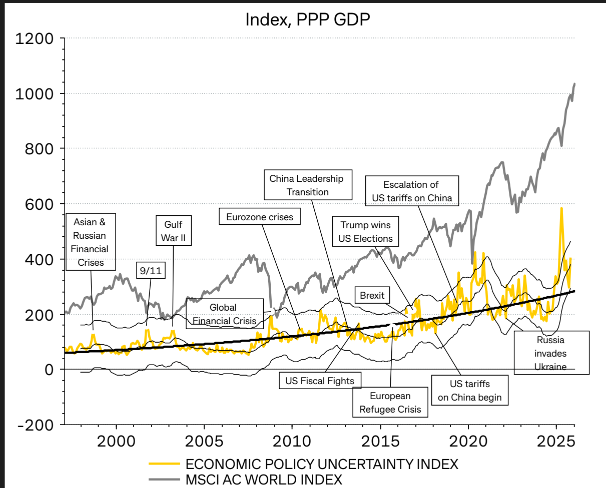
Monetary policy is likely to remain a key source of regional divergence in 2026 and resultant market volatility. In the US, the upcoming change in the Chair of the Federal Open Market Committee (FOMC) has seen markets embed expectations of lower interest rates and looser financial conditions, a dynamic reflected in elevated equity valuation multiples. Australia faces a different backdrop, with the Reserve Bank of Australia (RBA) increasing rates in February following higher than anticipated inflation. While these cyclical factors may drive short-term market movements, we continue to expect equity returns over time to remain anchored to fundamentals. Sustainable earnings growth, balance-sheet strength, and the ability to convert revenue into free cash flow ultimately outweigh transitory, rate-driven themes.

James Foot, Chief Investment Officer
Commonwealth Private

Should Investors Be Worried About Geopolitics?

- Geopolitics raises volatility, but fundamentals ultimately determine market direction.
- Structural shifts create both risk and opportunity for disciplined long-term investors.

World Economic Policy Uncertainty Index



Source: LSEG Datastream 27/01/2026

Markets are often said to dislike uncertainty, yet they continue to operate and at times prosper against a geopolitical backdrop that feels anything but certain. As we move further into 2026, investors face a world shaped by ongoing conflict in Ukraine, heightened tensions in the Middle East, political volatility in the United States, instability in Venezuela and an increasingly assertive China. Taken together, these risks appear sufficient to undermine confidence. Yet markets have remained notably resilient.

Equity indices have continued to advance, volatility has stayed subdued and capital continues to flow. Even the VIX, the market's widely watched fear gauge, has remained well below levels typically associated with periods of genuine stress. This apparent disconnect between unsettling headlines and market behaviour isn't new. History suggests markets have a remarkable ability to look through geopolitical turmoil and refocus on fundamentals.

This isn't because conflict and political shocks don't matter. Rather, markets are often quicker than investors to assess the implications of geopolitical shocks and move on. From the Cuban Missile Crisis (1962), Iraq (2003) and Venezuela (2026), the pattern has been consistent. Conflicts may persist, but investor attention shifts back to inflation, interest rates, earnings and liquidity.

Markets don't trade headlines for long; they trade economic outcomes.

Geopolitical events become a market problem only when they create a persistent economic one. Enduring supply shortages, inflation or political responses that materially alter growth and liquidity are what matter. The oil shocks of the 1970s are a clear example of how prolonged supply constraints can reshape markets for years, rather than months.

Looking ahead, 2026 may not provide the "Goldilocks" conditions of the past. Intensifying US–China competition, a fragmenting global order and an unusually high number of active conflicts are driving a renewed focus on national security. This is translating into structurally higher defence spending, greater emphasis on emerging technologies such as AI, increased protection of strategic industries, including semiconductors and critical minerals along with the continued use of tariffs and economic policy as geopolitical tools.

For investors it reinforces the importance of a long-term perspective as geopolitical cycles are long, often spanning decades. Markets, however, are watching a relatively simple set of questions: Do tensions spill into the real economy? Will energy become sustainably elevated? Are governments and central banks forced into policy choices they would rather avoid? These issues, rather than headlines, are what ultimately drive returns.

While uncertainty feels uncomfortable, it doesn't preclude opportunity. The ongoing shift toward national security and resilience is likely to support long term investment themes across defence, technology, critical minerals, biotechnology, cyber security and renewable energy. For investors, history suggests that staying disciplined, diversified and focused on long-term fundamentals matters far more than reacting to geopolitical noise.

Are equity markets getting too comfortable?

- Market practitioners are near universally bullish after strong, extended gains in equity markets.
- In recent years, earnings have lagged prices, pushing market valuations higher.
- Diversification remains the most reliable defence as optimism reigns.

"Success breeds complacency. Complacency breeds failure. Only the paranoid survive."

The CEO of Intel, Andy Grove, wrote this in the 1990s as he transformed Intel from memory chip maker to a micro-processing powerhouse that dominated the early 2000s. There's irony in the fact that Intel's next generation of leaders ignored this advice, missing both the smartphone and AI booms that have ultimately squandered Intel's dominance.

The word *complacency* also comes to mind when we look at equities today. Each year, major investment banks, fund managers and consultants release 2026 Market Outlooks. After reviewing over 20 of them, not one was negative on equities. All were "positive", "optimistic", or similar. This is striking given the strength of markets over the last three years: the MSCI World ex Australia returned 13%, 31% and 23%, while the ASX 200 delivered 10%, 11% and 12%, respectively.

What happens when you get the timing of investing in equities wrong? Let's backtrack to the Global Financial Crisis. If you invested at the bottom in March 2009 through to the end of 2025, you would have earned 13.5% p.a. in the MSCI World ex Australia and 10.7% p.a. in the ASX 200. Invest at the 2007 peak instead, and those returns drop to 9.4% p.a. and 5.7% p.a. respectively, a meaningful difference.

Now to today's set up. For the ASX 200, despite solid market returns, we've seen three consecutive years of earnings-per-share (EPS) declines. Markets have risen while earnings have fallen, driving multiple expansion. FY26 is expected to be the year EPS growth returns, with forecasts of 7.9% in FY26 and 7.7% in FY27. In FY26, Banks (comprising 24% of the ASX) are expected to grow earnings at 4.8% (no significant credit cycle balanced by rising competitive dynamics), whilst resources (25% of the ASX) are forecast to grow 11.4%, with iron ore holding up despite a complex picture in China (housing market weakness, low consumer confidence, trade tensions countered by policy support), whilst copper and gold prices remain firm.

The challenge is that after three years of falling earnings, at the end of 2025 the ASX 200 traded at 18.3x, or a 22% premium to the 20-year average multiple of 15x earnings, according to JP Morgan data. Most investors are relying on a return to earnings growth to justify further gains. Is this a complacent view?

Internationally, the themes that dominated 2025 remain in place. AI related valuations will stay under scrutiny where Magnificent 7 AI capex is forecast to reach US$520bn in 2026, up more than 30% year on year. Inflation, central bank policy divergence, bond pricing and geopolitics will remain key variables. On the positive side, S&P 500 EPS growth is expected to be 14%-15% in 2026, with the gap between the largest seven companies and the remainder expected to narrow to its smallest in years. Overall, S&P 500 forward valuations remained elevated at c.22x at the end of 2025, well above the 30-year long run average of 17.1x (according to JP Morgan data).

Europe and Japan delivered low single digit earnings growth in 2025 yet still outperformed the US, due to lower starting valuations. We see potential for this theme to continue in coming years, with the European backdrop supported by improved fiscal spending.

So how do we set expectations moving forward? We believe the transition toward AI-beneficiaries coupled with ongoing valuation dispersion will offer scope to see a broadening out in the coming years. This broadening out means that at a sub-asset class level, we preference remaining diversified by region and sector. At a headline asset class level, our approach also remains unchanged: staying diversified while remaining focused on the opportunities ahead. This framework positions portfolios to adapt, participate in upside, and remain resilient through changing market conditions.

What is the monetary policy outlook and the implications for fixed income investors?

- Regional divergence in monetary policy and market rates is set to remain a feature in 2026.
- The Fed is expected to maintain its easing trajectory over 2026, amid the appointment of the new FOMC Chair last week.
- Having pivoted from an easing bias, the RBA has sought to address domestic sticky inflation.

Fixed income investors are facing low credit spreads, regional disparity in monetary policy and market rates, but constructive all in-yield levels, especially in Australia.

Economic and credit fundamentals are also supportive. The US economy continues to display resilience through positive (albeit sub-trend) economic growth, an overall stable consumer, and a softening but historically lower unemployment picture. While there is evidence of moderating inflation, it remains above target with a growing number of Fed members voicing concerns as a result and resisting further near-term policy accommodation. To this end, early last week, the Fed held rates steady.

This has come amid ongoing market unease over Fed independence, and the flagged appointment of the new FOMC Chair (given the term for current Chair Jerome Powell ends in May). Late last week, previous FOMC Board member, Kevin Warsh was announced as the new Fed Chair. Mr Warsh has recently supported easing policy in the US. That said, he is considered less dovish compared to the two other key contenders (Rick Rieder and Kevin Hassett), given Mr Warsh's preference to reduce the Fed's balance sheet. Importantly Mr Warsh also brings continued institutional credibility to the table.

In terms of what this collectively means for US monetary policy over this year, overall, as of late January, market expectations are for a further two interest rate cuts from the FOMC. This will likely prolong the easier financial conditions, which, together with the US government's pro-growth policies should further support economic growth, while also upping the risk of inflation.

AUD market rates have been volatile in recent months following the higher-than-expected Q3 inflation print in October. This saw consensus pivot from an RBA easing bias to a rate rise this year. Market interest rates swiftly moved to price this in, with the yield on the two-year AUD government bond rising by circa 0.9% between mid-October and late-January. The December labour market data, which surprised decisively to the upside, added impetus for a hiking bias.

Last week's quarterly (Q4) trimmed mean inflation data (the RBA's preferred inflation measure) showed that the underlying inflation pulse is firm and above the RBA's target range. Earlier this week, the RBA sought to address this through a 0.25% interest rate hike.

This has several important implications for domestic fixed income investors in 2026. Firstly, the higher for longer interest rates complex and fixed income portfolio yields is constructive for the forward-looking return potential for the asset class. Indeed, AUD interest rates are now among the highest in the developed markets, materially above that for the US and NZ, and well above European and Japanese levels. A key risk to this sanguine fixed income outlook is a material breakout in inflation (from the current "sticky" inflation picture), and therefore, interest rates.

To mitigate against inflation risks, for stand-alone fixed income investments that do not form part of a diversified portfolio, interest rate exposure (interest rate duration) should be measured and actively managed. In a similar vein, amid historically low global credit spreads, we continue to favour measured and actively managed credit exposures in 2026.

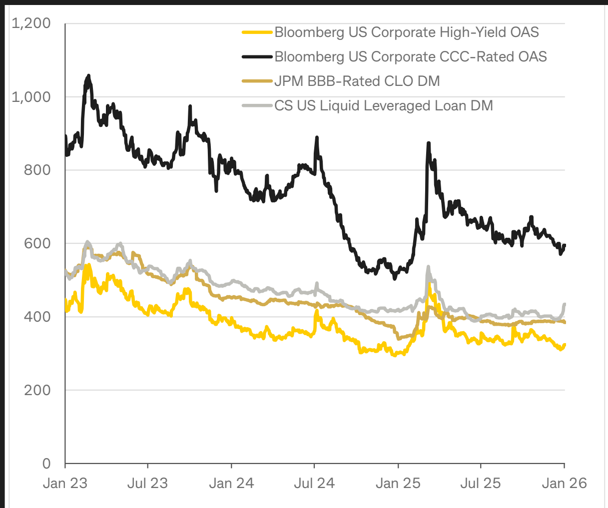
Is the Private Markets party over, or just getting ready for the next round?

- While investors look to participate in private markets as essential elements of a diversified portfolio, objections are easily found. Deeper examination indicates that these objections may be overstated.
- We expect Private Equity transactions to accelerate in 2026.
- While risk will always be present, the outlook for Private Credit is supported by positive fundamentals.

Over the past decade, individual investors have progressively followed institutional investors into Private Markets – including Private Equity (PE), Private Credit (PC), Infrastructure, and Real Estate, with such investments now being widely recognised as essential elements of diversified investment portfolios. However, the journey for investors hasn't been straight-forward.

PE exits over the past few years, and the consequential return of capital to investors, have been noticeably below long-term averages, and PE firms are reported to have large amounts of capital awaiting deployment ("dry powder"). This has contributed to a decline in new investments into the asset class, with Private Equity International reporting that the USD$735bn raised globally in 2025 was the lowest full-year total since 2020 and a 20% decline from the previous five-year average. However, common objections to PE investing at this time can be put in perspective.

Underlying this situation, PE firms have postulated that they're holding onto portfolio companies longer with the objective of maximising returns to investors. The dearth of exits via public listings ("IPOs") since 2020, due to both COVID uncertainty and the subsequent turn of the interest rate cycle in late 2021, is often cited as a significant contributor to this slowdown. However, historically, IPO's have historically represented only 10% to 20% of exit activity post GFC (Source: HarbourVest, Private equity's expanding exit playbook), and the value of IPO exits increased substantially across 2024 to 2025. No doubt, the broader challenge for



Source: Bloomberg

PE firms has been to achieve their desired exit valuations, when (a) base interest rates remain high compared to historical post-GFC levels, and (b) US policy has provided an uncertain outlook. Rather than chase exits, PE firms have focussed on adding value to their portfolio companies by providing strategic advice, direction, and the additional capital necessary to accelerate growth.

Overall, this has resulted in positive outcomes for investors. While trade sales or exits to other PE firms continue to provide the majority of exit pathways, PE firms have also created liquidity for investors by launching GP-led secondaries or continuation funds. This additional exit pathway, and the broader PE secondaries market, continues to grow. Overall, on average, exit transactions are taking place at valuations above their prior 12-month book value (Source: KKR).

While the delay in exits has resulted in less recycling of capital into new deals, and thereby contributing to lower new investment levels, the number and total value of private companies continues to grow. This allows the level of dry powder to be put in a new perspective, being that dry powder as a percentage of total unrealised PE value has declined from circa 60% in 2016 to 2018, to circa 40% in early 2025 (Source: S&P Private equity dry powder recedes from all-time highs amid slow fundraising). Further, there is no imperative for PE firms to deploy dry powder in short order. With circa 50% of this capital being heavily concentrated in closed-end funds between two and five years old, it's also possible that a significant portion of it won't be called as those closed-end funds pass the end of their specified investment periods. In total, we see that PE capital is being deployed faster than new capital is being raised.

Contribution to this decrease in dry powder is the value of PE deal flow, with Q3 2025 transaction value totalling USD$537.1bn. While this is still well below the peak activity of the heightened post-COVID deal catch-up (average USD$622.8bn per quarter in 2021), Q3 2025 value exceeds the quarterly average of USD$439.1bn since Q3 2022.

That being said, the number of PE transactions declined over the year to end-Q3 2025, indicating the market preference for large, high-quality transactions (Source: KPMG Pulse of Private Equity Q3'25. Remove Pitchbook).

We expect transaction activity to continue to increase over 2026, supported by ongoing pressure from investors in historical transactions to have their capital returned, as well as the expected lower cost of debt capital in Private Credit markets discussed below.

Meanwhile, Private Credit capital raising continued to be robust, with the USD$357m raised in 2025 matching 2024 levels and the average over the prior 4 years (Source: Private Debt Investor, Fundraising Report Full Year 2025 after Investor).

Over the past few years, financial markets have become largely tolerant of broader geopolitical risk and focused on macroeconomic data. However, there is always some impact, for example the increase in US 10-year government yield since mid-October 2025 may be seen as a flag of policy-driven inflation risk. It may also be seen as a return to rate curve normalcy and an indication that underlying economic activity is sound.

This relative calmness has also been seen in non-investment grade credit markets, with credit spreads in high yield bonds, liquid corporate loans, and asset-backed securities compressing to historically tight levels. In direct Private Credit (PC), spreads have remained relatively stable compared to the spread compression seen in liquid non-investment grade debt such as high yield bonds, leverage loans and asset backed securities. However, transparency is limited, potentially masking a wider increase in default cycle. This potential has been discussed widely in financial markets, with participants largely refuting the implication raised by JP Morgan's CEO, Jamie Dimon, who observed "when you see one cockroach, there are probably more..."

From a fundamental perspective, S&P Global (S&P) has recently published its assessment that after two years of supportive market conditions, credit quality has generally improved. It expects resilient global credit conditions to continue in 2026, as economic growth holds up and investment in technology continues. With this backdrop, S&P expects that defaults are likely to be contained, with its base-case expectations for small declines in defaults of non-investment grade borrowers in both the US and Europe, albeit remaining above long-term averages.

However, S&P notes that it expects to see "continued divergence in outcomes between consumers at the top and bottom ends of the income scale, and borrowers (corporate and otherwise) at the higher and lower rungs of the ratings ladder—and even economies more broadly, given varying levels of resilience in labour markets". i.e. "K-shaped" markets.

Contributing to this positive outlook, the combination lower floating reference rates (e.g. the Secured Overnight Financing Rate, or SOFR, in the US), and tighter credit spreads has taken pressure off US corporates by lightening their interest expense, thereby reducing corporate stress and potential defaults. This lower cost of debt capital, combined with ongoing robust inflows into PC, have improved both the availability and cost of debt financing for future PE transactions. In this regard, we see the PC conditions being further supportive of PE markets in 2026.

If S&P's base-case default expectations hold true, PC will continue to perform well in 2026, and as such, we are cautiously optimistic. Nevertheless, with non-investment grade spreads at historically tight levels, the potential for a credit market correction remains. As such, we currently favour credit strategies that are well diversified across borrowers and credit quality, with lower credit spread duration. We expect these strategies to be more resilient in case of a deterioration in credit conditions, and that have the potential to change gear and take advantage of any such market shift.