July 2026

Market Outlook.

The market has returned to AI with conviction, but the harder question is whether returns will follow as easily as capital has.

CIO Foreword

The Middle East remains an important and fluid source of market uncertainty. While diplomatic efforts between the US and Iran have at times eased concerns around disruption to the Strait of Hormuz and helped contain the oil price risk premium, the situation remains fragile and subject to sudden shifts. For investors, the more relevant point is that markets have increasingly looked beyond the immediate geopolitical shock and re-engaged with other drivers of returns, particularly technology and AI. Since late March, the Nasdaq has led markets higher as capital has returned to a narrow group of perceived AI beneficiaries. That recovery is encouraging, but it also highlights how dependent index-level returns remain on a concentrated set of assumptions: that AI delivers, earnings continue to rise, and current market leadership endures. The economics of adoption, monetisation and competitive advantage, however, remain unsettled.

Holding a Bearing Through Fog

That's why the AI thematic is best understood not as a clear specific destination, but as a bearing held through fog. The broad direction may prove correct, but the route from excitement to durable shareholder returns is unlikely to be simple or linear. Markets may be confident in the scale of the opportunity, but far less certain about how quickly it will monetise, where returns on capital will ultimately settle, and which business models will prove most durable. This is a more realistic way to think about markets today. AI may prove to be one of the defining and enabling technologies of this era, but the companies leading in the current phase will not necessarily be those that create the most value over the full cycle.

Inverted Thinking Matters

Inverted thinking starts with the assumptions already embedded in prices. Rather than asking only who wins from AI, investors should also ask what could go wrong with what the market already believes. What if the infrastructure buildout remains strong, but the return on that spending arrives more slowly than expected? What if the next phase is less about who spends the most, and more about whether customers and adopters can convert AI into genuine productivity gains?

These questions matter because market leadership is currently concentrated in a narrow group of perceived AI winners, particularly semiconductors within the broader technology complex. Their share prices have risen alongside earnings expectations, reflecting strong conviction in the theme. Yet, optimism now rests against a capital-intensive buildout across the AI ecosystem, raising the hurdle for future outcomes to justify current valuations.

Valuation and Compounding

Labelling companies as AI "winners" or "losers" is far too simplistic, in our view. Cycles are usually not as straightforward than that. In past technology cycles value has migrated over time. Markets first reward the providers of essential tools and infrastructure. Later, the larger and more durable gains often accrue to the users of the technology.

The issue is not whether AI is real or structurally important. It clearly is. The question is whether current equity valuations already discount too much of that future. Narrow market leadership has created significant dispersion, with a small group of companies driving a large share of index returns. In such an environment, outcomes depend less on whether a business is "good" and more on whether it can exceed elevated expectations. At these levels, execution matters more than narrative. Durable returns will accrue to companies that translate AI from concept into operating leverage, margin expansion, and sustainable cash generation, a far more demanding test than simple thematic association.

Discipline Over Narrative

This is the discipline required of investors today. In an environment defined by concentration and valuation dispersion, price, expectations, and business quality all matter. The task is to identify where markets are overpaying for certainty, underestimating the durability of growth, and where the next cohort of beneficiaries may emerge beyond the current centre of attention. This is not a cycle navigated by labelling companies as "winners" or "losers." It requires a more nuanced approach. The challenge is less about riding a single wave and more about navigating a complex system, where progress will be uneven, leadership will shift, and eventual winners may differ from those currently in focus.

James Foot,
Chief Investment Officer
Commonwealth Private

Beyond the Noise: Prepare, don't predict

What's going on here:

- Markets are being shaped by two powerful forces, AI and deglobalisation, creating more volatility and a wider range of possible outcomes.
- The key message is simple: focus less on predicting the next headline and more on time horizon, diversification, valuation and portfolio resilience.

What does this mean?

On 25 June, we invited clients to join Commonwealth Private's Chief Investment Officer for an exclusive webcast, **Beyond the Noise**, designed to look past short-term market headlines and focus on the forces shaping long-term portfolio outcomes.

The discussion came at an important moment for investors. Markets are moving quickly, with AI continuing to dominate headlines, capital spending plans and investor expectations, while geopolitical events and deglobalisation are keeping inflation risks alive. These themes are powerful, but uncertain. The challenge isn't just identifying what matters, but understanding how to position portfolios when the winners, losers and timing remain difficult to predict.

That is why the focus should shift from prediction to preparation. Instead of asking "what will happen next?", investors should ask "is my portfolio built to withstand more than one outcome?" This is especially important when markets are pricing in a lot of optimism, and when a small number of companies or themes are driving a large share of returns.

Commonwealth Private's view is that investors should think about returns as a range of possible outcomes, not a single forecast. In periods of uncertainty, that range widens. This doesn't always mean underlying value has deteriorated. Often, it simply means markets are adjusting to new information, whether that is inflation, policy, earnings, technology disruption or geopolitical risk.

Time horizon also matters. Short-term market moves can feel uncomfortable, but they often say more about sentiment than long-term value. Over longer periods, fundamentals such as earnings, cashflow, income, and valuation tend to matter more.

Why should I care?

For HNW investors, this reinforces the importance of staying anchored to long-term objectives rather than reacting to every headline. The practical takeaway is clear: the strongest portfolios aren't built around one market view. They're built to be resilient across a range of environments.

That means holding assets with different jobs to do. Some investments are designed to generate income. Some provide growth. Some help defend capital in weaker markets. Others provide exposure to long-term structural themes, such as AI infrastructure, energy transition, domestic supply chains and productivity growth. The aim is not to own everything, but to own the right combination of assets for the client's objectives, risk tolerance and time horizon.

This is where Commonwealth Private's approach is important. We believe investment decisions should be guided by valuation, diversification and role in portfolio, not simply by what is performing best today. A strong theme can still be a poor investment if too much optimism is already priced in. Equally, volatility can create opportunity when markets overreact and quality assets become mispriced.

For clients, this means three things. First, avoid letting short-term noise drive long-term decisions. Second, be selective, especially where valuations already reflect high expectations. Third, make sure the portfolio is diversified not just by asset class, but by return driver, liquidity profile and sensitivity to inflation and growth.

The current environment is not one where investors need to be passive or defensive by default. But it is one where discipline matters. AI, deglobalisation and higher inflation risk may create meaningful opportunities over time, but they will not benefit every company, sector or asset class equally.

The opportunity for clients is to use this period to review whether portfolios are positioned for resilience, income and growth, rather than relying on a single market outcome. In a more uneven cycle, success is likely to come less from chasing the loudest theme and more from staying diversified, valuation-aware and prepared for multiple paths ahead.

Why currency exposure still matters

What's going on here:

- Rate expectations favour the US dollar, while softer commodity sentiment and China uncertainty can act as a headwind.
- Partial hedging leaves portfolios positioned to benefit if AUD weakness continues, while partially cushioning offshore equity volatility.

The AUD has weakened in recent weeks, moving below US70 cents as relative interest rate expectations, US dollar strength and commodity sentiment have all moved against it. While short-term currency movements are often noisy, the medium-term AUD outlook remains closely linked to two factors: the Australia-US rate differential and Australia's terms of trade. Both are currently providing less support.

What does this mean?

Rate differentials favour the USD

The clearest pressure point is relative interest rates. FX markets are focused less on where cash rates are today and more on where policy rates are expected to move next. On that basis, the balance has shifted in favour of the US dollar. The Reserve Bank of Australia (RBA) remains alert to inflation risks, but expectations for further Australian tightening have moderated. By contrast, CBA Economics expects the US Federal Reserve (Fed) to resume rate hikes from December-26, supported by resilient US growth, persistent inflation and the broader US "exceptionalism" theme.

A higher expected US rate path increases the relative appeal of USD assets and reduces support for the AUD. This has been reinforced by ongoing demand for US equities and fixed income, particularly as the US continues to attract capital through stronger growth prospects and AI-related investment.

Commodity support is fading

The second driver is commodities. The AUD remains closely tied to Australia's export base, particularly iron ore, coal and Liquid Natural Gas. Strong commodity prices typically support national income, the trade balance and the currency.

Conversely, softer Chinese construction activity, steel demand or industrial production tends to weigh on the AUD. China remains central to the marginal demand picture for Australian commodities.

While AI-related investment may lift demand for selected commodities such as copper, uranium and critical minerals, it's unlikely to replicate the broad-based commodity super-cycle that accompanied China's earlier industrialisation phase. That means any AI-related commodity support for the AUD is likely to be more targeted, and not enough to offset the stronger US dollar impulse.

Taken together, the near-term backdrop remains challenging, with the pain likely to continue as CBA Economics expect the AUD to weaken further, moving toward USD64 cents by year end.

Why should I care?

This has direct implications to investors' portfolios. International equity allocations and currency hedging is an important driver of realised returns. A lower AUD increases the dollar value of foreign assets where exposures are unhedged or only partially hedged. This translation effect has been helpful recently, with AUD weakness providing support to international equity returns in Australian-dollar terms.

It can also provide a useful buffer in periods of market stress. The AUD is typically pro-cyclical and tends to weaken when global growth expectations fall or risk appetite deteriorates. The USD, by contrast, often benefits from safe-haven flows. If global equities decline at the same time as the AUD weakens, the currency translation effect can partially offset the equity-market loss for Australian investors. The trade-off is that this works both ways. If the AUD were to rally sharply unhedged offshore returns would be reduced. For this reason, partial hedging can play a useful role in international equity allocations. It helps reduce currency-related volatility while retaining some of the diversification benefits that foreign-currency exposure can provide.

Currency is therefore not simply a tactical consideration; it is part of total portfolio risk. Given the AUD's sensitivity to global risk appetite, commodity prices and relative interest-rate expectations, unhedged international equity exposure can remain an important source of diversification, downside cushioning and potential return support.

Why is the investment case for fixed income now enhanced?

What's going on here:

- We examine the implications of the marked interest rate and Budget changes for fixed income in recent months.
- Cyclically higher interest rates have advanced further this year, while the Federal Budget's tax proposals build the case for defensive, actively managed fixed income in the second half (H2).

What does this mean?

Following an eventful first half of 2026 dominated by the Iran war and a sharp rise in global inflation and interest rates, and the subsequent Federal Budget tax proposals, we examine the implications for fixed income. These events are supportive for Fixed Income in H2 and beyond. Given uncertain macro conditions, more volatile bond markets and low credit spreads, for standalone fixed income investments, we favour those that are liquid, high-grade based and actively managed.

Starting with market rates, short-term domestic interest rates were already elevated before the Iran conflict and have moved higher since late February, leaving yields near the upper end of their post-GFC range. Against a backdrop of elevated domestic policy rates, with Australia's cash rate among the highest in developed markets, higher-for-longer portfolio yields allows fixed income investors to target investment-grade (IG) assets and pursue attractive income without taking excessive credit, duration or liquidity risk.

Why should I care?

Starting yields are generally solid predictors of forward-looking fixed income returns and provide greater visibility over expected returns, noting that yield is not the whole story – it's total returns.

Elevated yields and monthly coupon income also offer upside return potential if rates decline in a weaker growth environment but also provide a greater buffer against adverse interest rate and credit spreads moves. This is what transpired during the Iran war with all of Commonwealth Private Limited's domestic absolute return fixed income funds posting materially positive returns in the March quarter (Q1), despite materially negative returns for key domestic fixed income credit indices in Q1.

This leads us to the tax reforms that were announced during the Federal Budget in May, namely the:

- Abolition of negative gearing for established residential investment properties from July 2027,
- Replacement of the 50% CGT discount on applicable assets held by individuals, trusts and partnerships, with base inflation indexation and a 30% minimum tax rate from July 2027, and
- Minimum 30% tax rate on discretionary trusts from July 2028.

Following industry pushback, on 18 June, Labor announced some changes including:

- Raising the turnover threshold for the 50% active asset reduction (i.e. exemption from the new CGT rules) for smaller businesses from $2m to $10m, and;
- Exempting income from testamentary discretionary trusts from the minimum 30% tax if established for genuine testamentary purposes (including deceased estates).

Subsequently, the Greens Party announced on 23 June it would support the first tranche of the tax bill to pass the Senate before its winter break in early July. This was agreed through: (1) disallowing self-managed super funds to purchase residential investment properties (without grandfathering), and (2) remove the Treasurer's wide ministerial discretion on the tax changes. Given this, the bill passed the Senate on 25 June.

Therefore, these tax rules will remove a structural tax advantage for property and equities that has steered asset allocation since the turn of the millennium, and one of several reasons why Australia, despite its aging population, has among the lowest allocations to fixed income in the OECD.

Under these tax changes, investment exposures to assets whose total return is mainly driven by income (not capital), notably high-dividend equities with franking and fixed income, will become relatively more attractive on an after-tax basis, given they would be materially less affected by the changes.

Put another way, a more level field playing field will exist for fixed income given most of its total return profile is based on coupon income which will be unaffected. This, together with the elevated interest rate environment and the well-reported removal of high-yielding domestic bank hybrids, should enhance the demand for fixed income going forward.

However, as witnessed in recent months, global bond market volatility is on the rise again, and indexed IG credit spreads in the US are back at their lowest level since 1998. Combined with slower domestic economic and housing conditions in H2, for standalone fixed income investments, we favour those that are IG-oriented, actively managed and take an absolute return focus with moderate interest rate and credit exposures.

In addition, with this evolving tax landscape, we restate the need for clients to discuss the changes with their tax advisor, and that tax factors alone should not be the sole of driver of investment decisions.

AI in Alternatives: Opportunity with increasing dispersion?

What's going on here:

- AI companies have provided strong returns to date as leading businesses in generative AI have scaled up to meet current and expected future demand. Whether these companies can monetise their capital investments is yet to be determined.
- Investment exposure to AI themes can be accessed via multiple asset classes, including Private Equity, Infrastructure and Private Credit.).

What does this mean?

AI and the broader technology supply chain required to support its development and deployment, has been one of the defining drivers of risk and return across both public and private markets over recent years. High-profile companies such as OpenAI, Anthropic and SpaceX have delivered significant early-stage returns and captured substantial investor attention. However, it doesn't necessarily follow that these same businesses will continue to offer the most attractive risk-adjusted opportunities going forward.

While demand for large language models and increasingly sophisticated AI applications is expected to remain robust, the scale of capital investment committed by leading participants is significant. These businesses require substantial and sustained revenue growth to support both current valuations and ongoing expansion. At the same time, the pace of technological development raises important questions around competitive dynamics and barriers to entry. Advances in AI itself may reduce these barriers, potentially accelerating disruption from new, lower-cost entrants. As incumbents look to consolidate their positions through strategic partnerships and brand recognition, the risk of price competition and margin erosion remains a key consideration. As such, the extent to which current market leaders can fully monetise their early advantages remains uncertain.

Within this environment, private equity (PE) continues to play a central role in accessing AI-related opportunities. The majority of AI-focused businesses have been conceived and developed within private markets, where longer investment horizons and flexible capital support innovation. Private equity portfolios typically maintain meaningful exposure to technology, often in the range of 25–35%, though this exposure extends well beyond direct investment in AI developers. Instead, it is diversified across the broader ecosystem, not only in the technology sector, but also in broad based business services, healthcare and consumer-facing companies. In addition, industrial and manufacturing businesses are vital in providing the physical infrastructure required for data centres as well as participating directly in AI-enabled manufacturing.

Why should I care?

The return profile of PE is inherently asymmetric. Individual investments can generate very high return multiples, with successful positions delivering many times the capital invested. However, this outcome is accompanied by a high degree of dispersion.

Not all investments will succeed, and some level of failure is an unavoidable feature of the asset class, particularly where capital is deployed at earlier stages of company development. At these stages, the probability of success is less certain, but the potential upside is significantly higher. A well-constructed and diversified portfolio enables private equity managers to absorb individual company failures, with a relatively small number of highly successful investments often driving overall portfolio returns.

While PE is the natural home for many AI-related businesses, we are also seeing increased investment activity in adjacent areas. Infrastructure assets, for example, are benefiting from the growing demand for energy generation, transmission, and digital capacity required to support AI applications. These investments provide exposure to the structural growth of AI, but within a more income-oriented and typically lower-volatility framework.

AI-related exposure is also emerging within Private Credit (PC) markets, although the return dynamics here are more nuanced. Credit investments benefit from structural protections, including the presence of an equity buffer which absorbs initial losses. However, this does not eliminate risk. Returns in PC are less symmetrical than in equity, with a defined maximum upside, primarily comprising contractual interest payments and return of principal. In contrast, downside outcomes can be more variable. While recovery processes may result in partial capital preservation in the event of default or restructuring, losses can still be material, and in some cases complete.

This asymmetry has important implications for portfolio construction. Unlike PE, where outsized winners can offset weaker outcomes, PC relies on consistency of income generation and preservation of capital. As a result, position sizing and diversification become critical. This applies not only at the individual borrower level, but also across sectors and economic exposures. Manager selection is a key determinant of outcomes, particularly in assessing creditworthiness, structuring appropriate protections, and actively managing risk throughout the investment lifecycle.

Across both PE and PC, the role of active management is paramount. Assessing businesses operating within rapidly evolving sectors such as AI requires not only financial discipline, but also the ability to evaluate emerging business models, technological change, and competitive positioning. Experienced managers with a demonstrated capability to navigate these dynamics are well placed to identify opportunities and manage downside risks.

Looking ahead, AI is expected to remain a powerful force shaping economic and investment outcomes, with the development of new businesses and technologies creating significant opportunity over time. However, the identity of the long-term outperformers, and their ability to sustainably monetise current market positions, remains uncertain. In this environment, we believe investors are well served by accessing these opportunities through experienced private market managers, maintaining diversified exposure across asset classes, and adopting a disciplined approach to portfolio construction.

Things you should know:
The information in this report provides general market-related information.
The content of this document is not a recommendation to any particular individual and has been prepared without taking into account any of your objectives, your financial situation, or your needs. You should consider whether the information is appropriate for you, having regard to your objectives, financial situation and needs before you act on the information.

The information in this report has been prepared by Commonwealth Private Limited ABN 30 125 238 039 AFSL 314018 (Commonwealth Private), a wholly owned non-guaranteed subsidiary of the Commonwealth Bank of Australia ABN 48 123 123 124 AFSL and Australian credit licence 234945 (Commonwealth Bank).

This document may contain economic and financial market projections and forecasts based on assumptions, data and product information provided by a range of third party research providers. Commonwealth Private has a commercial arrangement with JPMorgan Asset Management (Australia) Limited (JPMAM) to receive research and investment consulting services including asset allocation, investment decisions, investment selection and product development.

All market and macroeconomic data cited in this report has been sourced from FactSet, JPMorgan and Bloomberg, as at July 2026, unless otherwise stated.

While care has been taken in the preparation of this report and information, opinions or advice are considered reasonable based on information available at the time, no liability is accepted by Commonwealth Private, its related entities, agents and employees for any loss arising from reliance on its content. Past performance is not a reliable indicator of future performance.

The information in this report is intended for distribution within Australia to Commonwealth Private clients only and should not be forwarded without the prior written permission of Commonwealth Private.