



Commonwealth
Private



June 2026

Market Outlook.

Navigating narrow equity markets
and divergent valuations.

CIO Foreword

Global equity markets have extended their recovery from their March lows, driven primarily by a strong earnings season and sustained momentum in AI infrastructure spending. Returns have been solid, but the nature of the rally warrants closer examination. Gains have been driven by a narrow cohort of large-cap stocks, and global equity indices are showing heightened concentration. At the same time, the broader macro backdrop presents several considerations, including a less accommodative rate environment coupled with a structural shift toward global economic decoupling.

The strategic value of time

Geopolitical events have driven significant volatility this year, yet the subsequent recovery in markets serves as a powerful reminder of the value of time. Different asset classes sit along an investment spectrum: cash is suited to short-term capital preservation, while equities are appropriate for longer-duration objectives. It is precisely because equities are volatile in the short term that they offer the prospect of superior long-term returns. Crucially, the variation in annualised returns falls significantly as the investment horizon lengthens. Since 1980, the spread between the best and worst calendar-year returns for Australian equities has ranged from -38% to 67%. Over rolling ten-year periods, that range narrows to between 3% and 18% per annum. For patient investors, time remains one of the most effective natural mitigants of volatility.

Dealing with concentration

AI is the most influential theme behind the current period of concentrated market leadership. The major platform companies have collectively committed hundreds of billions of dollars in AI-related capital expenditure, directed toward data centre infrastructure, custom silicon, and energy capacity. This level of investment has become harder to finance through operating cash flows alone, with several hyperscalers increasingly turning to debt markets to fund the build-out. The sheer scale of investment is reducing the free cash flow available for shareholder distributions and contributing to an increasingly uneven pattern of capital return across the AI complex. Meanwhile, cash flows are migrating toward the hardware layer, exemplified by NVIDIA's board approving an additional US\$80 billion in share repurchases.

Capital cycles of this magnitude have historically carried material risks. Rapid investment has frequently given rise to overcapacity and disappointing returns on invested capital whether in railroads, telecommunications, or mining booms. The risk today is that productivity gains

either take longer to materialise than markets currently anticipate or ultimately accrue to a different set of beneficiaries than those making the heaviest capital commitments.

With valuations already reflecting favourable outcomes, there is little room for disappointment, and diversification becomes essential. Prudent diversification can be achieved through exposure across multiple layers of the AI value chain, looking beyond the immediate beneficiaries toward the adopters of AI with enduring competitive advantages. History is instructive, suggesting that, in many capital cycles, the strongest returns accrue to enterprises that benefit from new infrastructure build-outs, rather than those who fund and build it.

Valuation discipline

The final tool for navigating the current environment is valuation awareness. Over the long term, the relationship between entry valuation and subsequent returns is well established. Acquiring assets at attractive valuations materially improves the probability of favourable outcomes. At present, markets exhibit an elevated degree of valuation dispersion. Since the end of March, index-level returns have been driven predominantly by mega-cap US equities, supported by market momentum and reluctance from institutional investors to underweight these consensus positions. Beneath the largest companies in global indices, however, meaningful relative value remains. This dynamic has widened the opportunity set, presenting active managers with an increasingly attractive landscape of mispriced assets beyond the mega-cap cohort.

As such, our preference is for portfolios that are geographically diversified, balanced across sectors, and deliberately positioned toward attractively valued assets. In an environment increasingly shaped by structural change, such an approach provides a more robust foundation for delivering durable long-term outcomes.



James Foot,
Chief Investment Officer
Commonwealth Private

Earnings priced for perfection in an imperfect world.

What's going on here:

- **Regime pressure:** Sticky inflation and higher oil prices raise the risk of rates staying higher for longer.
 - **Narrow leadership:** Hyperscaler tech stocks have driven returns, leaving markets vulnerable to higher yields or weaker earnings.
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For much of the past three years, equity markets have been built on a simple assumption that inflation would gradually fall back toward target without a meaningful slowdown in growth. Central banks would ease policy, earnings would remain resilient, and elevated equity valuations, particularly in growth equities, would continue to be justified by a lower-rate environment.

That “Goldilocks” regime has worked remarkably well. But the macro backdrop is beginning to shift in ways markets may not yet be fully pricing.

Recent inflation data suggests the disinflation process is proving more difficult than expected. US headline CPI rose 3.8% year-on-year in April, while core inflation remains well above the Federal Reserve’s 2% target.

A key risk is energy. Oil prices have remained elevated following ongoing disruption through the Strait of Hormuz, with Brent crude oscillating around US\$100 per barrel. JPMorgan estimates the energy shock alone could add more than 1 percentage point to global CPI over a three-month period.

That pressure is already visible in supply chains. Shipping costs have risen sharply, up more than 40% since February. At the same time, the global goods cycle is reaccelerating, driven by inventory rebuilding and ongoing investment tied to AI infrastructure and technology demand.

The combination matters because it could make inflation more persistent. Estimates suggest global core goods inflation could accelerate toward 2–3% annualised over the next six months as higher transport costs, semiconductor bottlenecks and firmer import prices feed through globally.

What makes this environment particularly challenging is that inflation pressures are rising while growth signals are softening.

Recent S&P Global services PMI surveys show weaker business activity, softer hiring intentions and declining confidence. Those same surveys also show rising input costs and output prices. In other words, margins are likely to come under pressure as demand slows, potentially creating a difficult backdrop for corporate earnings.

This leaves markets facing two uncomfortable scenarios. If inflation remains sticky, central banks may be forced to keep policy restrictive for longer, delaying the easing cycle investors continue to anticipate. Alternatively, if higher energy prices and rising costs ultimately weigh more materially on demand, inflation may eventually fall but likely alongside weaker earnings growth and a slowing economy.

That repricing is already emerging in bond markets. US 10-year and 30-year Treasury yields have both moved higher as investors reassess the outlook for inflation and the likelihood of policy easing. Rising long-end yields directly challenge the valuation framework underpinning long-duration growth assets.

Recent equity performance has been driven by a small group of hyperscaler technology companies benefiting from enthusiasm around artificial intelligence and infrastructure spending. Valuations across parts of the mega-cap growth complex have expanded materially following an extraordinary rally, leaving index performance increasingly concentrated in a handful of names.

This creates a vulnerability because these businesses are also among the most sensitive to changes in discount rates and investor risk appetite. The strong performance of long-duration growth assets has been heavily reliant on the assumption that inflation and bond yields would continue to move lower over time.

This is not a case for abandoning equities, but does suggest investors may need to reassess where risk is taken. If the macro regime is moving away from the conditions that defined much of the past decade, businesses with genuine pricing power, exposure to real assets, or earnings linked to nominal growth and inflation may prove more resilient.

Weighing up the second order effects of the Budget's tax reform

What's going on here:

- The Budget's tax changes to negative gearing, capital gains tax (CGT) and discretionary trusts continue to attract heightened attention.
- Further questions have materialised and have added to uncertainty for the investment environment, especially across the property and equity sectors.

What does this mean?

Three weeks on from the Budget, the reaction to the tax proposals continues to build among a widening range of demographics and sectors. In our 19 May "*Weighing up the proposed changes in the 2026-27 Federal Budget*" note ("the Budget note") we outlined several of Labor's key tax proposals, including:

- (1) Removing the discount on CGT assets held by individuals, partnerships and trusts in favour of inflation indexation and a minimum 30% tax rate from 1 July 2027,
- (2) Abolishing negative gearing for existing investment properties from 1 July 2027, and
- (3) Introducing a minimum 30% tax on discretionary trusts from 1 July 2028.

Initially targeting investors on higher marginal tax rates, entrepreneurs and small business (SMEs) owners are coming to terms with the implications of these tax changes, all of which are combining to create a more uncertain private investment environment in 2026.

Why should I care?

Starting with **property investors**, CBA's Senior Economist Trent Saunders¹ believes that the combined effect of the tax plans will: (1) reduce established dwelling prices relative to the previous baseline price level, (2) reduce turnover of residential properties, (3) modestly increase rental pressure over time, and (4) provide *some* relative support for new construction (provided projects remain financially feasible). Considerable uncertainty exists for the latter, however, noting the recent escalation in housing construction and input costs.

On residential house prices, CBA Senior Economist Trent Saunders now expects dwelling price growth over the year to December 2026 to slow to 0%, down from the March forecast of 5%. Growth is then expected to remain at 3% for the year to end-2027. In addition to these tax changes, the property sector has been dealing with three RBA rate hikes and the Iran war which have raised housing construction costs and created a more uncertain economic environment.

By sector, CBA Senior Economist Trent Saunders believes the house price impact is likely to be concentrated in market segments where investor participation is highest, with apartments, townhouses and lower priced established dwellings likely to be more affected than detached housing markets dominated by owner-occupiers. By capital city, CBA Senior Economist Trent Saunders expects the Melbourne and Sydney markets to experience greater house price softness partly given their greater exposure to investment properties. However, this is not expected to be a long-term dynamic given lower property prices would lift rental yields which may bring investors back into the market.

Meanwhile, investors' borrowing capacity is expected to reduce given this cohort will not be able to factor in savings from negatively gearing a property. Indeed, several key Australian banks have already announced updates to their lending policies.

The combination of weaker house prices and credit demand are two key drivers why **bank stocks** are experiencing de-ratings. Other factors include higher provisioning from the macroeconomic and interest rate outlook, together with higher costs (with the continued investment in tech being an earnings drag). While asset quality measures are likely to weaken, they are expected to remain resilient.

CBA² Director Fixed Income and Interest Rate Strategy Hamid Yahyaei asserts that the changes to the CGT discount will reduce the tax bias against assets that are income-oriented and offer a more stable capital price profile. As discussed in our Budget note, within the **equity sector**, compared to growth stocks, the tax proposals are expected to make stocks that offer higher dividends, embed more franking credits and are generally steadier and income-oriented relatively more attractive,

¹CBA Global Economic & Markets Research (GEMR), Economic Insights "[2026 Budget: Updated Housing Outlook](#)" published 13 May 2026

²CBA research: 2026/27 Federal Budget Implications for asset classes published 13 May.

given they are less affected by the tax changes. In contrast, equities that are growth-based would face a larger **after-tax** return headwind, particularly where the expected capital growth substantially outweighs inflation.

Further analysis has also revealed some potential “stings in the tail”, which remain unclear as of late-May. Notable among these are reports that only nominal, or non-indexed, capital losses on stocks will be permitted to be offset real, or indexed, capital gains under the new rules. ***If*** this proves to be the case, after-tax outcomes for in-scope investors in a portfolio of individual stocks may be less optimal, with CGT imposed on the large nominal capital gains (stock winners) but less tax losses recognised for the inflation-adjusted underperformance (stock losers) elsewhere in the stock portfolio. The after-tax outcomes would be magnified for investors holding many higher risk growth stocks that underperform and only several outperforming low risk stocks that gain in capital price. Through a rise in the effective tax rate, this may make direct investments less attractive compared to ETFs, given that the nominal gains and losses are effectively netted and distributed within an ETF. As with the broader industry, we are seeking clearer guidance on these impacts and will report back accordingly.

In addition to the broader effects noted in our Budget note, ***if legislated in their current form***, the tax changes could result in further implications for in-scope investors and the investment environment. This includes the increased:

- Imposition of higher accounting and legal costs,
- Consideration of gearing into the investment of ETFs and equities³,
- Headwinds to private investment, especially from the CGT proposals, and
- Economic uncertainty which supports CBA Economist Belinda Allen’s⁴ forecast for the RBA to remain on hold in 2026.

Where to from here?

As of late May, the situation remains fluid, especially as it relates to the CGT proposals, and we caution again that these tax proposals are yet to be enacted. On 28 May, Labor introduced the first tranche of tax legislation into Parliament, which has been referred to a Senate committee, thereby allowing multiple industry submissions before the Committee reports back later this month. Multiple press agencies report that the Government is already consulting with small business and large industry regarding CGT carve-outs, not necessarily limited to tech-based start-ups.

With respect to the relative probability that these tax proposals are passed through Parliament, Labor has an outright majority in the Lower House but must engage with the crossbench and/or the Greens Party in the Senate. We note that the Government is pushing hard for these proposals to be enacted, with the Greens party reportedly supporting the negative gearing plans, however, there is scope for more carve outs for the CGT changes. Given this uncertainty, and as outlined in our Budget note, wholesale investors should maintain discipline, a watching brief and seek tax advice.

³While the Budget papers did not specifically rule out negative gearing on equities, multiple reports assert this will continue to be a tax effective method of investing.

⁴CBA Economics: “RBA Hike the cash rate in May as expected”, published 5 May and found [here](#)

High-yield credit: holding the line in volatile times

What's going on here:

- High-yield credit investments can be volatile, with multiple potential drivers of that volatility.
- Well-chosen investments can still provide enhanced returns. However, investors need to understand the return drivers, be tolerant of return volatility, and have a long-term investment horizon that aligns with the underlying asset liquidity.

What does this mean?

Over the past six months, high-yield credit markets, including high-yield bonds, broadly syndicated loans, structured credit, and direct corporate lending have faced heightened scrutiny and volatility. This was initially triggered by a limited number of corporate defaults in late 2025, followed by rising concerns about the impact of Artificial Intelligence (AI) on software companies and the use of fund-level redemption gates to limit outflows. For the moment, however, these markets have calmed considerably.

Why should I care?

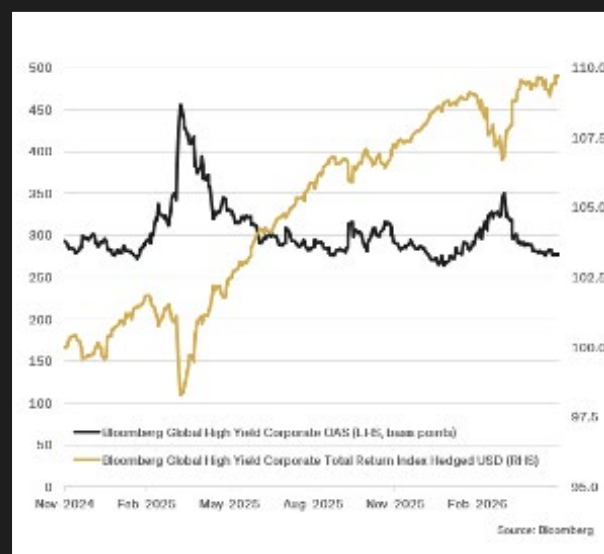
While default rates across speculative-grade credit have edged higher over this period, this has been incremental rather than disruptive. Credit rating agencies have generally characterised the current credit environment as benign-to-moderate, and their forward-looking commentaries point to a gradual increase in defaults rather than systemic acceleration.

At the same time, the enforcement of periodic redemption gates by certain US private credit funds, which was initially perceived as a signal of rising risk, has been contextualised and is now more widely appreciated to be protective of all investors in those funds. That is, these mechanisms are designed to protect long-term investors by aligning redemption liquidity with the underlying asset liquidity.

The question now confronting investors is whether the asset class is positioned to deliver through what may be a more challenging macroeconomic regime.

Global High-yield bond index credit spreads and returns

USD Hedged, Indexed to 100 at 30/11/2024



As discussed earlier in this report, the upward march of interest rate curves globally, as well as the transition of the expected path of US Fed funds rate from rate cut to rate hikes, indicates that global investors are worried about rising and persistent inflation. For high-yield and private debt, the impact is both direct and indirect.

The immediate consequence of higher interest rates is an increased debt servicing burden for corporates and consumers. While this will prove challenging for some weaker credits, aggregate credit quality within the high-yield universe has improved in recent years, supported by higher interest coverage ratios and sound equity buffers. Together, these provide a foundation for resilience. As such, the potential impact of limited near-term interest rate increases is manageable. Current market expectations are for the US Federal Reserve to increase the cash rate from its current mid-point level of 3.6% p.a. to circa 4.0% p.a. over the coming 12-months. This would be well below its recent peak level of 5.3% across 3Q2023 to 3Q2024.

However, the persistence of higher rates introduces a second-order challenge. If higher interest rates persist, or inflation rises meaningfully, it will increase the difficulty of refinancing existing debt, as lenders are likely to exercise greater caution in underwriting new loans. While this is expected to have the greatest impact in lower quality segments, it would potentially result in credit spread widening across all high yield credit (and to a lesser extent, investment grade credit as well).

This has important valuation implications, as credit spread widening is mirrored in lower valuations of already-issued debt, resulting in downward pressure on fund net asset values.

The relationship between credit spreads and liquid high-yield index level returns over the past 18-months can be seen in the chart above. Despite the volatility over this period, trailing 12-month returns across various high-yield indices were still positive. While this is due in part to the combination of base interest rates, running yields, and the pull-to-par of discounted asset valuations, the rapid re-compression of credit spreads has been the primary driver of post-selloff valuation recovery.

While illiquid direct private credit has historically benefited from low volatility and infrequent mark-to-market adjustments, it is not immune to broader credit market dynamics. Indeed, there is a growing recognition that private market valuations should, at least partially, reflect movements in comparable public market instruments. This alignment enhances transparency and ultimately strengthens investor confidence.

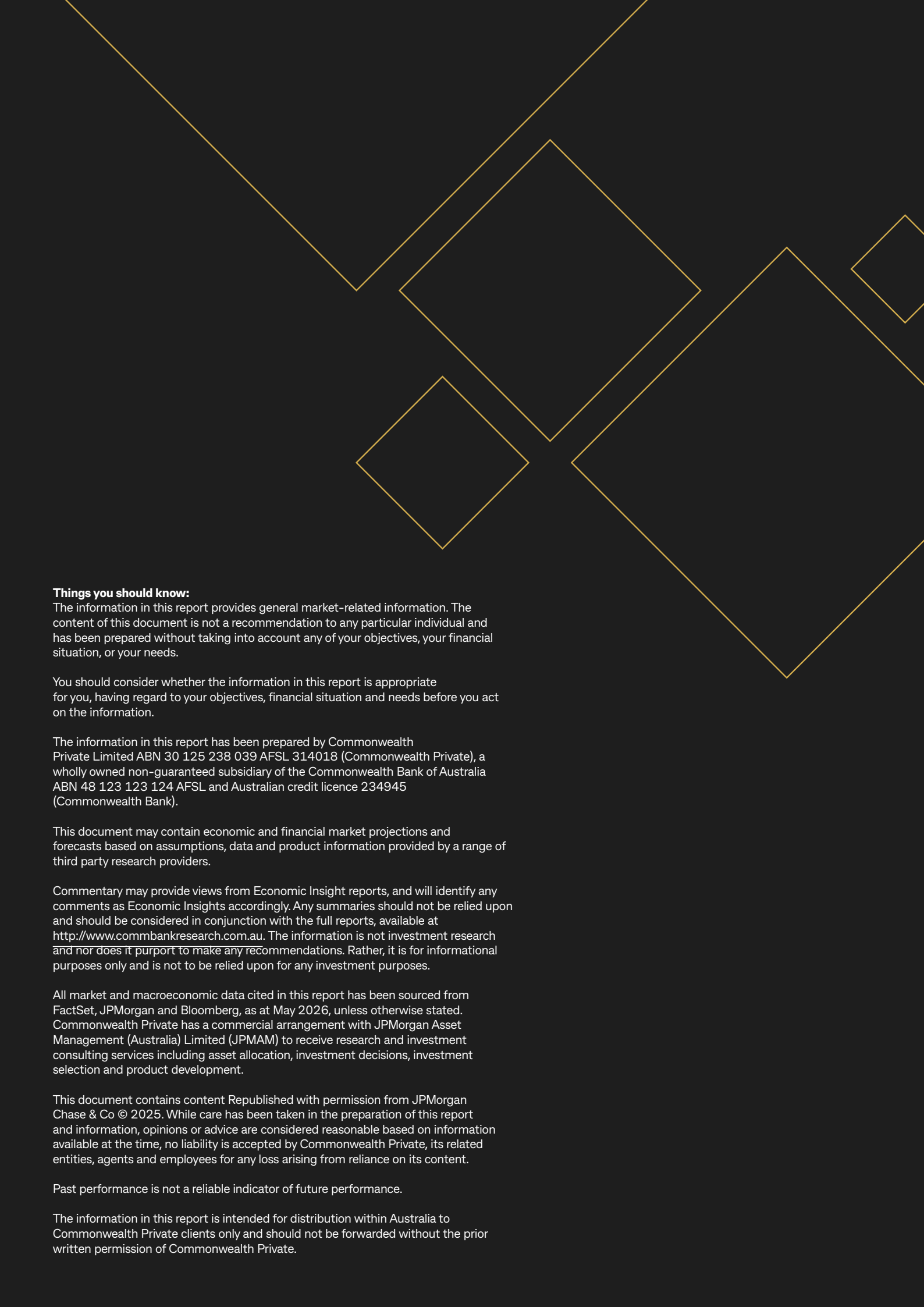
What happens if credit spreads don't re-compress so quickly? Paradoxically, while changing market dynamics can challenge investment returns in the short term, they can also lay the foundation for improved long-term returns. Here, higher base rates, wider credit spreads, and the pull-to-par of discounted asset valuations increase the prospective yield on both existing and new assets, thereby providing a more fertile environment for both opportunistic and longer-term investment. The critical caveat is that defaults must be contained.

In a higher-rate, higher-spread, environment, the dispersion of outcomes between borrowers is likely to increase, pushing default rates higher. Avoiding defaults, and minimising credit downgrades, is paramount. This reinforces the importance of deep fundamental credit analysis and active portfolio monitoring. As such, Commonwealth Private prioritises high-yield managers that:

- a. Have the necessary resources to conduct such analysis,
- b. Have experience in navigating stressed environments successfully, and
- c. Provide well diversified portfolio exposures.

Ultimately, we wish to work with managers that seek below-system default rates across a range of credit conditions, allowing them to capitalise on the potential for return enhancement from high-yield investments.

It is also essential that investors align their expectations with the characteristics of the asset class. That is, investors need to understand, and be comfortable with, the potential for return volatility, and have the discipline to "hold the line" and invest over a full market cycle to capture the returns available from this asset class.



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