May 2026

Market Outlook.

Positioning in a world of structural shifts.

CIO Foreword

Investor attention shifted back to earnings expectations in April, with the S&P 500 reaching a new record as upgrades in energy and technology lifted sentiment. Australian equity markets also rebounded, despite gains being impacted by inflation concerns around the Iran conflict and weak consumer confidence. The sharp repricing followed by stabilisation echoed last year's tariff-related volatility, reinforcing how conditioned investors have become to rapid recoveries.

Episodes like this highlight the importance of perspective in investing. ***The key is to focus on what is both important and knowable.*** Geopolitical events (such as the current Iran conflict) are inherently unknowable, whereas the way economies and businesses adapt tends to be gradual and observable. Maintaining this distinction helps avoid investors from overreacting to short-term noise while staying anchored to longer-term fundamentals.

Structural shifts in inflation and investment

Inflation dynamics continue to evolve. While long-term expectations remain relatively well anchored, regionalisation and reshoring are likely to place sustained upward pressure on costs as economies prioritise resilience and security over efficiency. This isn't a temporary adjustment. The reconfiguration of global trade is inherently inflationary and is supportive of a prolonged cycle of capital expenditure across infrastructure, energy systems, and domestic manufacturing. As a result, as discussed herein, inflation is likely to remain above pre-2020 norms, at least until productivity gains from technology begin to offset these pressures.

AI increasingly central to market narratives

Optimism around US equity earnings continues to build, centred on Artificial Intelligence (AI) hardware as investment in infrastructure accelerates. Amazon, Microsoft, Meta and Alphabet are further fuelling this optimism by, again, pointing to substantial capital expenditure plans in their latest results. Markets are forward-looking mechanisms that price future expectations in real time. While the opportunity for AI in general, and hardware in particular, is significant, share prices have already re-rated on this optimism. In contrast, the software sector has seen weaker sentiment, with AI often viewed as a disruptive threat. This is unlikely to be universal.

What this means for investors

AI, deglobalisation and the macro backdrop is likely to generate a broad set of beneficiaries over time. Leaning toward these winners is clearly preferable. While probabilities, valuations, and economic drivers provide a framework to discern these winners, it's also important to acknowledge that the precise winners and losers will be difficult to predict in advance with 100% accuracy. It's therefore more helpful to think of return expectations (especially in areas shaped by geopolitics, AI, and shifting industry dynamics) as a distribution of potential outcomes, rather than a single point estimate. Periods of volatility often reflect a widening of that distribution, not necessarily a deterioration in underlying value. This is where some software names currently sit.

Sustained growth and preservation of real capital depend just as much on robust portfolio construction as sound investment selection. This thinking doesn't just apply to AI winners and losers. It extends to broad macro-economic drivers of asset class fundamentals. Different asset classes perform differently across inflation and growth regimes. Combining exposures across asset classes to build resilience across a range of scenarios is a key objective for well-constructed diversified portfolios.

While the current conflict in Iran and oil price pressure may de-escalate over time, the more persistent forces: deglobalisation, evolving inflation dynamics, and the growing influence of AI are likely to remain firmly in place. Success in this environment is not just about selecting the right assets at the right price, but about diversifying with the right combination to navigate an uneven and evolving cycle.

James Foot,
Chief Investment Officer
Commonwealth Private

Earnings resilience driving the recovery in US equities

What's going on here:

- Earnings driving a rebound: Earnings are now rising in one of the strongest revision cycles outside recessions.
- Narrow leadership, broader earnings: Growth remains concentrated, but AI capex is spreading earnings across semiconductors and infrastructure.

What does this mean?

US equities staged a sharp recovery through April, reversing the drawdown triggered by the Iran conflict. Yet within four weeks, the S&P 500 rebounded 13% from its lows to new records. The speed of the move was notable: the market shifted from oversold to overbought at one of the fastest paces in decades, highlighting both the depth of sidelined capital and the strength of the earnings backdrop.

Critically, the drawdown was a *valuation event*, not an *earnings event*. At the lows, price-to-earnings multiples compressed by close to 20%, while earnings expectations remained intact and, in parts of technology, continued to rise. Historically, periods where multiple compression coincides with stable or improving earnings, a strong foundation for forward returns follows.

April's rebound was sentiment-driven but also represented the market recalibrating around resilient earnings. With roughly 30% of S&P 500 market capitalisation having reported, earnings are tracking around 13–15% earnings-per-share (EPS) growth on high single-digit revenue gains, with close to 77% beating both EPS and revenue estimates. More importantly, the typical pattern of downward revisions early in the year hasn't materialised. Analysts have revised earnings estimates up approximately 4% since January, while 12-month expectations have risen close to 11% YTD, one of the fastest revision cycles outside of the GFC. Full-year expectations point to 18–19% EPS growth in 2026.

Technology continues to lead, but the composition of that leadership is evolving. The Magnificent 7 are expected to deliver 22.8% earnings growth in Q1, versus 10.1% for the remaining 493 companies. Excluding NVIDIA, growth for the remaining six falls to 6.4% below the broader index, while NVIDIA alone is expected to contribute approximately 21% of total S&P 500 earnings growth in 2026.

Why should I care?

The implication is nuanced. Market performance remains narrow, but the earnings cycle is beginning to broaden. Beyond mega-cap platforms, companies tied to semiconductors, cloud infrastructure and adjacent industries are contributing meaningfully to growth. ***This narrowness is largely foundational and related to AI enablement***, leaving scope for broader upgrades if macro conditions remain resilient and the benefits broaden.

Underpinning these trends is the scale of AI infrastructure investment. Microsoft, Alphabet, Amazon and Meta are collectively projected to spend over $700bn in capex this year, on the back of strong profitability.

This capex is flowing into semiconductors, memory, networking, power systems and industrial capacity effectively converting big tech investment into revenue growth for a widening group of companies. Reflecting this, technology-related companies are expected to drive approximately 67% of total S&P 500 earnings growth in 2026 and account for 84% of upward earnings revisions.

The Q2 outlook remains constructive. Earnings revisions are positive and the AI-driven investment cycle continues to build momentum. The forward 12-month P/E of ~20.9x remains above long-term averages but is supported by strong earnings growth and high-quality profitability.

Risks, however, remain. Oil poses a headwind to margins, while index-level earnings remain heavily influenced by a small number of companies. Macro uncertainty may also slow the pace of broadening.

The key question is whether the recovery can broaden? If earnings strength continues to diffuse beyond the narrow leadership cohort, the rally has the potential to become more durable. If not, performance will remain dependent on a small set of outcomes, leaving less margin for error as the year progresses.

Stagflationary conditions worry domestic fixed income investors

What's going on here:

- The risk of stagflation is now material, resulting from higher inflation and slowing domestic activity.
- Current conditions present both opportunities and risks for fixed income investors.

What does this mean?

Early this year, domestic fixed income investors were experiencing so-called "goldilocks" conditions, namely positive, but subpar economic growth, and stable cash rates, albeit with higher core inflation.

With inflation increasing, the Reserve Bank of Australia (RBA) responded with consecutive interest rate hikes in Q1. The Iran-conflict further locked in higher inflation and compelled the RBA act again in May, making the economic picture less clear.

On the inflation front, the moves to de-globalisation and onshoring present persistent cost pressures. The upshot is that global inflation is likely to remain above pre-COVID levels, with Australia a poster child for the developed world given these pressures were present prior to the Iran conflict.

This was confirmed in the March CPI data which showed we're materially above the RBA's 2-3% target band. Against this outlook, the RBA felt compelled to up the Cash Rate again this week to 4.35%.

A combination of multiple rate hikes, a supply-side shock and resultant higher energy, food and input prices is likely to weigh on economic activity, bringing into focus the risk of stagflation. These conditions present both key risks and opportunities for fixed income investors.

Why should I care?

Firstly, portfolio yields are set to remain elevated. Given credit spreads are again low, these all-in yields mainly stem from higher underlying interest rates. Indeed, Australia's Cash Rate is now the highest across the developed markets and AUD market yields have moved swiftly to price in higher inflation.

Looking ahead, depending on the relative floating rate exposure in portfolios, yields can drift even higher as floating rate bonds reset to the bank bill swap rate (which, as of late April, is circa 0.9% higher compared to mid-October 2025 levels).

Importantly, from a defensive viewpoint, higher for longer yields and coupon income levels provide a greater buffer for funds against adverse interest rate and credit spread moves, and thus negative returns.

Investors should seek fund managers who operate measured interest rate exposures, while remaining active and nimble to take advantage of bond market volatility. For example, while we remain strong advocates of moderate interest rate duration in standalone fixed income investments, with the sharp rise in the two-year AUD government bond yield (which, as at 30 April, is up 1.5% since mid-October 2025 and +0.6% since the start of the Gulf conflict), some portfolio managers may view these levels as a good entry point to extend interest rate exposure, while also providing some defence in their portfolios against weaker growth.

In terms of credit fundamentals, while domestic issuers are generally better placed to weather sluggish activity (given their higher grade and often oligopolistic attributes), managers should still selectively favour higher quality, liquid, investment-grade fixed income exposures, to reduce ratings (and default) risks. Any higher-yielding credit exposures should be high conviction, selective and shorter-dated to reduce credit spread sensitivity. In anticipation of this more "demanding near-term environment", APRA has now launched new dynamic stress tests for its regulated banks, while some banks have started to top up the level of provisions on their balance sheets.

As investors face into these conditions, taking an active, absolute return and diversified approach to fixed income investing becomes even more important to negotiate risks and take advantage of now equity-like fixed income yields.

Preparing for incoming tax changes

What's going on here:

- This year's Federal Budget is reportedly set to contain significant changes to the Capital Gains Tax (CGT) and negative gearing concessions.
- New superannuation tax rules (Division 296) for balances above $3m take effect on 1 July.

What does this mean?

Ahead of the Federal Budget on 12 May, multiple press agencies are reporting the Government will introduce major changes to the current CGT and negative gearing concessions. This comes as the new Division 296 tax rules for superannuation take effect on 1 July, ensuring Commonwealth Private clients will have plenty to consider on the tax front.

Continuing the usual practice of pre-announcing key measures via mainstream news before the budget, The Australian reported that the current 50% discount on CGT for assets held for at least one year will be removed in favour of inflation-linked indexation for all assets. However, as is typical with major tax amendments, these reports suggest 'partial grandfathering' will be applied.

While we await the official announcement, these reported tax amendments are consistent with recent commentary from the Federal Treasurer and the Prime Minister that speak of tax reform to address the issue of "intergenerational equality".

Why should I care?

Under this mooted inflation-indexation model, which was in place pre-1999, the capital gain on an asset is adjusted down for inflation with the remainder amount taxed. While this would mean investors will only be taxed on real capital gains, outcomes will vary depending on economic conditions.

In a lower growth, higher inflation world, such as the one we believe Australia is entering, CBA believes that investors will generally be better off under an indexation model, compared to investors operating in an environment of high asset price growth and low inflation.

In addition, based on media commentary, changes to the negative gearing provisions on investment properties will be implemented with the focus shifting from capping the number of properties permitted for tax concessions, to the abolition of negative gearing.

Additionally, the Division 296 superannuation tax rules will take effect on 1 July. As superannuation investors will recall, following significant industry pushback, sanity prevailed last year, when the government removed the controversial parts of the legislation, namely a tax on unrealised capital gains and the lack of indexation.

Nevertheless, the new Division 296 provisions still contain some important changes that clients should be aware of. These include:

- Individuals with a total superannuation balance (TSB) over $3m (which is indexed) will be subject to an additional tax of 15% on super earnings,
- An additional 10% tax applies to the proportion of earnings attributable to the part of the TSB above the $10m (also indexed and on top of the 15% tax applicable to the above $3m TSB),
- Earnings on TSBs below $3m will continue to be taxed at the concessional 15% tax rate, and
- The new tax levy is assessed to the individual. However, members can elect to pay the amount via their super account (similar to the existing Division 293 tax provisions).

While the CGT and superannuation tax landscape is clearly evolving, and clients should discuss these changes with their tax advisor, we reiterate our view that tax considerations alone should not be the chief of driver of investment decisions and exposures. This reiterates our view as to why we continue to favour a diversified exposure across income and growth assets over multi-year time horizon.

[1]CBA Economics: 2026 Federal Budget Preview published 29 April.

Real Assets: A foundation for diversified returns

What's going on here:

- Real Assets such as property and infrastructure can provide both ongoing returns and investment stability over the long-term.
- They are providing valuable diversification of risk and return drivers within investment portfolios.

What does this mean?

From a high-level fundamental perspective, global commercial property valuations have been slow to rebound from their recent lows in late-2024. With negative returns from the sector leading up to this point still fresh in mind, and equity markets continuing push new all-time high points, many investors are reluctant to deploy meaningful new capital into the sector. Those that commit must also choose where to invest, with various challenges and opportunities presented by global economics (regional growth, interest rates and inflationary expectations) and AI (reduced staff levels potentially impacting demand for office space). In total, investors are being both selective and patient.

Why should I care?

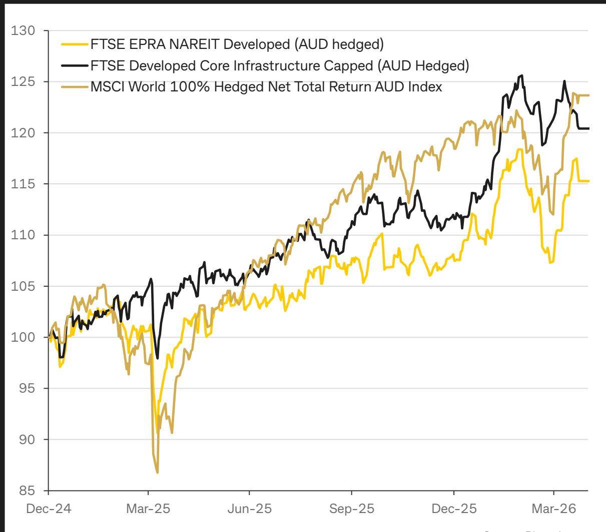
For those already invested, returns from direct property were positive in 2025. Starting from current realistic valuations, prospective returns are anchored by contracted growing rental income. Rising construction costs have also pushed replacement costs above current valuations for many properties, thereby providing significant hurdles to the construction of new assets that would compete with current stock. As such, the downside in direct property investment appears well mitigated.

However, while underlying asset valuations are stable, listed real estate securities have been caught up in the recent equity market volatility. This "non-fundamental" volatility reflects, at least in-part, that investment decisions are impacted by near-term sentiment instead of maintaining focus on the medium-to-long-term.

Similarly, listed infrastructure investments have also been volatile, but less so than broader equity markets. This lower volatility is due to the essential nature of infrastructure assets,

Real Asset investment returns

AUD Hedged (Indexed to 100 at 31/12/2024)



Source: Bloomberg

such as energy generation and transmission, communications infrastructure, water, and transportation, making the sector less sensitive to reduced discretionary demand during periods of consumer stress. Further, these assets typically have inflation-linked income streams, thereby providing a shelter against asset value erosion. *This asset class continues to evolve*, bringing new opportunities to market in sectors such as the transition to renewable energy, digital infrastructure and waste recycling, which will provide a base for infrastructure investment and returns in the decade to come.

We believe that well-selected infrastructure will continue to perform over the medium term regardless of the outlook for inflation and consumer discretionary demand.

With a reminder that listed markets can be subject to periods of heightened volatility, we believe that investment decisions need to be taken with a long-term horizon. This allows the compounding value of the underlying investments to be properly recognised. It also should remind investors to consider less liquid investment vehicles, whether that be monthly liquidity funds, or closed end funds with limited periodic liquidity.

In total, we believe that the differentiated aspects of property and infrastructure investments, including their varied risk and return drivers, justify their inclusion in diversified portfolios.

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