

Commonwealth Private

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Market Outlook.

The price of resilience – raising the bar

CIO Foreword

Investors have spent much of 2026 navigating an unusual combination of resilient economic activity, persistent inflation, strong equity markets and sharply rising bond yields.

As we enter the final months of the year, markets appear to be becoming more discriminating. Fundamentally, it's not enough for an investment narrative to be compelling. Ultimately, for investors, earnings, cash flows and returns on invested capital must be delivered.

This can be clearly observed in the recent reassessment of the artificial intelligence (AI) trade. The long-term opportunity presented by AI remains significant, but several of the semiconductor and technology companies closely associated with the theme have experienced substantial equity and credit market volatility, as investors question the scale, financing and eventual returns from extraordinary levels of AI infrastructure investment. Recent market moves have, therefore, looked less like a rejection of the AI thematic itself, and more like a recalibration of the price investors are willing to pay for future growth.

That distinction is particularly relevant as the latest corporate reporting season progresses. As we discuss in this month's equities outlook, the test for markets is increasingly one of earnings and governance: whether companies can convert ambitious investment programmes and strong structural themes into durable earnings growth, while maintaining the capital discipline and governance required to protect shareholder returns. Recent corporate reporting has remained comparatively resilient, suggesting that the resulting pressure on share prices has so far been more about demanding valuations and expectations than a broad deterioration in corporate profitability.

Inflation, however, continues to complicate that picture. In Australia, the September CPI report showed annual inflation rising to 4.3%, from 4.0% in August, while trimmed-mean inflation increased slightly to 3.6%. The result materially strengthened expectations of further monetary tightening. Regardless of the Reserve Bank of Australia's (RBA) policy decision this week, the message is an uncomfortable one for households and markets: the path back towards price stability is proving less straightforward than many had hoped.

Similar tensions are evident globally. Investors are balancing still-resilient corporate earnings against elevated valuations, persistent inflation pressures and higher funding costs. At the same time, the recent rotation away from some of the most highly valued technology exposures has shown that market leadership can change quickly.

For investors, we believe this reinforces the importance of selectivity and diversification. Strong structural investment themes can remain intact even as their valuations become more volatile. Equally, attractive starting yields in fixed income mean diversified portfolios have more potential sources of return and defence than they did when yields were exceptionally low.

As we look towards 2027, the investment environment may increasingly reward the ability to distinguish between a sound story and a sound investment. That means maintaining exposure to long-term opportunities, including AI, while remaining disciplined on valuation, balance-sheet strength, earnings quality and governance. In an environment where expectations are high and capital is no longer cheap, those disciplines matter more, not less.



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When economic resilience becomes an inflation risk

What's going on here:

- Economic resilience is a double-edged sword: stronger growth reduces recession risk but makes returning inflation to target more difficult.
- Capacity constraints are reshaping policy: resilient demand amid limited supply could keep inflation and interest rates higher for longer.

What does this mean?

For much of the past few years, economic resilience has been good news for investors. Despite one of the sharpest monetary tightening cycles in decades, geopolitical shocks and persistent uncertainty, the global economy repeatedly avoided the downturn many expected. Strong labour markets, healthy household and corporate balance sheets, and more recently an AI-driven investment boom have all helped sustain activity.

But resilience is beginning to take on a different meaning. Rather than simply reducing recession risk, continued economic strength is increasingly complicating the task of bringing inflation sustainably back to target.

The global economy is still expanding at a reasonable pace. CBA economics[1] expects global growth of 2.5% in 2026 before strengthening to 2.7% in 2027. Yet global headline inflation is expected to rise to 4.7% this year. The unusual combination reflects two powerful forces pulling on the global economy at the same time: higher energy and commodity prices are acting as a negative supply shock, while rapid investment associated with AI is providing a positive demand shock. The result is an economy experiencing upward pressure on prices from both sides.

This matters because the inflation challenge is becoming less straightforward. The initial post-pandemic inflation surge could largely be understood through disrupted supply chains, extraordinary policy stimulus and the reopening of economies. Today's pressures are broader. Energy and geopolitical risks remain important, but they're being accompanied by substantial investment in technology, data centres and energy infrastructure, while fiscal policy remains supportive in many economies and labour markets have proved surprisingly resilient.

In other words, the global economy may increasingly be running into capacity constraints rather than simply excessive demand.

Australia provides a useful example. Economic growth has slowed, but not enough to eliminate domestic capacity pressures. Inflation has remained stronger than expected, prompting the RBA to raise the cash rate to 4.85% in November. The RBA highlighted not only higher global energy prices, but also rising technology-related goods prices associated with AI demand and continued domestic cost pressures.

This creates an uncomfortable dilemma for central banks. Monetary policy can reduce demand, but it cannot produce additional energy, expand electricity grids, build data centres or quickly increase the supply of skilled labour. When supply is constrained, relatively modest increases in demand can generate greater inflation pressure than they would in an economy with significant spare capacity.

Why should I care?

For investors, this suggests the macro debate may need to move beyond simply asking when central banks will pause or cut interest rates.

The more important question may be what level of interest rates is required in an economy characterised by greater investment demand, more active fiscal policy and recurring supply shocks. If nominal growth and inflation remain structurally higher than in the decade following the global financial crisis, the neutral level of interest rates may also prove higher.

That doesn't necessarily imply an imminent recession or permanently high inflation. But it does suggest that the comfortable combination of resilient growth, falling inflation and steadily declining interest rates may be increasingly difficult to achieve.

Economic resilience remains a positive. The challenge for markets is that too much resilience, in an economy with limited spare capacity, can eventually become part of the inflation problem.

[1] Housing, AI and geopolitics define the economic outlook, CBA Newsroom

Australian interest rates: are we there yet?

What's going on here:

- There are two ways to read the economy: the cyclical and structural views, with CBA[2] leaning to the former (i.e. the RBA's job is almost done).
- Having risen significantly to 15-year highs, AUD market rates have priced in a decent amount of tightening risk.
- As such, we're growing more comfortable that shorter-dated bond yields can stabilise.

What does this mean?

For fixed income investors, the main game in town has been the surge in global bond yields. Our views on the drivers and implications of this move have been well documented. Here, we consider the key question: *"Are we there yet?"*

Cash Rates: CBA's Chief Economist asserts there are two ways to read the economy and thus the cash rate. The **cyclical view** says that after five rate hikes in quick succession, the RBA's job is almost done; growth and consumers are under pressure, house prices are posting annualised double-digit falls, unemployment is rising and the lags from rate hikes will do the rest.

The **structural view** asserts that low productivity, high government spending and AI capex levels mean policy isn't restrictive enough, inflation will remain persistent and the RBA will have more work to do.

In CBA's view, the RBA is aware of the structural risks and is committed to getting inflation down, even if it results in economic pain. However, the RBA is not yet 'all in' on the structural view and is moving one hike at a time, searching for the point where the cycle breaks. CBA's base case is that the cycle wins... but only just. With Q3 trimmed mean inflation at 3.6%/year, 1.1% above the RBA's target, the economy slowing and unemployment rising, the RBA is close to being done. However, the structural forces have raised the risk that several more interest rate hikes will be needed over the next six to 12 months. Either way, cash rates will stay structurally higher.

Market Rates: This is where we have somewhat more clarity. Short interest rates started rising more than a year ago and recently reached their highest levels in 15 years. We believe that market rates will stabilise.

Why do we favour a stabilisation in market rates?

As noted, the moves in both the AUD cash and market rates have been significant – across the developed world, we boast the highest cash rate (outside of Iceland) and one of the highest short-term market rates. For the latter, we judge that a decent amount of tightening risk has been priced in by the market. For these reasons, noting the difficulty of forecasting in the current environment and the capitulation phase may not yet be over, CBA[3] now believes yields are nearing their peak, albeit they will cycle around a much higher average going forward. Longer-dated AUD bond rates will continue to be driven more so by movements in global and especially USD benchmarks.

Why should I care?

For fixed income investors, elevated portfolio yields of 6-7%+ provide sound yield compensation, constructive total return potential, and a meaningful cushion against adverse moves in interest rates or credit spreads.

What are the main risks to non-stabilisation?

The key risk to our view that market rates will stabilise is that the structural view plays out, and inflation remains sticky and elevated. External factors, such as tensions in the Middle East driving oil prices higher or a potential super El Niño adding to food and input prices, could also increase inflationary pressure. Collectively, these factors could result in further tightening by the RBA.

Nevertheless, with policy rates already substantially higher than in 2022, we are becoming more comfortable that shorter-dated Australian bond yields can stabilise.

[2] CBA Economics note dated 14 Oct 2026.

[3] CBA Market Strategy & Rates Research Weekly Strategy Research: 25 Sep 2026.

The test for earnings and governance

What's going on here:

- Annual General Meeting (AGM) season, most of which takes place in October and November, provides the first meaningful test of listed companies' FY27 assumptions since the August reporting season.
- Higher interest rates, weaker consumer sentiment and persistent inflation risks are making business conditions tougher, so timely management commentary on demand, pricing, costs and funding is more valuable.
- Governance is playing a growing role in investment decisions, with AGMs scrutinising remuneration alignment, incentive design, director elections, board renewal and accountability for capital allocation.

What does this mean?

AGMs will provide an early test of whether FY27 guidance remains credible amid more challenging macroeconomic conditions. As much of the guidance issued in August predated the latest monetary policy tightening, updated commentary should offer a clearer view of the impact of higher funding costs and softer demand on earnings.

Our focus will be on demand, pricing power, cost control and capital discipline. Consumer, housing-linked and leveraged domestic companies appear most vulnerable as weaker discretionary spending, slower housing activity and higher interest costs place further pressure on earnings.

The detail underpinning guidance will matter as much as the headline numbers. Second-half weighting, delayed customer decisions, discounting, cost pressure or weak cash conversion could prompt earnings downgrades even if guidance is maintained. By contrast, companies that reaffirm their outlook with clear evidence of trading momentum should outperform. Markets are likely to favour durable earnings and punish even minor disappointments in high-conviction stocks.

Governance should also contribute to stock dispersion. We'll assess whether remuneration reflects shareholder returns and delivery, incentive hurdles remain demanding, and boards have addressed previous dissent, operational failures or poor capital allocation. Director elections and board renewal will face greater scrutiny where performance has disappointed. Persistent opposition may point to weak accountability and sustain a governance discount.

Signal	What we want to hear	Red flag	Market implication
Revenue	Resilient volumes; firm prices	Deferrals; discounting	Cyclical revisions
Margins	Productivity offsets cost increases	Wage/input pressure	Quality premium
Guidance	FY27 reaffirmed or up/ downgraded	Caveated outlook	High stock dispersion
Capital	Disciplined capex; flexibility	Leverage increase/ funding needs	Rate-sensitive downside
Governance	Aligned pay; orderly renewal	High dissent; weak oversight	Governance discount

Why should I care?

AGM season should create stock-specific opportunities rather than set the market's direction. A sustained re-rating requires resilient guidance and confidence that rates are near their peak. Until then, restrictive financial conditions and demanding valuations leave little room for disappointment.

Companies with resilient earnings, balance sheet flexibility and strong governance are likely to fare relatively better. The ability to defend margins through pricing, productivity and cost discipline, rather than rely on recovering demand, will be viewed positively by the market. Highly valued stocks requiring flawless execution, but with earnings risk, remain vulnerable.

Stock dispersion should remain high. Banks face funding, housing and credit risks; retailers must defend volumes and margins; and leveraged sectors remain rate-sensitive. Selected resources and offshore earners offer diversified exposure and some protection from a slowing domestic economy, while A-REITs may also add diversification.

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