Quarterly Market Update

"AI of the needle"

Can markets navigate a technological revolution against a backdrop of rising tension

June 2026

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JACARANDA FINANCIAL PLANNING | Perpetual

Contents

Executive Summary

2026 has not been for the faint hearted. The world continues to navigate a technological revolution in artificial intelligence (AI), with historic levels of capital investment chasing data center build-outs, GPU and memory chip acquisition and agentic compute solutions.

Whilst the proclamations of the mass replacement of human workers has not yet come to pass, much of the corporate landscape is feverishly rushing to unlock productivity gains and identify new competitive edges before that of their peers.

In the meantime, the geopolitical landscape proves to be challenging, with the Iran war continuing, and little end in sight. Despite a 'memorandum of understanding' being sold as a deal; at the time of writing, it is already seemingly in the dustbin of history just a few short weeks after it was signed. Iran's behavior suggests that they have now determined that control over the Strait of Hormuz is as important as any nuclear program, and a key way for them to exert themselves on the world stage and potentially fund a rebuild, post hostilities.

President Trump, true to form, continues to fight fire with more and more fire. Whilst in hindsight his 'blockade of a blockade' proved to be an important enhancement of US leverage, much of his maximum pressure campaign appears to only be further entrenching the hardliners of the Iranian regime.

As a result, energy markets continue to be disrupted, alongside much of the commodities complex. Indeed, the two ends of the risk spectrum – AI's emergence and the Iranian conflict – are both inflationary for raw materials. Data centres driving demand whilst a closed Strait, constrains supply.

Interestingly, markets continue to prove remarkably resilient. Whilst it is fair to say that companies, particularly the key beneficiaries of the AI thematic, are showing impressively strong earnings growth, the world is growing increasingly risky. Additionally, it is not overwhelmingly difficult to find examples of earnings quality falling.

With the US mid-term elections just a few short months away, it does not seem likely that the investment outlook will become less confounding any time soon. As Donald Trump is already ramping up claims around the security of elections, it feels all but certain that the political temperature will continue to be elevated.

Additionally, AI related companies, are likely to face an increasing level of scrutiny. Providers, such as Open AI and Anthropic, are going to need to start demonstrating a return on the billions of dollars of investment, as it's clear that sources of funding are becoming dubious about the continued cash burn of these businesses.

As a result, the path ahead is likely to be bumpy. Similar to what we noted last quarter, there is a high level of potential for upside, but also some pretty concentrated risks that could drive a meaningful correction in markets.

Our mindset as we look towards the end of the year, is to embrace diversification where we can find it, and keep a good degree of powder dry for the moment the clouds part and the environment warrants more determined investment positioning.

Asset class snapshot

Australian equities

Australian equities recovered over the June quarter, with the S&P/ASX 300 returning +4.1%[1] as easing concerns around Middle East tensions and lower oil prices supported constructive risk sentiment. From a style perspective, Growth (+3.7%[2]) modestly outperformed Value (+3.4%[3]), while small caps (+3.3[4]) slightly lagged the broader market as higher funding costs and weaker domestic demand continued to weigh more heavily on smaller companies. Sector performance was led by Consumer Discretionary (+18.0%[5]) and Information Technology (+17.4%[6]). In contrast, Energy (-16.7%[7]) was the weakest sector as oil prices retreated, while Utilities (-6.6%[8]) and Health Care (-6.1%[9]) lagged.

International equities

International equities rebounded strongly over the June quarter, with the MSCI All Country World Index returning +13.6%[10] as easing concerns around Middle East tensions and energy supply disruptions allowed investor focus to shift back toward corporate earnings and AI-related growth. From a style perspective, Growth (+17.5%[11]) materially outperformed Value (+8.0%[12]), driven by semiconductors, cloud infrastructure and data centres. Sector performance was led by Information Technology (+37.5%[13]), while Energy (-14.0%[14]) lagged as oil prices fell. Regionally, the S&P 500 (+13.8%[15]) and Japan's Nikkei (+32.9%[16]) drove Developed markets, and Emerging Markets (+22.6%[17]) outperformed on strong Korean and Taiwanese technology exports. China's Hang Seng Index (-7.6%[18]) remained a notable weak spot.

Real estate

Listed real estate rebounded as expectations for further rate rises moderated. The S&P/ASX 300 A-REIT Index returned 13.5%[19], with Goodman Group (+22.5%), ~40% of the benchmark) doing most of the heavy lifting on the back of continued data-centre enthusiasm. Globally, REITs also delivered positive returns, with the FTSE EPRA Nareit Global Index gaining +7.3%[20] in AUD terms. Regional outcomes remained mixed, with the US (+10.6%[21]) leading returns, while Hong Kong (-9.2%[22]) and Japan (-7.9%[23]) lagged as energy-related pressures and softer economic conditions weighed on sentiment.

Growth Alternatives

Private markets continued to exhibit a growing divergence between managers, with specialist and operationally focused investors increasingly differentiating themselves from the broader market. In private equity, higher financing costs supported a continued shift towards lower leverage and greater emphasis on operational value creation, with sector specialists in areas such as technology and health care attracting increased investor interest. Private real estate transaction activity improved as valuation pressures stabilised, although allocator demand remained subdued and traditional sectors continued to face headwinds. In contrast, data centres, specialist housing and social infrastructure attracted strong capital flows. Infrastructure remained well supported by demand for inflation-linked assets, energy security and digital infrastructure, while increased dispersion across equity and credit markets created a favourable backdrop for select hedge fund strategies focused on relative value and asymmetric return opportunities.

Defensive Alternatives

Defensive alternatives navigated a mixed quarter, with investor attention increasingly focused on the rapid growth of AI-related financing and its impact across debt markets. Within private credit, deal activity remained constrained as private equity exits and sponsor-led transactions stayed subdued, contributing to slower principal repayments and longer holding periods. Broadly syndicated loan markets stabilised as default activity moderated and liability management exercises declined, supporting a more constructive outlook. Elsewhere, private debt secondary markets continued to grow as investors sought additional liquidity options. Australian floating-rate credit, catastrophe bonds and insurance-linked investments remained attractive diversifiers, providing exposure to income-generating assets with relatively low correlation to traditional equity markets.

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Fixed income

Fixed income markets recovered over the June quarter as easing concerns around energy-driven inflation and a moderation in rate expectations supported bond prices. In Australia the Bloomberg AusBond Composite returned +2.7%[24] for the quarter and +1.5% over twelve months. Credit also performed well, with the Bloomberg AusBond Credit Index returning +2.5%[25] for the quarter and +2.8% over the year, while floating-rate credit gained +1.4%[26] and +4.9%, respectively. Globally, bond markets were supported by easing oil prices and lower sovereign bond yields. The Bloomberg Global Aggregate returned +1.5%[27] (AUD hedged), while Global Investment Grade credit returned +2.0%[28] and Global High Yield outperformed with a gain of +3.8%[29], with credit spreads tightening as recession fears eased.

Australian Cash Rate

The RBA continued its tightening cycle over the quarter, lifting the official cash rate by 25 basis points to 4.35% in May before pausing in June. The May decision passed by an 8–1 majority, reflecting concerns around persistent inflation, elevated energy prices and a tight labour market, while the June hold was unanimous as the Board opted to assess the impact of prior tightening. While headline inflation eased alongside falling oil prices, underlying inflation remained elevated, supported by housing and services-related price pressures. As a result, the RBA maintained a data-dependent approach, with markets continuing to price a higher-for-longer interest rate environment.

Australian dollar

The Australian dollar (AUD) appreciated modestly over the June quarter, rising 1.2% against the US dollar (USD) to finish near US$0.69. AUD/USD reached quarter-highs near US$0.73 in early May as the RBA continued tightening while markets anticipated a more accommodative Fed. Those gains faded as escalating Middle East tensions, softer risk sentiment and a more hawkish-than-expected US Federal Reserve prompted a broad rebound in the US dollar, eroding the AUD's rate advantage.

Refer to footnotes description on page 30

A solution in search of a problem

Artificial Intelligence (AI) is everywhere. Having murmured along as a niche branch of computer science for decades, mostly confined to the halls of academic research; it exploded into public consciousness in the opening weeks of 2023, somewhere between the launches of OpenAI's Chat GPT 3.5 and 4.0. models.

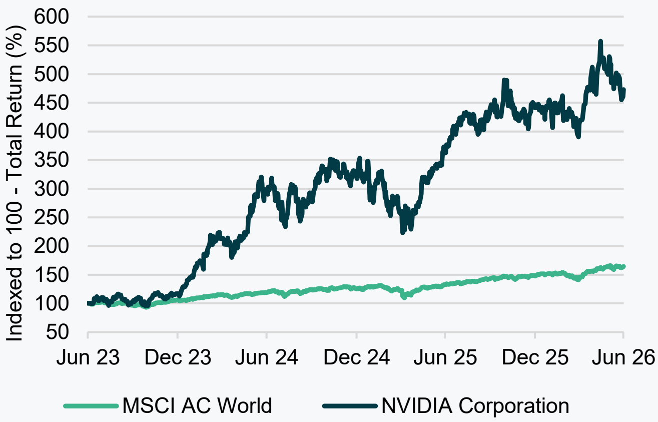
LLMs (otherwise known as Large Language Models) are the primary technological branch of what most people are referring to when they talk about AI, and in three short years, they have absolutely proliferated. As a ready example, the mobile phone in your pocket has multiple layers, exposures and variants of AI. Whether to enhance photographs, categorise emails, act as a personal assistant, improve web searches, or just simply working as a reference library, the plethora of different AI services that now compete for your attention can be maddening.

Indeed, it would be fair to speculate that the current iteration of AI has generated the fastest adoption of any new product or service in human history. Chat GPT for instance grew to 100m active monthly users in just 2 months, faster than any consumer application in history, and growing to 900m just a year later.

Such is the impact of this technological revolution, that just as it has in our everyday lives, the impact of AI has permeated through most if not all parts of business and the global economy.

Perhaps the best 'poster child' of the AI boom is Nvidia. Nvidia has grown from being a relatively successful business selling graphics cards to video gamers, to one of the most important technology providers in the world, from both an economic and a geostrategic point of view.

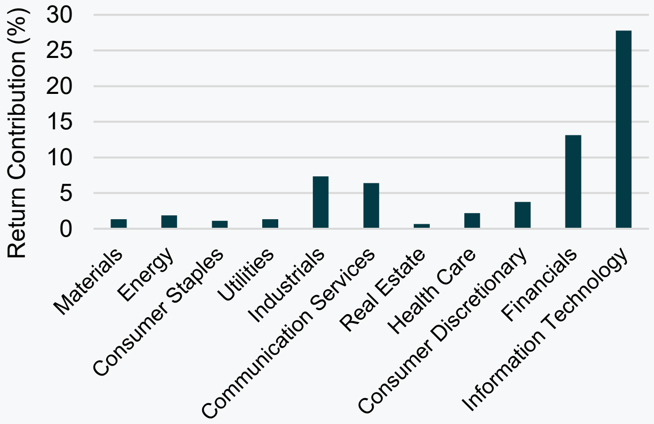
Figure 1 – Nvidia vs the World



Source: FactSet. Data as of 30 June 2026.

However, Nvidia is not on its own. It has been joined by a raft of related businesses, all of whom have grown at rates approaching exponential. It's worthwhile noting, that in spite of us talking so much about the growth of AI across all aspects of modern life, the two companies who are the most synonymous with the technology, Anthropic (provider of the Claude series of models) and Open AI, are currently not even listed on capital markets. Even without them though, assets linked to the AI thematic, whether they be shares of companies in developed markets, emerging markets, investment grade credit, real estate (via data centres) and numerous sectors within the alternatives space; now dominate investment flows and market outcomes. If we were to remove the performance of these areas from market returns over the past few years, in many cases, the remaining outcomes could only be described as tepid, at best.

Figure 2 – Information Technology Contribution to the 3-year MSCI ACWI Return to 31 December 2026



Source: FactSet. Data from 31 December 2023 to 31 December 2026

With so much of our fortunes tied to this single factor, it is sensible to contemplate its drivers and their trajectory. To that point, it is also worth considering what areas might provide protection should this meteoric rise hit an air pocket.

To infinity and beyond

In order to ascertain the sustainability of the AI thematic, it's important to address the 3 crucial aspects that are known to sustain the longest and most stable new trends:

- Technological benefit – does the technology produce an inherent economic benefit?
- Economic efficiency – does the economic value provided by the technology generate more economic value than it costs?
- Market expectations – does the market's valuations match a sober analysis of its technological benefit and its economic efficiency?

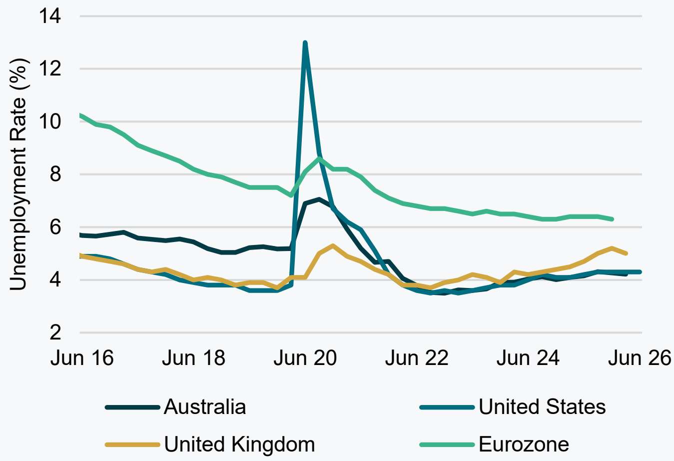
Technological benefit

The technological benefit of AI is a crucial question. It essentially asks, is there a 'there' there?' Is it a useful and advantageous tool, or is it a just a novelty?

What is clear to anyone who has entered a query into Chat GPT, Claude, Grok, Gemini or any of the other publicly available LLMs, is that the technology is impressive. The ability to ask a question in plain language, and receive back a valid and detailed answer (or picture, or video or computer program), is impressive by any pre-2023 standard. When we consider the clunky chatbots of the years prior, the ability of AI to so readily and fluently handle natural language requests, quite simply, feels like magic. The essential consideration however, is 'is the technology efficient enough and reliable enough, to replace or enhance human labour?'

The outcome here is clear. It is not. Not yet, at least. The ways we are able to know this are multiple. The easiest and cleanest way is to simply look at labour markets.

Figure 3 – Global unemployment



Source: FactSet, ABS, BLS, ONS, Eurostat. Data as of 30 June 2026.

Despite a seemingly constant stream of AI CEOs talking about how many human jobs would be replaced in just a few years, they are now rapidly rowing back such comments. To this point, in May of this year, Open AI's Sam Altman noted in an interview with Time Magazine "I thought there would have been more impact on entry-level white-collar jobs being eliminated by now than has actually happened." Similarly, and again, coding is the strongest current use case for AI, Anthropic's Dario Amodei noted in March 2025 "In three to six months, AI is writing 90% of all the code", this still hasn't been achieved over 12 months later.

Businesses are by necessity, economically rational. As such, if the application of AI had allowed them to reduce their human capital, they would have. The fact that they have not is a clear signal. We can extrapolate this outcome further by recognising that for many applications, the tools are available at or near to free. Therefore, we know that current levels of adoption and implementation are highly unlikely being held back by cost – but effectiveness – essentially a function of reliability.

Indeed, if you consider most commercial provisioning of LLMs to consumers, most can ultimately be described as enhanced, though still flawed, chat bots. Far better than previous iterations but still, far more frustrating than dealing with a human doing the same job. To this point, there are examples abound of large corporations who have attempted to replace chunks of their workforce with AI, only to have to rehire them later. CBA, IBM, and Ford are all examples of companies who went through this. The CEO of Afterpay competitor Klarna, had a similar experience and found their use of AI to be detrimental to their customer relationships, acknowledging "Cost unfortunately seems to have been a too predominant evaluation factor ... what you end up having is lower quality."

The rise of what is known as 'vibe coding' is a clear example of this. That someone with zero programming experience can quickly and by making simple instructions in their natural language, create applications is immensely impressive on its face. What is missed here though, is that AI is simply providing another layer to the coding process rather than revolutionising it as such. Linus Torvalds, one of the godfathers of modern computing, recently compared AI coding to another long-established programming tool, the compiler. Just as compilers automated the translation of source code into machine code without eliminating the need for programmers, AI automates parts of software development without removing the need for humans to understand architecture, logic and system design. In the interview at the Open Source Summit in May, he noted "AI is a great new tool, but it's a tool, and when I see people saying, 'Hey, 99% of our code is written by AI,' I literally get angry, because those same people — I can pretty much guarantee — that 100% of their code is written by compilers. But they never say that."

Economic efficiency

In the absence of a clear and immediate technological benefit, the next question becomes, 'does the technology produce more value than it consumes'? Here the record is also pretty spotty.

In the past few years, more than two trillion dollars have been invested or committed to AI infrastructure, primarily in the form of data centres. In fact, according to leaked financials from OpenAI, the best known provider of AI, it lost nearly $38bn ($20.9b on an operating basis) against revenue of $13.1bn in the past 12 months.

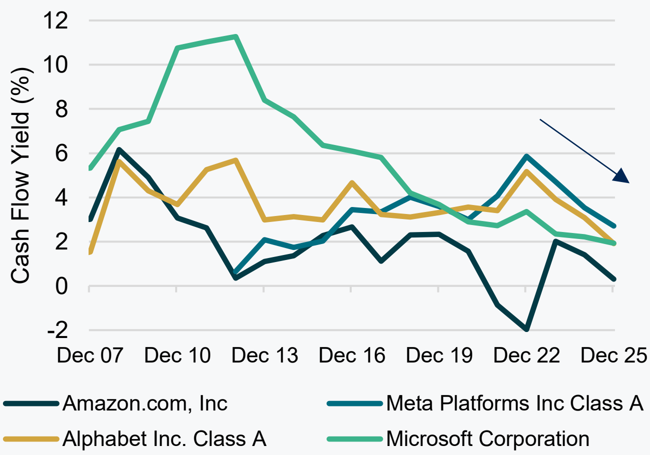
These are astoundingly large numbers and places this phenomenon as the largest capital investment undertaken in modern human history (and perhaps even beyond). The Tech sector is not unfamiliar with the concept of spending significantly well in advance of being validated by revenue. Amazon was unprofitable for years, as were Facebook, Google and many of the large tech companies that are staples of today's business landscape. With that said, this particular iteration is different. Whereas previous technological booms have been centred around moving traditional (and commercially validated) activities onto the internet – i.e. shopping on Amazon, social interaction on Facebook/Meta, transport on Uber; at the moment, AI is mostly being used as an enhanced search engine for the aggregation of knowledge. Sure, the application to coding is impressive, but the problem is that for these use cases, it is expensive and still leaves much to be desired in the quality and cyber security of its output. In the words of one of Anthropic's co-founders, "when I look at the code, I'm horrified". This is not at all useless. It just doesn't come close to justifying the immense investment that it has commanded.

Market expectations

What is particularly interesting is when we contemplate free cash flow yields (Figure 4) or even the price/earnings multiples (Figure 5) of the hyperscalers, we see companies producing lower levels of cash flow and becoming cheaper on a forward earnings basis. Defenders of the ongoing strength of the AI thematic point to this as clear evidence that we are not yet near the end of this current boom. We interpret this another way. Multiples are coming down because markets are concerned about the sustainability of current earnings. For instance, Microsoft's Q2 2026 earnings were almost 25% higher due to an increase in the value of their investment in OpenAI. More broadly, reported earnings across the sector are increasingly being supported by accounting treatments and assumptions that deserve closer scrutiny. The AI build-out is occurring through an unprecedented wave of capital investment, much of which is currently being capitalised on balance sheets rather than expensed through income statements. This has the effect of boosting current earnings while deferring part of the economic cost into future years through depreciation.

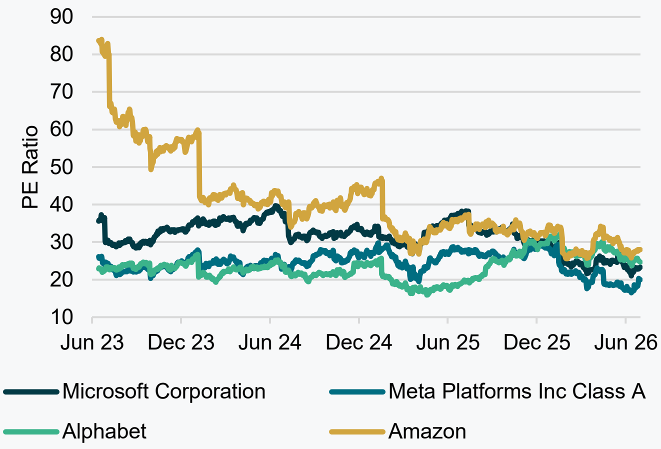
At the same time, revenue growth has yet to demonstrate a commensurate acceleration relative to the scale of investment being undertaken. Investors are therefore being asked to assume not only that AI will prove commercially valuable, but that it will ultimately generate returns sufficient to justify hundreds of billions of dollars of investment. In our view, this is not a valuation bubble in the traditional sense. Rather, it is an earnings expectations bubble, one that assumes an extraordinary level of future profitability that has yet to be demonstrated. Let's not forget, the vast majority of AI at the moment is substantially if not entirely subsidised by its providers.

Figure 4 – Hyperscaler Free Cash Flow Yield (%)



Source: FactSet. Data as of 31 December 2025

Figure 5 – Hyperscaler 1-Yr Forward P/E ratios



Source: FactSet. Data as of 13 July 2026

What will it leave behind

A central element of the AI boom is the immense amount of capital investment it is consuming. Whilst we address this above from a corporate profitability point of view, its macroeconomic and societal impacts are equally meaningful.

At its very core, computing power is energy hungry. It seems to have gone somewhat unnoticed, but expected electricity consumption has adjusted upwards by orders of magnitude. By some measures, the amount of power required just for the data centres currently planned and under construction, is greater than all of the power currently being produced. As a result, we are seeing a rapid build out in energy infrastructure. This is an inherent societal good, something that is likely to reduce future energy costs whilst increasing energy security across entire economies, particularly once it achieves an overbuilt state (historically most infrastructure booms result in significant excess capacity).

Similarly, compute is also being built out in a substantial way. Data centres have seen hundreds of billions of dollars in commitments in the past few years, with McKinsey expecting growth to continue at around 20% per year through 2030. In our increasingly modern world, computing power is becoming just as important a commodity as many other key business inputs. As such, the build out that is currently being conducted to support AI, can readily be repurposed for other business support functions, or even provide a platform for supporting self-hosted open source models, something which would ultimately feed into some variant of Jevons paradox, whereby falling costs generate increased use.

Whether they can create cures for cancer or completely revolutionise business, remains to be seen. What is clearly evident, is that LLMs are a useful technology. Whilst some of the more advanced models, such as GLM 5.2 are clearly impressive, they are not currently feasible for home use given their hardware requirements. With that said, there are many small model variants that can be run on consumer hardware and perform to a level sufficient to be useful. As such, whether today's major model providers survive in their current form, does not matter. Their legacy will live through the models they both provided, as well as in those open-source equivalents that were generated to compete with the commercial models and will themselves ultimately prove to be a public good.

What today's environment is ultimately generating is a massive boom in computing infrastructure. Just as the railroad boom of the 1840s and 1850s and the TMT build-out of the late 1990s left behind far more infrastructure than the market immediately required, today's AI boom is likely to do the same. Many of the investors who funded those earlier eras earned disappointing returns, but society inherited railways, fibre networks and communications infrastructure that underpinned decades of future economic growth. Whether today's AI investments ultimately justify their cost remains unclear. What seems far more certain is that society will inherit an unprecedented stock of computing capacity, energy infrastructure and digital capability that will continue generating economic benefits long after the current investment cycle has passed.

Winners and losers

Ultimately, we agree that we are undergoing a generational step-change in technology. We have zero doubt that AI will remain pervasive throughout our society and the global economy. Where we think it's important to add nuance, is that the halo of the theme is fading. Moving forward, investors will increasingly deem that it is no longer enough for companies to simply embrace the technology. It's going to become increasingly important that it demonstrates meaningful economic value. The maturing of this theme in the market's purview, is important and will ultimately lead to winners and losers, with an immense gap between the outcomes for both.

The ripple effects from the pending reckoning will almost certainly be turbulent. With so much of the current market structure resting on AI, its rationalisation will undoubtedly generate investment and economic air-pockets, some of which may trigger cascades in the market pricing of certain elements of financial risk. Just as a slowing housing market, ultimately threatened the entire international banking system, so too can the months and years ahead see the aggregation of risks, accrue to previously unexpected areas of investment markets.

Our base case however is somewhat more benign but still presents its fair share of challenges. Here, we see the likely path as one of significant rationalisation. Put simply, we still lack a 'killer app' for AI, something that inherently justifies its economic existence. Over the coming months and years, it is going to need to find an economic edge and be adopted by those who can achieve a meaningful commercial benefit from its use, not just those experimenting with minor enhancements to team spreadsheets. This may be some new form of business, or an enhancement of an existing one. What is for sure though, the heavy degree of subsidisation from LLM providers is unsustainable and the period of grace for AI related businesses is coming to an end.

AI of the Needle

On paper, the June quarter should have been a difficult one for investors. It opened with the United States and Israel still trading blows with Iran, the Strait of Hormuz barely navigable, and oil threatening to make a genuine mess of the global inflation picture. The interest rate backdrop had turned less friendly too. The Reserve Bank of Australia had already lifted rates twice earlier in the year and moved again in May, while offshore there was a similar hawkish turn, with markets that had spent much of the past year anticipating US rate cuts now positioning for the possibility of hikes. Against a backdrop like that, you would ordinarily expect risk assets to come under pressure and global growth to falter.

Instead, they climbed. Global shares finished the quarter at record highs, returning 13.6%[10] for the period. Credit spreads held firm, and the anxiety that had gripped markets in March faded almost as quickly as it arrived. In many respects it was a continuation of the pattern we described last year in our "Shock and yawn" piece: markets in aggregate absorbed a barrage of bad news and simply moved on.

However, if you strip out a handful of companies tied to artificial intelligence that did exceptionally well throughout the quarter, the returns look decidedly more muted. AI has become the market's centre of gravity, the source of its earnings growth, its momentum and, increasingly, its risk.

It is this tension we explore in this edition of our Quarterly Market Update. The resilience is real, underpinned by genuine earnings growth and a still-healthy global economy. Yet the market's growing dependence on a single theme has left it threading an ever-narrower path, one where the rewards remain considerable, though it would not take much for the good times to unravel.

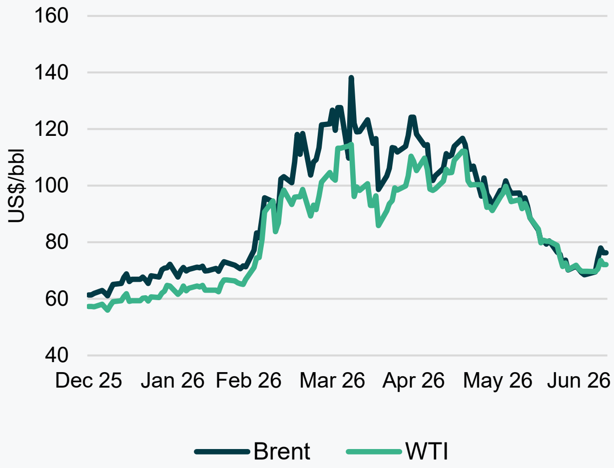
Refer to footnotes description on page 30

The war premium unwinds

For a few weeks in March, before this quarter had even begun, it looked as though the year would be defined by the Middle East. The conflict between Iran and a US-Israel coalition had pushed oil above US$100 a barrel and raised the prospect of a sustained energy shock capable of undoing two years of progress on inflation. Roughly a fifth of the world's seaborne oil passes through the Strait of Hormuz, along with a meaningful share of global LNG and critical inputs such as urea, aluminium and helium. Any prolonged closure carried the potential to reverberate well beyond energy markets.

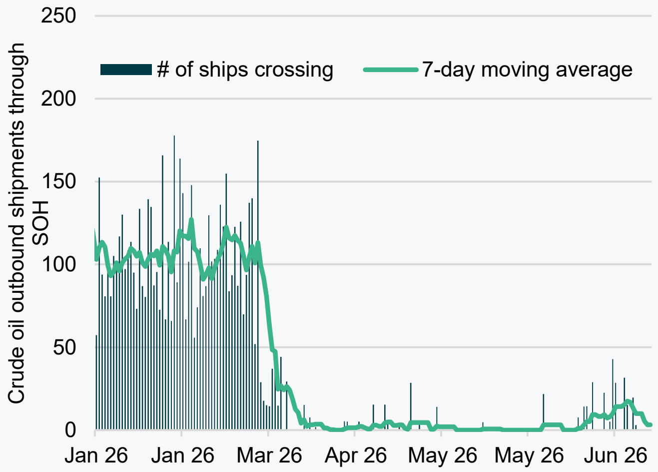
An early-April ceasefire proved fragile, holding only loosely as sporadic fighting continued for weeks, and a formal memorandum of understanding was not signed until June. However, markets needed little encouragement to look beyond the conflict. As traffic through the Strait gradually resumed - though it remained well below pre-war levels - the worst-case scenarios failed to materialise. Oil retraced its entire war-driven spike, with the spot price settling back below US$70 a barrel by quarter's end. Gold, which had surged earlier in the year on safe-haven and strong retail demand, also gave back ground as the geopolitical premium faded.

Figure 6 – Oil prices (US$/bbl)



Source: FactSet. Data as of 10 July 2026.

Figure 7 – Crude oil outbound shipments through the Strait of Hormuz



Source: World Trade Organization. Data as of 10 July 2026. Note, only AIS-Traceable Vessels travelling outside the Persian Gulf have been recorded

Falling commodity prices were a mixed blessing for Australia. Lower oil helped take some of the heat out of near-term inflation and, with it, some of the pressure on the RBA. A broader softening across the complex, with iron ore slipping back below US$100 a tonne, weighed on the terms of trade that underpin so much of the domestic economy.

There were also good reasons to expect the calm to hold. With US mid-term elections approaching, there was little political appetite in Washington for a war that voters had never much supported, nor for the higher petrol prices that came with it. At the end of the quarter, at least, the incentives pointed towards de-escalation.

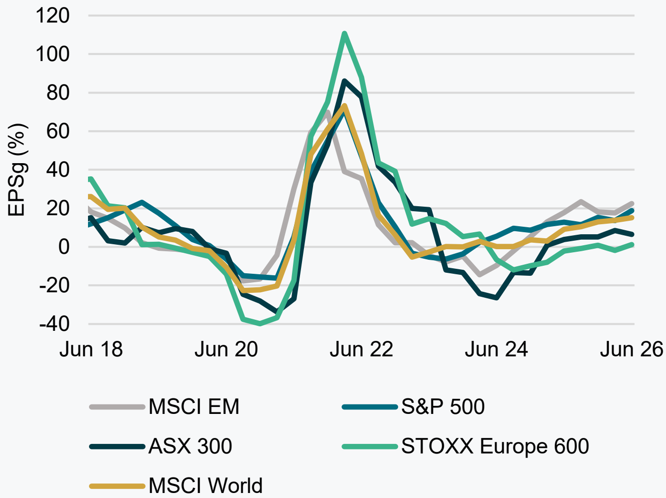
Those incentives have not entirely held, however. A memorandum of understanding is a long way from a durable peace. As we write, the calm has already fractured, with fresh Iranian attacks on shipping and renewed US strikes a reminder that the underlying conflict remains unresolved. Markets have handed back some of their earlier optimism without fully pricing in a sustained re-escalation, leaving the Middle East as one of the clear risks to the second half of the year. That markets could absorb an energy shock of this magnitude and still finish the quarter at record highs owed much to what was happening elsewhere.

The thread holding it together

If the Middle East was the quarter's loudest story, artificial intelligence was its most important. The companies tied to the theme did much of the heavy lifting in dragging the market back to record highs, and the strength of their earnings was the clearest reason the rebound proved so durable.

Following the first-quarter US reporting season, annual earnings growth for the S&P 500 came in around 18%, close to double its long-run average. More than four in five companies beat expectations. The technology names captured the headlines, though the result was broader than that, with a wide range of sectors delivering solid numbers against a still-healthy economic backdrop and gross margins continuing to expand.

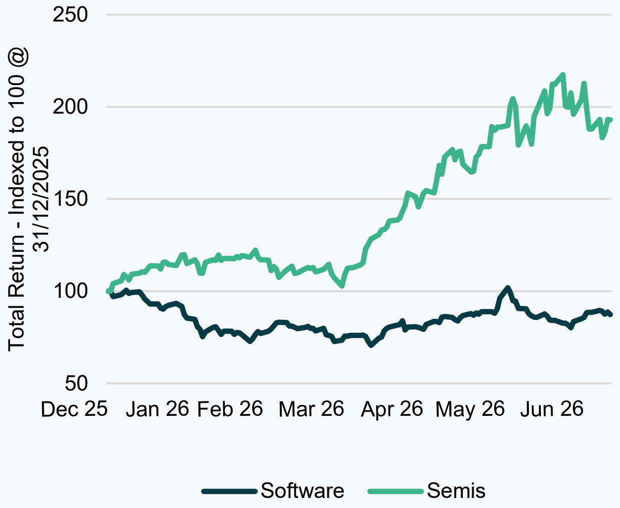
Figure 8 – Earnings per share (EPS) growth YoY%.



Source: FactSet. Data as of 30 June 2026..

What has shifted is the character of the trade. Where earlier phases rewarded almost anything with a plausible link to AI, investors have become far more discerning, concentrating on the "picks and shovels" of the buildout: the semiconductors, memory manufacturers, data-centre operators and component providers that supply its raw materials. Memory chips have been the standout. Some spot prices rose as much as six- to nine-fold over the past year, and several companies linked to the thematic joined the US trillion-dollar club, as demand for the hardware behind AI comfortably outran supply.

Figure 9 – US Software vs Semiconductors



Source: FactSet. Returns are in USD. Data as of 10 July 2026. IGV: iShares Expanded Tech-Software Sector ETF, SOX: iShares Semiconductor ETF. Past performance is not indicative of future performance.

Software told the opposite story. The rapid arrival of more capable, agentic AI tools raised uncomfortable questions about whether parts of the sector might be disrupted by the very technology driving the boom. This prompted a sharp fall beginning in February, across a number of previously highly valued businesses in an episode some labelled the "SaaSpocalypse". Within the one trade, investors are seeking to distinguish between the likely winners and losers.

The scrutiny by investors has grown louder in other ways too. Questions around the return on the enormous sums being invested, the durability of pricing as computing power becomes more commoditised, and the competitive threat from lower-cost and open-source models have all gathered pace. Tellingly, that caution has shown up in earnings rather than valuations. Even as profits across the AI supply chain have surged, many of these companies trade at a discount to the broader market, with investors already anticipating an eventual peak in the cycle. It is a dynamic that suggests the risk of an earnings bubble is building rather than a valuation one.

For all the debate about returns, the theme now carries serious economic weight. The sums involved are enormous, with cumulative AI infrastructure investment estimated at three to five trillion US dollars over the second half of this decade . That spending, directed towards data centres, power and computing capacity, has become a meaningful driver of activity in its own right. It helps explain why the economy, particularly in the US, has held up as well as it has, even as the outlook for interest rates has moved firmly in the other direction.

Higher for longer, again

Another important shift took place not in equity markets but in the outlook for interest rates. Having spent much of the past year expecting the US Federal Reserve to begin cutting, investors found themselves recalibrating in the opposite direction. By quarter's end, markets were pricing close to an 80% chance of two hikes over the coming year. It was a familiar lesson. For close to two years now, markets have repeatedly assumed a faster and deeper easing cycle than central banks were ever likely to deliver, and time and again they have been proven wrong.

Some of this is cyclical. Core inflation across most major economies remains stubbornly above target, and the energy shock earlier in the year was a reminder of how easily progress can stall. However, the more important driver, is structural. As governments increasingly prioritise national resilience over globalisation, from energy security to supply chains, to the sizeable investment now flowing linked to artificial intelligence, the global economy is hot. That combination of persistent demand and recurring supply disruptions raises the floor under inflation, and with it the level at which interest rates are likely to settle.

Despite expectations, Kevin Warsh's debut as Federal Reserve Chair did little to soften that message. His first meeting was read as distinctly hawkish, and his reluctance to offer forward guidance left markets to draw their own, more cautious, conclusions. Our own sense, however, is that the Fed is more likely to hold than to hike. Beneath a run of solid payrolls numbers, the US labour market looks softer than the headlines suggest, and there is little evidence that higher energy costs are feeding through into broader prices. The more probable path may therefore be one of careful communication rather than action, talking tough on inflation one month and sounding more relaxed the next, while leaving rates exactly where they are.

The view from home

For Australian investors, the global story arrives with a domestic accent. The Reserve Bank finds itself in a considerably more difficult position than the Federal Reserve, entering this year's energy shock with inflation already above its 2–3% target. Having lifted the cash rate to 4.35% by May, the RBA has good reason to lean hawkish. Underlying inflation is running near 3.6% , and the Bank itself does not expect it back within its own target until well into 2027. Markets now put the odds of a further increase before year-end at close to even, and the June quarter inflation figures, due shortly, loom as the decisive input into that call.

Households are already feeling the weight of tighter policy. Consumer sentiment has fallen to historic lows, spending has stalled in real terms, and the housing market is cooling, aided by the investor tax changes announced in the Federal Budget, which are expected to reduce turnover by around a fifth and deliver a modest price correction. The wider growth picture is subdued, with the economy expected to slow to 2% by year-end.

The equity market told a similar story of underperformance. Australian equities returned a respectable 4.1%[1] over the quarter, yet that was a fraction of the 13.6%[10] delivered offshore. Much of the gap comes down to what our market is made of. Where global indices are increasingly powered by technology and the AI buildout, the local benchmark is dominated by banks and miners, neither of which participated in the same way. The major banks lagged as concerns around credit growth and housing mounted. The resources sector, though supported by firmer commodity markets, lacks the earnings momentum driving the technology names abroad.

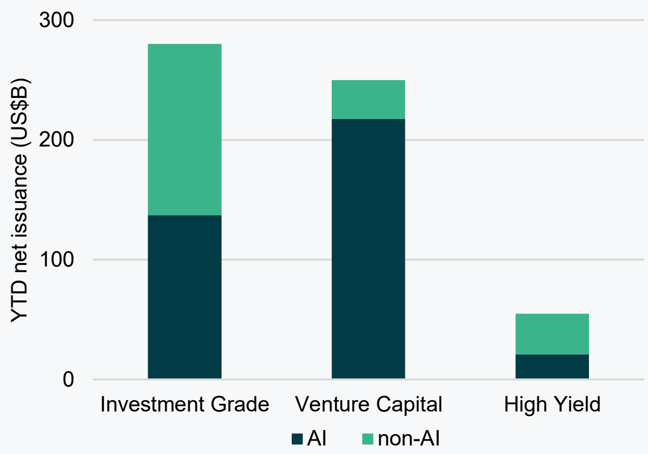
Australia is not entirely absent from the theme. The data-centre and electricity investment boom has become a feature of the domestic economy in its own right, and pockets of the listed market, from industrial property to select infrastructure, offer direct exposure to it. It remains, however, a smaller slice of a market whose fortunes are still tied more closely to interest rates, housing and the price of iron ore than to any chip maker.

The allocator's dilemma

For investors, this concentration creates an awkward problem. For much of the past several decades, the standard response to a concentrated equity market has been to diversify, spreading risk across regions, asset classes and styles. That instinct is sound, yet it is becoming harder to act on, because the AI theme no longer lives in equities alone.

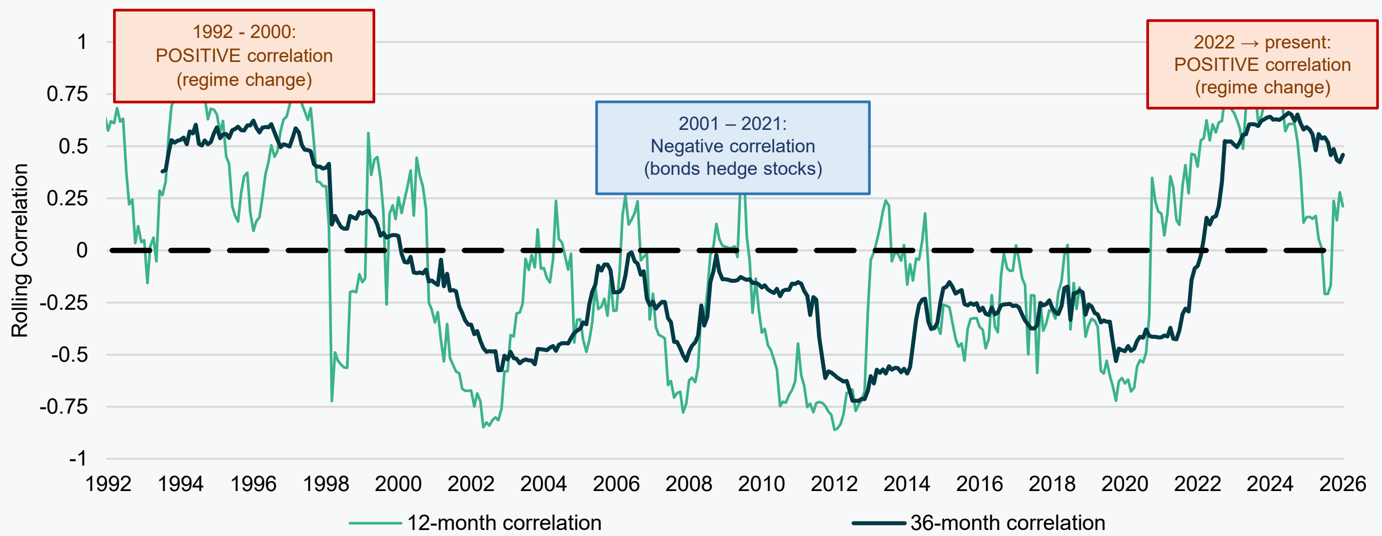
Its reach now extends across the capital structure. The enormous sums being committed to data centres, chips and power are increasingly funded in the bond market. A wave of issuance from the largest technology companies is flowing into investment-grade credit. Private markets carry their own exposure. Even the relationship between shares and bonds, long relied upon to steady a portfolio, has been shifting, with the two moving together more often as a common set of forces drives both. In part, this reflects inflation becoming a more important driver of markets than growth. When central banks are focused on inflation, shocks can reverberate through equities and bonds simultaneously, weakening the diversification benefits of holding both. A portfolio that looks well diversified on a spreadsheet may, in practice, be making a far larger bet on the same underlying factor exposure than its owner realises.

Figure 10 – YTD net issuance split: AI vs. Non-AI by channel (US$B)



Source: Tal Barak Harif, Goldman Sachs, JP Morgan, Bloomberg, Crunchbase, Apollo Analyst, Apollo Chief Economist.

Figure 11 – Positive stock-bond correlation



Source: FactSet. Data as of 30 June 2026. S&P 500 TR and Bloomberg US Treasury TR indices. Returns in USD. Past performance is not indicative of future performance.

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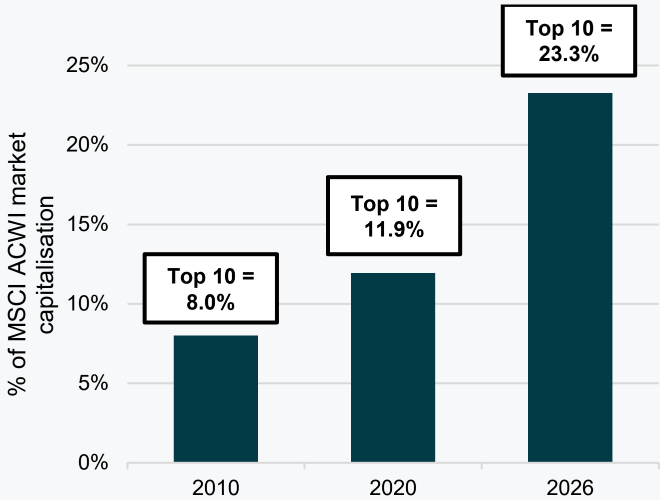
Compounding the issue is the sheer weight of a handful of names at the top of global indices. The ten largest companies in the MSCI All Country World Index have swelled from around 12% of the benchmark at the end of 2020 to 23% by quarter-end, a degree of concentration without recent precedent. For the rising share of money invested passively, that exposure is inherited automatically, whether or not the investor holds any view on AI at all.

Figure 12 – Top 10 MSCI ACWI companies by market capitalisation (%)



Source: FactSet. Data as of 30 June 2026

This is where the distinction between an earnings bubble and a valuation one matters. If the vulnerability lies in earnings rather than valuations, a disappointment need not begin with a dramatic collapse in share prices. It could arrive through a downgrade to the profit expectations on which so much now rests, and from there ripple outward across every corner of a portfolio exposed to the theme. None of this argues for abandoning the trade, which continues to be underpinned by strong earnings and heavy capital spending. It does, however, change what genuine diversification looks like.

Threading it from here

This is a more rewarding environment than usual, and a riskier one, and the two are inseparable. Markets are being carried higher by earnings growth and a still-resilient global economy, yet the same forces that have driven returns have also left portfolios more concentrated, more correlated and more dependent on one theme than at any point in recent memory.

We are not retreating. We are being deliberate, in keeping with our "protect and grow" philosophy. The first priority is selectivity. In a market this narrow, the gap between the winners and the also-rans is unusually wide, which is precisely the environment in which disciplined active management should earn its keep, even if the past few years have tested that conviction. The second is genuine diversification, by which we mean spreading risk across exposures that will actually behave differently when it matters, rather than a collection of holdings that quietly share the same underlying bet.

That thinking shapes how we are positioned. Global infrastructure and quality real assets remain attractive, with the AI-driven buildout of digital and energy infrastructure providing a powerful structural tailwind. We continue to see a strong role for hedge fund strategies with flexible mandates, which have historically added value when correlations break down and dispersion is elevated. In private markets, we remain selective on private credit as spreads compress, and favour sector-specialist private equity managers with real operating capability. Within equities, we retain exposure to the businesses positioned to benefit as AI adoption drives productivity gains across the wider economy, not only the largest platform names.

None of this is cause for complacency. Good runs do not last forever, and the conditions that have made the past four years so rewarding will not persist indefinitely. Three risks in particular hold our attention: the fragile calm in the Middle East, where a renewed and sustained closure of the Strait of Hormuz would quickly revive the inflation threat; the AI investment cycle, which rests on companies continuing to see a return on enormous sums of spending; and inflation itself, which if it proves sticky could force central banks to move in a direction few portfolios are positioned for. None of these are our base case, though each is worth watching closely.

For now, the path remains open, if narrow. The rewards on offer are real, and so is the discipline required to capture them without being caught out. Threading that needle, staying invested while the good times run yet alert to how quickly they could turn, is the task that will define the year ahead.

Australian Equities

Australian equities recovered over the June quarter, with the S&P/ASX 300 returning +4.1%[1] as investors regained confidence following the volatility experienced in March. While geopolitical tensions, elevated oil prices and concerns around inflation created a challenging backdrop early in the period, sentiment improved as energy prices retraced and fears of a prolonged disruption to global supply chains eased. Domestically, the Reserve Bank of Australia (RBA) raised the cash rate to 4.35% in May before pausing in June, while the Federal Budget introduced significant tax reform proposals that added a degree of policy uncertainty for investors. Despite the recovery, Australian equities materially underperformed international markets, where AI-related earnings growth and technology leadership drove a much stronger rally.

Market performance remained relatively balanced beneath the surface. Growth (+3.7%[2]) modestly outperformed Value (+3.4%[3]). Small-cap stocks (+3.3%[4]) also lagged the broader market, reflecting ongoing investor caution towards businesses exposed to softer domestic demand conditions and higher funding costs.

Consumer Discretionary (+18.0%[5]) was the strongest-performing sector, rebounding sharply from depressed levels as falling bond yields and reduced expectations of further RBA tightening improved sentiment toward consumer-facing businesses. Information Technology (+17.4%[6]) also performed strongly, supported by renewed enthusiasm for AI-related investment and growing interest in the data-centre investment cycle. A-REITs (+13.5%[19]) rallied as investors became increasingly confident that financing costs were approaching their peak, improving the outlook for commercial property valuations. Industrials (+9.0%[34]) and Materials (+7.4%[35]) also generated solid gains, with Materials benefitting from continued strength across several commodity markets and growing investor interest in resources linked to electrification and AI infrastructure themes. Financials (+1.7%[36]) rose only modestly, underperforming the broader market as growing concerns around credit growth and the outlook for the domestic housing market weighed on the major banks.

At the other end of the market, Energy (-16.7%[7]) was the weakest-performing sector, reversing much of the previous quarter's strength as oil prices retreated and concerns around supply disruptions eased. Health Care (-6.1%[9]) remained under pressure as investors continued to reassess valuation multiples across several large-cap healthcare companies, while Utilities (-6.6%[8]) and Communication Services (-3.8%[37]) also lagged as investor preference shifted towards more cyclical areas of the market.

Chart 13: Australian Shares

Source: FactSet, Perpetual Private

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Australian equities – Manager insights and outlook

The volatility experienced through March created a more attractive opportunity set for active managers. While broader market valuations remained elevated, the sell-off resulted in meaningful dislocations across several high-quality businesses, particularly within Healthcare, Consumer Discretionary and Technology. Managers used this weakness to selectively add to existing positions and establish new holdings where share-price declines appeared disproportionate to any change in long-term fundamentals. In several instances, businesses that had previously been exited on valuation grounds re-entered portfolios as market volatility created more compelling entry points.

Portfolio positioning remains deliberately balanced across investment styles, although managers continue to identify greater value opportunities away from the largest companies in the market. Despite the continued concentration of index returns, several managers reduced exposure to crowded large-cap positions and redeployed capital toward selected mid and small-cap opportunities, where valuation dispersion remains more pronounced and the opportunity for active management to add value is greater. At the same time, improving commodity fundamentals, particularly across copper, gold and uranium, have supported renewed interest in the Resources sector, where managers are identifying a growing number of attractive opportunities.

One of the most significant contributors to relative performance during the quarter was the portfolio's underweight position in the major banks. Following a prolonged period of exceptional share-price performance, sentiment towards the sector weakened as investors became increasingly focused on elevated valuations, softer housing-market conditions and a more challenging outlook for credit growth. Given many of our managers had maintained cautious positioning towards the banks for some time, the reversal in sector leadership provided a meaningful tailwind to performance.

Healthcare remains a key area of conviction despite being one of the market's weakest-performing sectors. The sector declined 6% during the quarter and is now down approximately 36% over the past 12 months, reflecting a combination of higher interest rates, valuation compression and stock-specific challenges across several industry leaders, most notably CSL and Cochlear. While these headwinds have weighed on near-term performance, the sustained sell-off has left valuations at increasingly attractive levels relative to both history and the broader market. Many healthcare businesses continue to possess strong competitive advantages, resilient earnings profiles and attractive long-term growth characteristics.

As a result, Healthcare remains a meaningful overweight position within the portfolio and an area where managers continue to identify compelling bottom-up opportunities.

Looking ahead, our outlook remains cautiously constructive. Although overall market valuations remain elevated, valuation dispersion across sectors and companies continues to create opportunities for active management. Discussions with managers suggest investor sentiment is gradually shifting away from areas that have benefited most from valuation expansion in recent years and towards sectors where earnings expectations and long-term fundamentals remain more supportive. Resources, in particular, continue to attract attention as improving supply-demand dynamics, stronger commodity markets and increasing investment linked to electrification and AI infrastructure support the earnings outlook. While macroeconomic uncertainty remains elevated, we continue to see attractive opportunities at the individual company level, particularly where short-term dislocations have created a disconnect between market pricing and long-term fundamentals.

International Equities

International equities delivered a strong rebound during the June quarter, with the MSCI All Country World Index gaining +13.6%[10] as fears of a prolonged energy shock gradually gave way to renewed optimism around earnings growth and economic resilience. Markets entered the period concerned that the disruption to Middle East energy supplies would reignite inflation and place further pressure on global growth. However, as oil prices retraced and the economic fallout proved less severe than initially feared, investors increasingly shifted their attention back towards corporate fundamentals. Strong earnings growth, particularly across businesses exposed to artificial intelligence (AI) investment, helped global equities recover March's losses and push to new highs by quarter-end.

Growth (+17.5%[11]) materially outperformed Value (+8.0%[12]) as investors increasingly rewarded businesses demonstrating tangible benefits from the ongoing AI investment cycle. Small-cap stocks (+13.6%[38]) also performed strongly, supported by resilient economic activity and growing evidence that AI-related capital expenditure was extending beyond a narrow group of mega-cap technology companies and into broader parts of the economy.

Information Technology (+37.5%[13]) was the strongest-performing sector by a wide margin. Earnings across semiconductor manufacturers, memory producers and digital infrastructure providers continued to exceed expectations as demand for AI infrastructure remained exceptionally strong. Industrials (+11.3%[39]) also benefited from increasing investment in data-centre construction, power infrastructure and associated supply chains, while Financials (+10.0%[40]) advanced as concerns around economic growth and credit quality eased throughout the quarter.

Regionally, the United States remained the primary driver of global equity returns, with the S&P 500 gaining +13.8%[15] and the Nasdaq Composite rising +20.2%[41]. Japan (+32.9%[16]) was another standout performer, supported by ongoing corporate reforms, improving profitability and strong investor inflows. Emerging Markets (+22.6%[17]) outperformed developed markets, driven largely by strength across North Asian technology exporters, including companies benefiting from rising demand for semiconductors and memory products used throughout the AI ecosystem.

At the other end of the market, Energy (-14.0%[14]) was the weakest-performing sector as oil prices retreated and supply concerns eased. Materials (-1.1%[42]) and Utilities (-1.1%[43]) also lagged, while defensive sectors such as Consumer Staples (+0.4%[44]) struggled to keep pace in an environment increasingly focused on growth and earnings delivery. China remained a notable weak spot, with the Hang Seng Index declining -7.6%[18] as persistent concerns around domestic demand and the property sector continued to weigh on investor sentiment.

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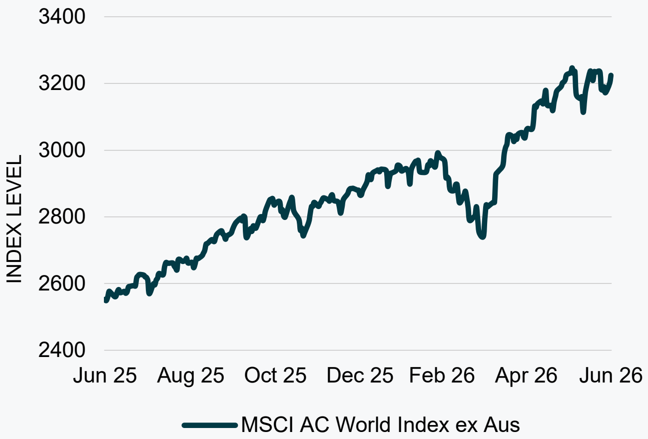
Chart 14: International Shares (local currency terms)



Source: FactSet, Perpetual Private

International equities – Manager insights and outlook

Markets entered the June quarter still shaped by March's geopolitical shocks, higher oil prices and renewed inflation concerns, which had pushed equities into a more macro-driven environment. With the margin for error narrower, we expected elevated valuations and less certain earnings profiles to face greater scrutiny, while companies with pricing power, balance sheet strength and clearer earnings visibility would be better supported.

For the portfolio, this meant maintaining a balanced approach across styles rather than positioning too heavily for a single market outcome. Our Quality Growth manager was expected to benefit from businesses delivering durable earnings growth and credible AI monetisation, our Value managers stood to benefit should geopolitical and energy risks persist, while our quantitative strategies provided diversified multi-factor exposure across the market capitalisation spectrum.

While the market ultimately delivered a stronger rebound than many investors anticipated, one of the more notable developments was the increasing selectivity within the AI investment theme. Earlier phases of the rally tended to reward broad technology exposure. More recently, investor attention has narrowed towards companies demonstrating direct participation in the AI infrastructure buildout, particularly semiconductors, memory manufacturers, data-centre operators and AI hardware providers. Companies able to translate rising AI investment into tangible earnings growth were rewarded, while those with less direct exposure struggled to keep pace.

These dynamics produced varied outcomes across our manager line-up. Our Quality Growth manager underperformed as its overweight exposure to software businesses and underweight position in semiconductors and AI infrastructure left it less exposed to the areas driving earnings upgrades and market leadership. Similarly, our Value-oriented managers faced headwinds as the retracement in oil prices reversed much of the strength previously seen in energy-related exposures. By contrast, our large and mega-cap quantitative manager benefited from the continued concentration of returns amongst large-cap technology businesses and direct beneficiaries of AI infrastructure spending.

Looking ahead, we remain focussed on the relationship between valuations and earnings delivery. Equity valuations remain elevated, market leadership remains concentrated and expectations for AI-related earnings have increased materially. While the investment cycle supporting data centres, semiconductors and digital infrastructure remains robust, the market is likely to become less forgiving of businesses that fail to convert rising investment into sustainable revenue growth, profitability and cash flow.

From a portfolio perspective, we continue to see merit in maintaining complementary style exposures through our levers-based approach. Although market leadership remains narrow, the growing divergence between winners and losers is creating attractive opportunities for active managers willing to remain disciplined on both valuation and earnings quality.

Real Estate

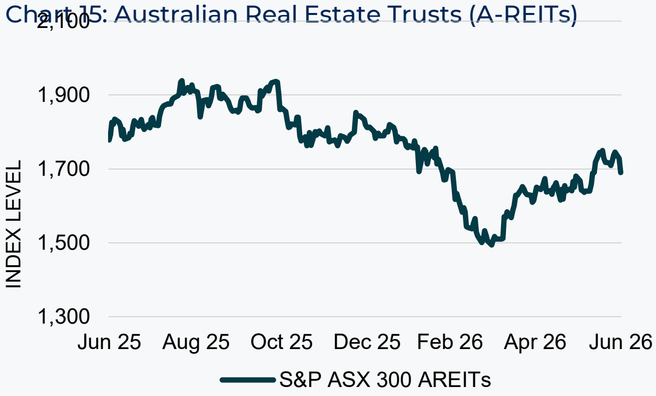
Listed real estate rebounded strongly over the June quarter as fears of a prolonged period of higher interest rates began to ease. With oil prices retracing and inflation pressures proving less persistent than initially feared, investors became more confident that financing costs were approaching their peak, supporting a broad recovery across listed property markets.

Australian REITs (A-REITs) were among the strongest-performing asset classes, returning +13.6%[19] over the quarter. Improving sentiment towards interest-rate-sensitive assets provided a supportive backdrop, while the market's growing enthusiasm for artificial intelligence and digital infrastructure also played an important role. Goodman Group, which accounts for approximately 40% of the benchmark, gained 22.5% over the three months as investors continued to reward businesses with exposure to logistics, industrial property and data centre development. Given its significant index weight, Goodman's strong performance was a major contributor to broader A-REIT returns.

Global REITs (G-REITs) also delivered a strong outcome, returning +7.3%[20], although performance varied considerably across sectors and regions. Hotels, Healthcare and Retail property were among the strongest-performing sectors, supported by resilient consumer spending and solid earnings outcomes. Regionally, the United States was one of the strongest-performing markets, gaining +10.6%[21], supported by continued demand for data centres, logistics assets and higher-quality retail property.

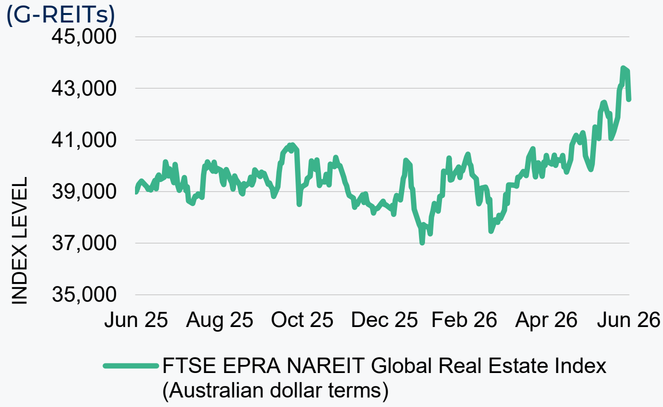
Europe also delivered a positive result (+5.3%[45]), although outcomes remained mixed across individual countries. At the other end of the spectrum, Hong Kong (-9.2%[22]) and Japan (-7.9%[23]) lagged over the quarter, with both markets impacted by weaker economic conditions and the lingering effects of higher energy costs.

Chart 15: Australian Real Estate Trusts (A-REITs)



Source: FactSet, Perpetual Private

Chart 16: Global Real Estate Investment Trusts (G-REITs)



Source: FactSet, Perpetual Private

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Real estate – Manager insights and outlook

Our outlook for listed real estate had become increasingly constructive heading into the June quarter. While elevated interest rates and geopolitical uncertainty continued to present risks, improving property fundamentals and stabilising financing conditions were beginning to support a more favourable medium-term outlook. Entering the quarter, we expected performance to remain highly differentiated across sectors, favouring areas supported by structural demand drivers such as industrial property, logistics, data centres, senior housing and selected retail assets.

Within Australia, the quarter reinforced many of these themes. Industrial and logistics assets continued to benefit from strong investor interest in AI-related infrastructure and digital connectivity, while our overweight position in Digico Infrastructure REIT was a significant contributor to performance. The company benefited from continued demand for data-centre capacity, improved balance-sheet strength and successful execution of key expansion projects. Conversely, our slight underweight position in Goodman Group detracted from relative performance given its significant benchmark weight and strong share-price performance. While office property remained one of the weaker areas of the market, our manager has maintained a selective overweight position, adding to holdings such as Dexus and GDI Property Group at material discounts to net tangible assets where valuation support is becoming increasingly compelling.

Globally, our G-REIT manager outperformed, supported by strong stock selection across Retail, Industrial and Office property. While data centres remain a long-term area of conviction, the sector delivered more subdued returns as investors weighed power constraints, rising development costs and signs of moderating expansion plans from major hyperscalers. Exposure to Japanese and Chinese property developers detracted, reflecting weaker property-market conditions across both regions. Among our highest-conviction positions, Vornado Realty Trust benefited from improving leasing conditions and stronger sentiment towards high-quality office assets, while Healthcare REITs led by Welltower were supported by improving operating fundamentals and growing demand for senior housing. Our manager also holds Ventas, reflecting a favourable long-term outlook underpinned by ageing populations and constrained new supply.

Looking ahead, we remain constructive on listed real estate. While geopolitical developments and inflation remain important considerations given their influence on interest-rate expectations, we believe REITs remain relatively attractive due to their income-generating characteristics and improving property market fundamentals. Following a broad re-rating across much of the sector as concerns around rising rates eased, valuations have normalised across parts of the market and transaction activity is beginning to recover. We continue to favour sectors supported by structural growth drivers and strong property fundamentals, while remaining selective in areas where market valuations appear disconnected from underlying asset quality. The significant dispersion across sectors and regions continues to create attractive opportunities for active managers to add value through disciplined security selection.

Growth alternatives

2026 continues to provide surprises, with markets looking through the geopolitical issues in the Middle East, public markets ‘climbing a wall of worry’, and the interest rate outlook continuing to evolve.

While many will have heard about the ‘K-shaped’ economy affecting certain industries, the same analogy can be used to describe the current state of the private equity ecosystem. Many GPs are managing through a more challenging environment, while a smaller cohort continues to perform strongly. We expect this divergence to persist, with those better able to adapt to the new environment well placed to raise capital and deliver top-quartile returns. Several trends that emerged over the past couple of years are now firmly taking hold:

1. Leverage is lower – older deals were able to tolerate high leverage due to the lower cost of debt. That is no longer the case, and we increasingly believe the industry has adapted its approach, with leverage likely to remain structurally lower for the foreseeable future.

2. Operational improvements remain key – we have been suggesting this would be the case for some time, and that view was supported by the growth in operating partner teams across many of the GPs we spend time with. AI has the potential to reshape this dynamic, increasing the pace at which operational improvements can be delivered. We suspect those with clearly demonstrable use cases for AI, linked to cost reduction, margin expansion or volume growth, will find capital raising easier in the coming years.

3. Sector / market specialists – LPs are looking to increase adoption of sector-specialist managers in certain areas such as Health Care and Information Technology. This trend is supported by capital-raising data, which shows sector specialists growing AUM while generalists face greater headwinds. LPs will be looking to the specialist approach both as an alpha-driver and a risk management tool.

In real estate, transaction volumes have picked up but remain below prior peaks. In the US and Europe, we believe cap rate expansion has peaked in most sectors, creating more stable conditions that should boost investor confidence. However, in Australia, market dynamics may drive modest further cap rate expansion in coming quarters. Globally, we are seeing increasing interest in alternative sectors such as data centres, social infrastructure and specialist housing, as traditional sectors continue to struggle. Private credit continues to be a growing part of the financing mix, as banks pull back from the sector. Of note, private credit lenders are likely to be more mercenary should assets run into operating issues. Buying below replacement cost will be key to asset selection going forward. Allocator demand for real estate remains weak, particularly for commingled fund structures.

Infrastructure remains in demand, with pricing sensible across most segments of the asset class. It remains a core portfolio holding, and the current environment has only reinforced its appeal. Elevated energy prices and supply chain disruption provide a natural tailwind for inflation-linked revenues, while the longer-term case for investment in energy security and diversification has strengthened considerably in the wake of recent geopolitical events. AI infrastructure, data centres and energy-related investments are attracting a greater share of capital, but allocation discipline remains key, with pricing beginning to look stretched in pockets.

Across traded markets, dispersion in equity and credit pricing continues to reflect divergent macroeconomic and political conditions. In response, we are reallocating towards hedge fund strategies with asymmetric return profiles and relative value approaches, as well as strategies that benefit from increased dispersion. While trend-based strategies have done well in recent periods, and capital raisers are speaking of greater interest in the sector, we remain cautious about adding following a period of strong performance, given the often ‘feast or famine’ return profile these strategies tend to exhibit.

Income alternatives

Artificial intelligence has dominated market attention for some time, and its impact on debt markets has been just as pronounced. AI-related debt issuance globally has grown so rapidly it now rivals the size of Australia's total government debt, with Pitchbook estimating more than US$250 billion of issuance in the past six months alone. Much of that has been raised to fund the US$600–700 billion in capital expenditure expected from the hyperscalers in 2026, with a significant portion flowing into the investment-grade market and the remainder into private markets.

Our portfolio holds no dedicated AI exposure. We have some indirect exposure through the asset-backed allocations within our insurance side-car investments (arrangements that share in the returns and risks of an insurer's underlying policies), as well as through AI-related companies held within our collateralised loan obligations (CLOs) and broadly syndicated loans. Overall, that exposure is small. The Investment Team is seeing opportunities emerge in the space and may look to build a larger position where the return adequately compensates for the risk.

US and European direct lending drew less attention this quarter than last, though deal flow remains a concern as private equity exits and sponsor-to-sponsor sales stay subdued. One notable development has been the limited take-up of private debt continuation funds alongside a rise in private debt secondary activity. Both improve liquidity in these markets, though they are also a symptom of slower principal repayments. That slowdown in private equity activity has fed through to higher defaults across both direct lending and broadly syndicated loans, and to longer holding periods for direct lending funds.

Broadly syndicated loans (pools of large corporate loans traded among institutional investors) posted a positive result for the quarter, reversing the losses of the March quarter to finish the first half in positive territory. Performance over the past twelve months has nonetheless been disappointing, with most of the losses stemming from concerns around software borrowers in late 2025 and early 2026. The outlook is improving, however, as US loan defaults have stabilised and liability management exercises, so-called "LMEs", have fallen. A more benign default environment combined with a reasonable spread over the swap rate makes the asset a good parking spot for medium term liquidity.

Our other liquid holdings, spanning Australian floating-rate investment-grade credit, catastrophe bonds and insurance premium funding, continued to perform well, outperforming the broadly syndicated loan market by a comfortable margin. These have been valuable diversifiers alongside our direct lending and broadly syndicated loan exposures.

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Fixed Income

Fixed income markets delivered positive returns over the June quarter, although volatility remained elevated as investors navigated persistent inflation pressures, geopolitical uncertainty and shifting central bank expectations. Government bond yields rose sharply early in the period as escalating tensions in the Middle East pushed oil prices higher and raised concerns that a renewed energy shock would complicate the path back to central bank inflation targets. However, as ceasefire negotiations progressed and prospects for a US-Iran agreement improved, oil prices retraced and bond yields reversed much of their earlier move, helping both government and corporate bond markets finish the quarter in positive territory.

In Australia, the Reserve Bank of Australia (RBA) continued its tightening cycle in May, lifting the cash rate to 4.35% before pausing in June. While headline inflation eased to 4.0%, largely due to lower fuel prices, underlying inflation remained more persistent as housing and services inflation continued to broaden. The decision to leave rates unchanged in June was well received by markets, reinforcing the view that policy rates may be at or near their peak. Australian government bonds returned +2.7%[24] over the quarter, while Australian investment-grade credit returned +2.5%[25]. By comparison, floating-rate credit delivered a more modest return of +1.4%[26], reflecting its reduced sensitivity to declining bond yields.

Globally, bond markets remained highly sensitive to developments in energy markets and monetary policy. The US Federal Reserve left rates unchanged throughout the quarter, maintaining that policy remained sufficiently restrictive, while Kevin Warsh chaired his first meeting following confirmation as US Federal Reserve Chair. Strong labour market data and resilient economic activity supported expectations that US interest rates would need to remain restrictive for longer than previously anticipated, contributing to a flattening of the US Treasury yield curve as shorter-dated yields moved higher while longer-dated yields eased modestly. Elsewhere, the European Central Bank raised rates by 25 basis points, while the Bank of Japan also tightened monetary policy, reinforcing a broader global theme of central banks becoming less willing to look through renewed inflation pressures. Despite the volatility, global government bonds delivered a positive return of +1.5%[27] (AUD hedged) over the quarter.

Corporate bond markets also performed strongly, with both Investment-Grade and High-Yield credit outperforming equivalent government bond markets. Global Investment-Grade credit returned +2.0%[28], while global High-Yield bonds gained +3.8%[29] in AUD hedged terms. Importantly, periods of market volatility were driven primarily by changing interest-rate expectations and macroeconomic uncertainty rather than any material deterioration in corporate fundamentals. Credit spreads narrowed through much of the quarter as investors continued to find value in attractive all-in yields, while primary issuance remained robust, supported by refinancing activity and ongoing capital expenditure associated with artificial intelligence and digital infrastructure investment.

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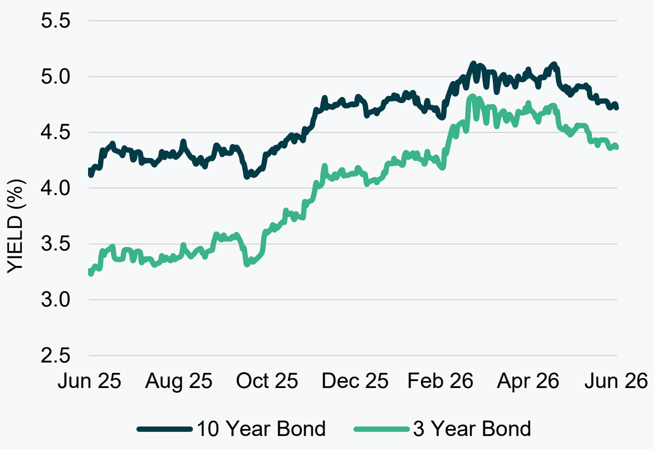
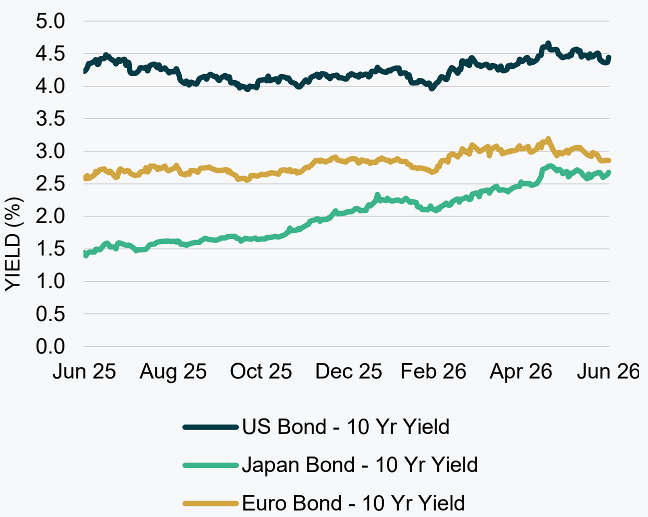
Chart 17: Australian government bond yields



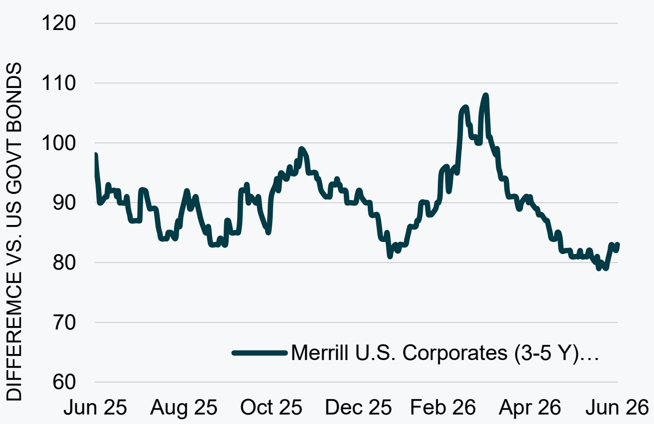
Source: FactSet, Perpetual Private. Note: Bond prices are inversely correlated with bond yields.

Chart 18: Global government bond yields



Source: FactSet, Perpetual Private.

Chart 19: Global credit markets



Source: FactSet, Perpetual Private.

Fixed income – Manager insights and outlook

Fixed income markets continue to navigate a difficult balance between slowing growth, restrictive monetary policy and persistent inflation risks. Yield curves have spent much of the last two years implying a materially faster easing cycle than ultimately occurred, highlighting the danger of treating market pricing as a forecast rather than an expectation. More recently, higher energy prices and geopolitical uncertainty have contributed to renewed volatility across government bond markets, prompting investors to reassess both the timing and magnitude of future policy easing.

One of the defining features of the current cycle has been the resilience of economic activity despite aggressive monetary tightening. Fiscal support has proven more persistent than expected, consumer spending more resilient than anticipated and AI-related investment has translated into tangible financing activity across the global economy. As a result, economic outcomes, particularly in the US, have continued to diverge from consensus expectations, repeatedly challenging forecasts that tighter monetary policy would lead to a more pronounced slowdown.

Recent enthusiasm surrounding artificial intelligence has inevitably drawn comparisons with previous technology cycles. Regardless of where valuations ultimately settle, the scale of investment supporting data centres, power infrastructure and computing capacity suggests the theme is already having a meaningful impact on economic activity. Beyond the financing activity already being generated across credit markets, AI-enabled tools are increasingly improving productivity and operational efficiency across a number of industries, reinforcing the growing influence of the investment theme on the real economy.

The post-COVID inflation experience is often explained through supply-chain disruptions and demand being brought forward. While both factors played an important role, the persistence of demand points to something more structural. Despite households largely exhausting their pandemic-era savings, labour markets have remained resilient and nominal income growth has continued to support spending. In our view, the key question now is whether labour income and credit growth can continue to sustain demand as fiscal support gradually fades and excess savings disappear.

This question is especially relevant in Australia, where large parts of the domestic credit market remain tied to the consumer, residential property and small business sectors. As a result, we continue to monitor consumer, small business and non-bank lender fundamentals closely as leading indicators of future credit conditions.

From a portfolio perspective, this reinforces our preference for globally diversified credit opportunities over increasing exposure to domestic spread assets. Australian credit continues to offer attractive income; however, spreads already reflect broadly benign credit conditions and appear to offer limited compensation should household, property or small business conditions weaken. Global credit continues to provide greater diversification benefits and, in our view, a more attractive balance between risk and return. We are comfortable holding this positioning for now, while retaining the flexibility to add to domestic credit should spreads move to better reflect the risks we are monitoring.

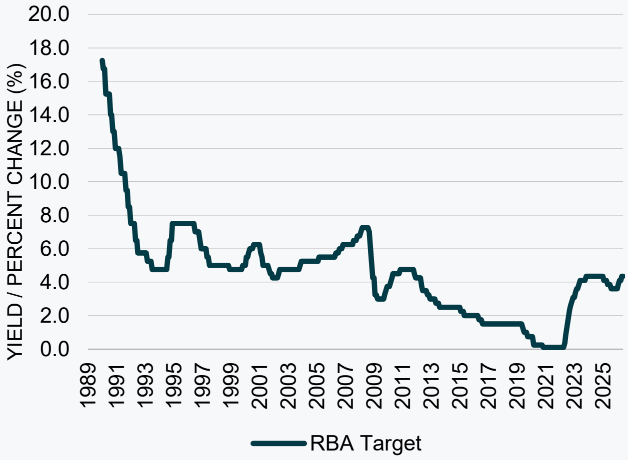
Australian Cash Rate

Following successive hikes to close the March quarter, the Reserve Bank of Australia (RBA) delivered a further 25 basis point increase in May to take the official cash rate to 4.35%, before pausing in June. The hold decision reflected growing evidence that tighter financial conditions were beginning to moderate demand, although the RBA stopped short of signalling any near-term easing bias, instead reiterating that monetary policy was well placed to respond to developments in the outlook for economic activity and inflation.

With no scheduled meeting in April, the May decision was the RBA's first of the final fiscal quarter, with an 8-1 majority vote to increase the policy rate illustrating the Board's ongoing concern around persistent inflationary pressures. Elevated energy prices amid geopolitical uncertainty and lingering domestic capacity constraints underpinned the Board's decision to increase, as labour market conditions also remained tight.

The June decision to leave rates unchanged was unanimous, with the Board electing to assess the impact of prior tightening. While there were signs that consumer spending and housing market momentum had begun to slow, policymakers remained alert to the risk that the recent inflation impulse could become entrenched, as evidence suggested some firms were already increasing the prices of their goods and services in response to rising cost pressures. Subsequent May CPI data affirmed this judgement, as headline inflation eased on falling oil prices, while core inflation continued to rise. Recognising that the recovery from the global oil supply shock will take time, the RBA appears to be positioned to wait before making a policy decision in either direction.

Chart 20: Long-term cash rate



Source: FactSet, Perpetual Private.

Australian cash rate – Outlook

Heading into the second half of the year, the RBA's focus remains firmly on returning inflation to target, though elevated unit labour costs, weak productivity growth and ongoing capacity pressures continue to complicate that task. While the Board now deems financial conditions 'somewhat restrictive', subdued productivity is constraining the economy's supply capacity even as demand begins to soften, with members envisaging a further two years before inflation returns sustainably to target.

Despite a temporary ceasefire between Iran and the US restoring oil flows out of the Middle East, though only partially, the prospect of a durable peace agreement remains tenuous, and as such, the RBA remains attentive to the risk of renewed disruptions.

Against this backdrop, the Board is widely expected to maintain its current policy stance throughout the upcoming quarter, allowing time for prior tightening to work through the economy, whilst also assessing whether emerging signs of softer activity translate into a sustained easing in underlying inflation.

That said, market expectations for the RBA's next directional movement have shown early signs of divergence, with recent tax reforms and an ensuing cooling in housing market conditions dividing opinion. While the extent to which discouraged investment might impact rental prices is difficult to measure with precision, elevated construction costs are ensuring that inflation risks remain skewed to the upside. At the time of writing, markets are pricing an implied 45% chance of a further 25 basis point hike before the end of 2026 . However, growing concern that a sustained housing downturn could materialise into weakened household confidence and subsequent consumption, particularly given the wealth effect of housing in Australia, has seen a small portion of investors assigning probability to policy easing in early 2027, should no further hikes eventuate.

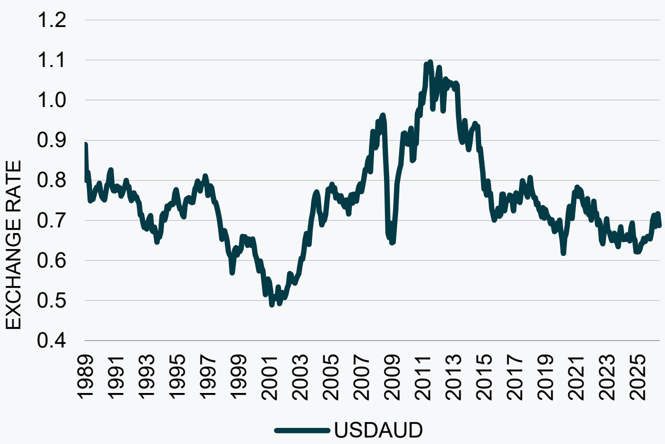
Australian Dollar

The Australian dollar (AUD) surrendered its early gains to strengthen only modestly against the US dollar (USD) over the June quarter, up 1.2% to trade near US$0.69 by quarter-end. With the RBA entering a rate hiking cycle in February, a time in which the US Federal Reserve was still considering a further cut, broad USD weakness and a divergence in policy path expectations helped lift the AUD to quarter-highs near US$0.73 by early May. However, heightened geopolitical tensions paired with fading expectations for further Fed easing prompted a renewed strengthening of the USD across major currencies.

While an early-year rally in precious metals was indicative of a de-dollarisation narrative that saw central banks diversify reserve exposures away from the US, escalating conflict and sustained export disruptions in the Middle East forced a gradual shift in market preference towards liquidity and capital preservation. As a risk-sensitive currency, the AUD struggled to sustain its earlier momentum as concerns around global growth and energy security intensified, tempering the earlier rotation away from the greenback and contributing to a reversal in AUD strength.

It was June's FOMC meeting, however, that ultimately marked a more decisive turning point for AUD/USD. Having held its own cash rate steady in June to let prior tightening filter through the domestic economy, the RBA increasingly contrasted with a more-hawkish-than-expected US Federal Reserve. The Fed's revised policy outlook, coupled with Warsh's reluctance to provide forward guidance, prompted a sharp repricing of US rate expectations and saw markets begin to contemplate the possibility of further Fed tightening rather than easing. In doing so, the relative rate advantage that had supported the AUD through much of the quarter was rapidly eroded, returning AUD/USD to levels last seen in early April.

Chart 21: Australian dollar US dollar (daily) long term



Source: FactSet, Perpetual Private

Australian dollar – Outlook

The outlook for the AUD is by no means straightforward, instead hinging on the evolution of economic conditions and forthcoming policy decisions. Australia is still grappling with one of the highest levels of core inflation across the developed world, while weak productivity and constrained supply-side capacity have left growth languishing below trend for an extended period. Against this backdrop, the RBA must now also weigh the potential implications of a housing market slowdown on the back of taxation changes, which could further dampen consumer activity. While markets had previously entertained the prospect of additional policy tightening by the RBA, expectations have since shifted toward an extended period of policy stability, with some consideration toward easing in early 2027 even emerging in forecasts.

The path of US monetary policy may prove equally consequential. While expectations for further RBA tightening are slowly fading, markets are now anticipating that the Fed may need to raise rates before year-end, with roughly 1.5 hikes priced into the US curve by December 2026. Should that divergence in policy trajectories emerge, it would likely move interest rate differentials in favour of the US dollar, limiting the AUD's upside despite improving domestic conditions. However, Warsh's emphasis on data dependency and the subsequent removal of explicit policy guidance has somewhat clouded the outlook for US rates, leaving markets more vulnerable to repricing should investors perceive a shift in Fed tone. More recently, softer-than-expected US labour data has started to pare back the extent of tightening priced for the Fed, a reminder of how quickly that repricing can occur.

We expect any changes in the Australian-US interest rate differential to be a primary driver of AUD performance over the coming quarter, though acknowledge a credible scenario in which both central banks leave policy unchanged throughout the period. Failure to secure a durable peace agreement in the Middle East could also present headwinds for the AUD, particularly given energy-driven inflation pressures have recently eased in domestic headline inflation figures.

1. As measured by the S&P/ASX 300 – Total Return index
2. As measured by the MSCI Australia Growth – Net Return index
3. As measured by the MSCI Australia Value – Net Return index
4. As measured by the S&P/ASX Small Ordinaries – Total Return index
5. As measured by the S&P/ASX 300 Consumer Discretionary (Sector) – Total Return index
6. As measured by the S&P/ASX 300 Information Technology (Sector) – Total Return index
7. As measured by the S&P/ASX 300 Energy (Sector) – Total Return index
8. As measured by the S&P/ASX 300 Utilities (Sector) – Total Return index
9. As measured by the S&P/ASX 300 Health Care (Sector) – Total Return index
10. As measured by the MSCI All Country World index in AUD (unhedged) terms
11. As measured by the MSCI World Growth index in AUD (unhedged) terms
12. As measured by the MSCI World Value index in AUD (unhedged) terms
13. As measured by the MSCI AC World – Information Technology index in AUD (unhedged) terms
14. As measured by the MSCI AC World – Energy index in AUD (unhedged) terms
15. As measured by the S&P 500 index in AUD (unhedged) terms
16. As measured by the Nikkei 225 index in AUD (unhedged) terms
17. As measured by MSCI Emerging Markets index in AUD (unhedged) terms
18. As measured by the Hang Seng index in AUD (unhedged) terms
19. As measured by the S&P/ASX 300 A-REIT index
20. As measured by the FTSE EPRA Nareit Developed index in AUD unhedged terms
21. As measured by the FTSE EPRA Nareit USA index in AUD unhedged terms
22. As measured by the FTSE EPRA Nareit Hong Kong index in AUD unhedged terms
23. As measured by the FTSE EPRA Nareit Japan index in AUD unhedged terms
24. As measured by the Bloomberg AusBond Composite (0+Y) index
25. As measured by the Bloomberg AusBond Credit (0+Y) index
26. As measured by the Bloomberg AusBond Credit FRN (0+Y) index
27. As measured by the Bloomberg Global Aggregate (AUD hedged)
28. As measured by the ICE BofA Global Corporate (AUD hedged) index
29. As measured by the Bloomberg Global High Yield (AUD Hedged) index
30. MSCI All Country World Index (ACWI) – Total Return (AUD unhedged)
31. JP Morgan and McKinsey Reports, May 2026.
32. Australian Bureau of Statistics, Consumer Price Index, May 2026.
33. Real GDP Growth YoY%. FactSet, Median Economist Estimate, Data as of 30 June 2026.
34. As measured by the S&P/ASX 300 Industrials (Sector) – Total Return index
35. As measured by the S&P/ASX 300 Materials (Sector) – Total Return index
36. As measured by the S&P/ASX 300 Financials (Sector) – Total Return index
37. As measured by the S&P/ASX 300 Communication Services (Sector) – Total Return index
38. As measured by the MSCI AC World Small Cap index in AUD (unhedged) terms
39. As measured by the MSCI AC World – Industrials index in AUD (unhedged) terms
40. As measured by the MSCI AC World – Financials index in AUD (unhedged) terms
41. As measured by the NASDAQ index in AUD (unhedged) terms
42. As measured by the MSCI AC World – Materials index in AUD (unhedged) terms
43. As measured by the MSCI AC World – Utilities index in AUD (unhedged) terms
44. As measured by the MSCI AC World – Consumer Staples index in AUD (unhedged) terms
45. As measured by the FTSE EPRA Nareit Europe index in AUD unhedged terms
46. Factset. Data as of July 10 2026

Authors

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Andrew provides investment research, portfolio construction and bespoke investment advice for Perpetual Private's clients.

Andrew works closely with advisers by providing specialist investment knowledge on Perpetual's investment process and strategy implementation, focusing on delivering optimal solutions to our stakeholders and partners. This is further augmented by his provision of transparent and accessible knowledge of financial markets and asset classes both globally and locally.

Having spent 15 years in London, Andrew returned to Melbourne with a wealth of international experience to benefit Perpetual's clients and partners. Having started his career working on private equity transactions and stock market listings, he then spent time working on equity trading desks, before moving into investment management. In his role as a Portfolio Manager for Barclays Investment Solutions, Andrew managed money across multiple asset-classes on behalf of various client groups, before focusing on the charity and not-for-profit segment. With responsibility for as much as £3bn in assets, he developed a strong reputation for delivering robust investment performance linked to his comprehensive understanding of global investment markets.

Andrew is a holder of the Chartered Financial Analyst and the Chartered Alternative Investment Analyst designations.

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Hugo is an Investment Specialist at Perpetual Private, where he joined the Investment Research Team in October 2023. He supports the Head of Managed Accounts and Perpetual Private Investment Directors by developing and maintaining investment content and collateral. He also helps communicate Perpetual Private's investment offerings to advisors and intermediary sales teams, representing the Multi-Manager and Direct Equities teams.

Before joining Perpetual, Hugo gained valuable international experience working as a Research Analyst for a wealth management firm in Vancouver, Canada. During his four years there, he focused on strategic and tactical asset allocation of multi-asset portfolios for the firm's high-net-worth clientelle. Prior to his time in Canada, he held roles in Sydney at BT Financial Group as a Customer Relations Consultant and TP ICAP as a Trainee Broker.

Hugo is a CFA charterholder and holds a Bachelor of Commerce degree, majoring in Finance and Accounting, from the University of New South Wales.

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