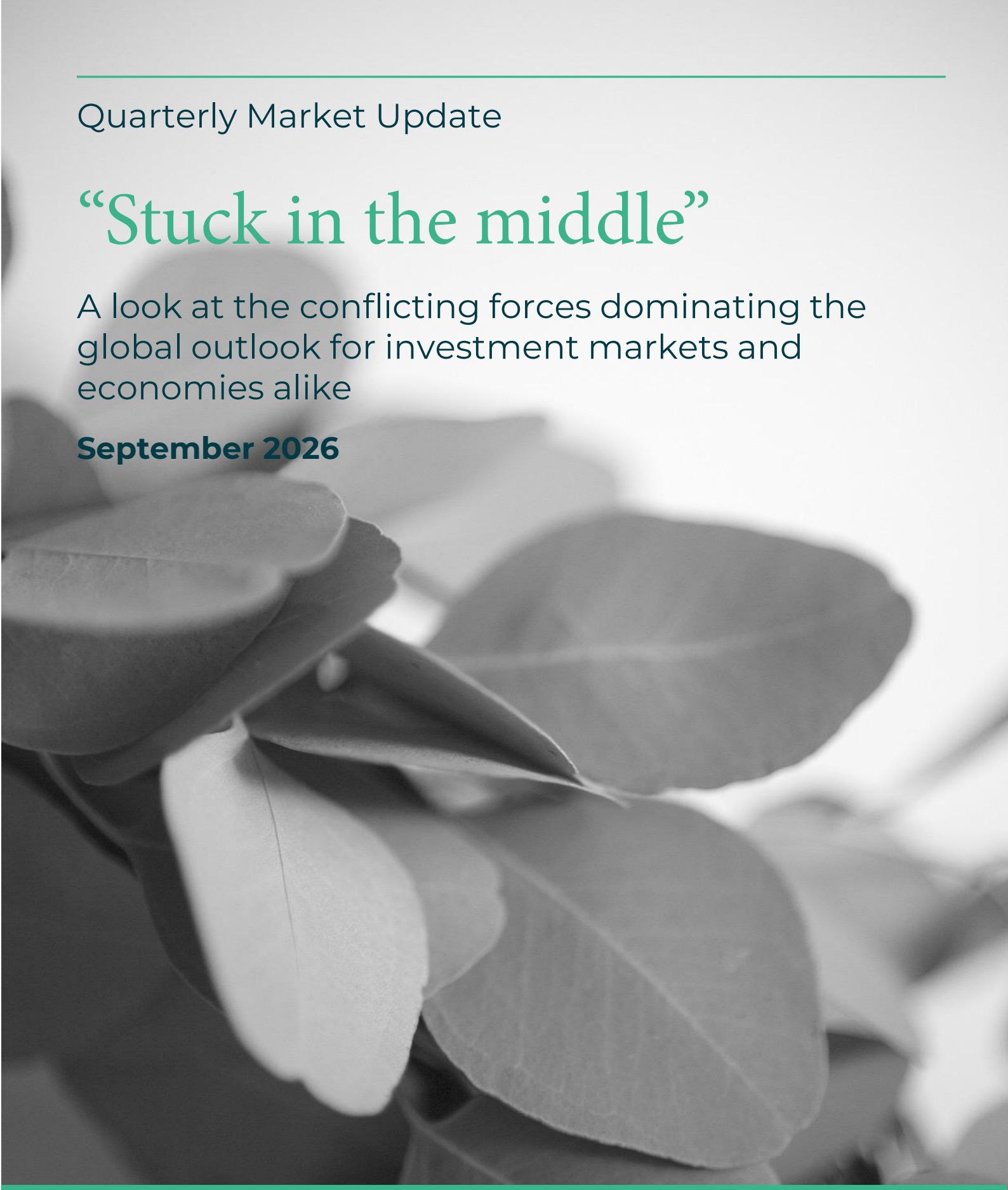
Quarterly Market Update

“Stuck in the middle”

A look at the conflicting forces dominating the global outlook for investment markets and economies alike

September 2026



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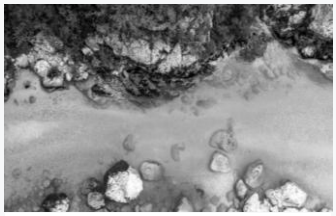
Contents

03
Executive summary

04
Asset class snapshot

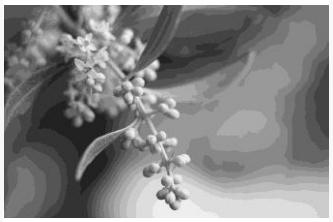
06
Pushing our luck



09
Stuck in the middle

14
Australian equities

16
International equities



18
Real estate

20
Growth alternatives

22
Income alternatives

24
Fixed income

26
Australian cash rate

28
Australian dollar

Executive Summary

2026 continues to provide challenges for investors. Markets are caught between the promise of a technological revolution and an increasingly uncomfortable collection of economic, geopolitical and political risks.

Artificial intelligence continues to attract historic levels of investment into data centres, semi-conductors and computing infrastructure. While this spending provides meaningful support to economic activity and corporate earnings, investors are increasingly asking whether the eventual returns will justify the scale, leverage and concentration of capital involved. Recent weakness among heavily indebted AI infrastructure providers suggests that enthusiasm is becoming more discriminating, which is healthy, but also exposes the financial risks beneath the thematic.

Meanwhile, conflict in the Middle East continues to disrupt energy and commodity markets. Constraints on shipping, higher insurance costs and uncertainty surrounding key trade routes have pushed oil prices higher and added to inflationary pressure. Data centres are increasing demand for power and raw materials, at the same time geopolitical disruption is constraining supply. Together, these forces have complicated the outlook for central banks and contributed to higher global bond yields.
Despite this backdrop, equity markets remained remarkably resilient during the quarter. Australian equities returned 1.3%, while International equities gained 1.2%. Those headline results, however, conceal considerable dispersion.

Australia's longer-term outlook presents another challenge. The 2026 Intergenerational Report (the feature of this quarter's 'Special Article') relies heavily on labour productivity growth of 1.2% a year, above the rate achieved over the past decade. AI may ultimately lift productivity, but adoption remains too limited to assume those gains. Without meaningful reform, Australia risks weaker per-capita growth and a wider divide between corporate winners and losers.

The path ahead is therefore likely to remain bumpy. AI investment, geopolitical conflict, persistent inflation, elevated bond yields and the approaching US midterm elections all carry the potential to disrupt markets. Yet volatility also creates opportunity. Our approach is to remain broadly diversified yet selective and patient: participating in durable growth where the earnings and cash flows justify it, avoiding excessive concentration, and keeping sufficient powder dry for moments when market dislocation presents more compelling opportunities.

Asset class snapshot

Australian equities

Australian equities retraced August highs to grow modestly over the September quarter, with the ASX300 returning 1.3%[1]. After a positive start, market sentiment weakened through September as rising oil prices, renewed geopolitical tensions and a sharp increase in global bond yields weighed on risk assets. The August reporting season was generally positive, with investors rewarding companies that delivered durable earnings and constructive outlooks, while penalising those that disappointed. From a size perspective, Small Caps (-0.5%[2]) lagged the broader market as higher funding costs and softer domestic demand weighed on investor sentiment. Value stocks (+7.4%[3]) materially outperformed Growth (-4.3%[4]), supported by strong performances from commodity-linked sectors and renewed pressure on growth-oriented companies as bond yields moved higher. Sector performance was led by Health Care (+25.4%[5]) and Energy (+17.3%[6]), while Information Technology (-9.4%[7]), A-REITs (-8.4%[8]) and Consumer Discretionary (-9.3%[9]) were among the weakest sectors as rising yields and slowing consumer activity weighed on valuations.

International equities

International equities stabilised following early quarter volatility, climbing 1.2%[10] through the period. While overall returns were subdued, market leadership broadened beyond the large technology companies that had dominated performance over recent years. Investor focus shifted towards earnings delivery and valuation support, resulting in greater dispersion across sectors, styles and regions. From a style perspective, Value stocks (+3.4%[11]) outperformed Growth (-0.4%[12]), supported by strong gains in energy-related businesses and increasing investor sensitivity to company valuations. Small-cap equities (-3.6%[13]) also lagged their large-cap peers as investors favoured larger, more established businesses.

At the sector level, Energy (+14.2%[14]) was the strongest performer as higher oil prices boosted earnings expectations, while Information Technology (+3.9%[15]) recovered from a weaker start to the quarter as demand for AI-related infrastructure remained supportive. In contrast, Utilities (-9.1%[16]), Real Estate (-5.2%[17]) and Consumer Discretionary (-4.0%[18]) underperformed.

Refer to footnotes description on page 30

Real estate

Listed Real Estate struggled over the quarter, with higher bond yields and renewed concerns around the interest rate outlook weighing on the sector. Australian A-REITs (-8.4%[19]) underperformed broader equities as investors remained cautious towards property companies facing elevated financing costs and subdued transaction activity. Residential-focused developers were among the weaker performers, while Office showed signs of stabilisation. Retail assets remained relatively stable, supported by rental growth and inflation-linked lease structures.

Global REITs (-6.1%[20]) experienced similar challenges as rising yields pressured property valuations and reduced investor appetite for rate-sensitive assets. Performance varied across regions, with Hong Kong (+5.6%[21]) benefiting from improving sentiment and attractive valuations, while Japan (-2.9%[22]) limited losses due to low vacancy rates and ongoing rental growth. By contrast, the US (-6.7%[23]) and Europe (-9.6%[24]) lagged, reflecting continued weakness in office and residential property markets. Elevated financing costs and ongoing property repricing remained key headwinds across global real estate markets during the quarter.

Growth alternatives

Growth alternatives continued to be shaped by increasing dispersion across private markets, with managers able to drive operational outcomes and access differentiated opportunities. In Private Equity, deal activity improved modestly, supported by large transactions and middle-market opportunities, while longer holding periods and subdued distributions reinforced the importance of operational value creation. Private Real Estate markets continued to recover, with capital concentrated in sectors supported by structural demand, including US residential housing, digital infrastructure and specialised real assets. Infrastructure remained underpinned by themes such as power demand, energy transition and data-centre development, while heightened market dispersion and periodic volatility created a supportive backdrop for Hedge Fund strategies focused on security selection, relative value opportunities and asymmetric return profiles.

Defensive alternatives

Defensive alternatives experienced mixed conditions over the quarter, as Broadly Syndicated Loan markets recovered from software-related weakness earlier in the year, supported by tighter spreads and reduced Private Equity issuance. Private credit conditions remained more challenging, with higher borrowing costs and subdued Private Equity activity continuing to constrain deal flow, repayments and capital recycling. Older-vintage exposures across special situations, property and Commercial Real Estate lending also remained challenged. Against this backdrop, Australian Floating-rate credit, Catastrophe Bonds, Insurance-linked assets and Specialty Finance were more resilient, benefiting from diversified return drivers and less reliance on sponsor-backed transaction activity.

Fixed income

Fixed income markets delivered negative returns over the September quarter as rising bond yields weighed on both government and corporate bonds. Persistent inflationary pressures, resilient economic data and expectations that interest rates would remain elevated prompted investors to reassess the outlook for monetary policy, pushing yields higher across major developed markets. Australian government bonds declined 1.5%[25] as the Reserve Bank of Australia (RBA) raised the cash rate and investors adjusted to a higher rate environment. Investment Grade credit fell 0.7%[26], with higher yields helping to offset some of the impact from receding bond prices. Floating-rate credit was a notable exception, gaining 1.2%[27] as higher interest rates supported income returns and reduced duration sensitivity.

Globally, bond markets weakened as yields rose to multi-year highs. Global bonds declined 2.4%[28], while Global Investment Grade and High Yield credit returned -3.0%[29] and -2.0%[30] respectively. Overall, duration-sensitive sectors remained under pressure, while floating-rate and shorter-duration credit continued to demonstrate greater resilience.

Australian cash rate

The RBA resumed its tightening cycle in September, raising the cash rate by 25 basis points to 4.60% after leaving policy unchanged in August. The move reflected renewed inflationary pressures, including higher energy and technology-related goods prices, persistent services inflation and ongoing domestic capacity constraints. Economic activity also proved more resilient than expected, while the labour market softened only modestly. Although housing prices and lending activity weakened during the quarter, the Board judged that further tightening was required to ensure inflation returns sustainably to the 2–3% target range. The RBA retained a data-dependent stance, with future decisions to be guided by incoming inflation, labour market and activity data.

Australian dollar

The Australian dollar experienced considerable volatility over the September quarter, rising from near US$0.69 in early July to above US$0.72 in early September, before finishing near US$0.70. Strength through July and August reflected growing expectations that Australian interest rates would remain elevated as persistent inflation and resilient domestic activity increased the prospect of further RBA tightening. The rally reversed later in September as stronger US economic data and renewed inflation concerns lifted Treasury yields and forward cash rate expectations, strengthening the US dollar.

Refer to footnotes description on page 30

Pushing our luck

What the 2026 Intergenerational Report means for Australia's growth outlook

In 1964, Donald Horne published The Lucky Country, and Australians have been misunderstanding him ever since. The title was never meant as a compliment. Horne described Australia as "a lucky country run mainly by second-rate people who share its luck", arguing that our prosperity owed far more to geology and good timing than to good management. Six decades later, it is worth asking whether Australia is still 'lucky', and whether the good times can continue once luck is no longer enough.

Our answer is yes, though perhaps less so than in the past. Every three years, Treasury publishes an Intergenerational Report (IGR) assessing the long-term opportunities and pressures facing the economy, population and federal budget over the next 40 years. The 2026 edition, released in September, expects productivity to run at a rate above what Australia has averaged over the past 20 years. We see that assumption as the main risk to the official outlook, and a key reason to expect more modest long-term returns from the domestic economy, than investors have been accustomed to.

Australia's luck over recent decades has been real enough. The country holds nearly 30% of the world's iron ore reserves alongside vast coal, gas and critical mineral deposits, while strong population growth, cheap global capital and China's rapid industrialisation have helped restrict our economy to only one recession in the past 35 years. Yet these advantages have done more to increase the size of the economy than output per person. In 2025–26, real GDP grew 2.3%, but real GDP per person rose just 0.9%, showing how little recent headline growth translated into higher output per Australian.

Chart 1: Real GDP per capita growth

Source: ABS, Perpetual Private. Data as of 30 June 2026.

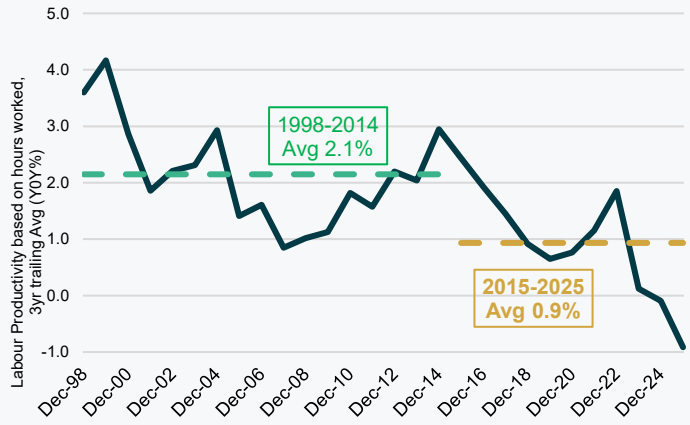
The IGR's outlook

The 2026 IGR is upbeat in tone, describing Australia as "better placed, better prepared" with a "better plan" than most countries, yet its projections show several long-standing tailwinds fading. Real GDP growth eases from 3% a year over the past 40 years, to 2% over the next 40, while growth in real income per person slows from 1.9% to 1.1% a year as population growth moderates and export prices retreat from near-record highs. Iron ore prices have repeatedly outlasted budget forecasts of a decline, so Treasury may again prove too pessimistic, but the outlook is still sobering when set against recent history.

The productivity assumption

If luck is fading, productivity has to make up the difference. The IGR assumes labour productivity growth of 1.2% a year, and most of the projected rise in Australians' living standards depends on it. ABS data show productivity growth has averaged around 0.9% a year since 2015, against about 2.1% in the 1990s and 2000s (Chart 2), so the outlook relies on Australia doing better than it has in more than a decade. Oxford Economics, a respected research house, is less optimistic still, forecasting growth below 1% a year to 2040, behind several developed-economy peers.

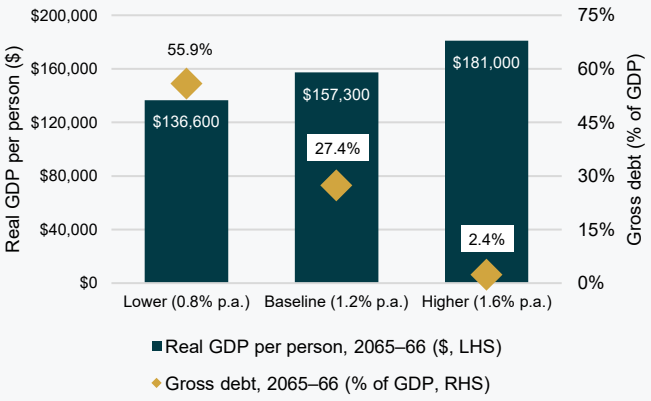
Chart 2: Labour productivity growth has been declining over the past 30 years



Source: ABS, Perpetual Private. Data as of 31 December 2025.

Treasury's own sensitivity analysis shows how much rests on that assumption. If productivity grows at 1.6% a year rather than 1.2%, real GDP per person reaches about $181,000 by 2065–66; at 2.4% gross debt all but disappears. At 0.8% a year, real GDP per person reaches only about $136,600, a gap of more than $44,000 a head, and gross debt rises to 55.9% of GDP (Chart 3).

Chart 3: IGR productivity sensitivity – real GDP per person and gross debt, 2065–66



Source: Treasury, 2026 Intergenerational Report (Tables A4.1 & A4.2), Perpetual Private.

There are good reasons to doubt the 1.2% assumption. OECD data put Australia's labour productivity growth over 2023–25 among the weakest in the developed world. Market concentration and profit margins have risen, leaving firms with less competitive pressure to invest, innovate and adopt better ways of working. Growth in non-market employment such as health, education and public administration has also doubled its drag on productivity growth, to about 0.3 percentage points a year.

Artificial intelligence (AI) offers some upside. The Productivity Commission estimates that AI could lift multifactor productivity by at least 2.3% over a decade, but a Reserve Bank survey found that fewer than 10% of Australian businesses describe their use of it as significant. It is too early to bank those gains.

The reform task

Australia faced a similar problem in the 1980s and reformed its way out of it. In 1986, with the terms of trade slumping and the current account deficit widening, Treasurer Paul Keating warned that the country risked becoming a "banana republic". Reforms including the 1983 float of the dollar, tariff cuts, financial deregulation and later National Competition Policy laid the groundwork for the productivity surge of the 1990s. The Productivity Commission's recent five-year inquiry shows that reform ideas are not in short supply, yet to date, little of those ideas have been acted on. Whether Australia can repeat the exercise without a crisis to force its hand remains an open question.

Nevertheless, the need for reform should not be mistaken for a crisis. Australia is one of only nine countries with a AAA credit rating from all three major agencies, its gross government debt is less than half the advanced-economy average, and past IGRs have tended to be too gloomy. The more realistic risk is slower growth than the official projections acknowledge, with the cost falling mostly on younger Australians and wage earners, who already face house prices of about eight times average full-time earnings, double the ratio of 25 years ago.

What it means for investors

Horne's complaint was that Australia had come to treat good fortune as a substitute for good management. Sixty years later, the IGR has in effect handed the job of sustaining prosperity to productivity. Closing the gap between what Treasury assumes and what Australia can deliver will likely take reform on the scale of the Keating years. Until there are signs of that, we expect a wider gap between winners and losers rather than a rising economy carrying the whole share market. Companies that rely on population growth and household spending face weaker tailwinds than they have for a generation, while a sustained higher cost of capital will weigh on rate-sensitive assets. Whilst we have therefore become more cautious on the domestic economy, disciplined company selection continues to uncover pockets of attractive opportunities. Returns from Australian shares are likely to depend more on which companies investors own than on exposure to the market as a whole, favouring businesses whose earnings and cash flow can keep growing through offshore or structural sources of demand. This includes selected resource companies supported by electrification, data-centre investment and supply constraints, despite the IGR's weaker long-term commodity outlook. While the path to sustainable prosperity will be challenging, a selective and disciplined investment approach remains important in preserving and building wealth over the long term.

Stuck in the middle

I don't know why I came here tonight

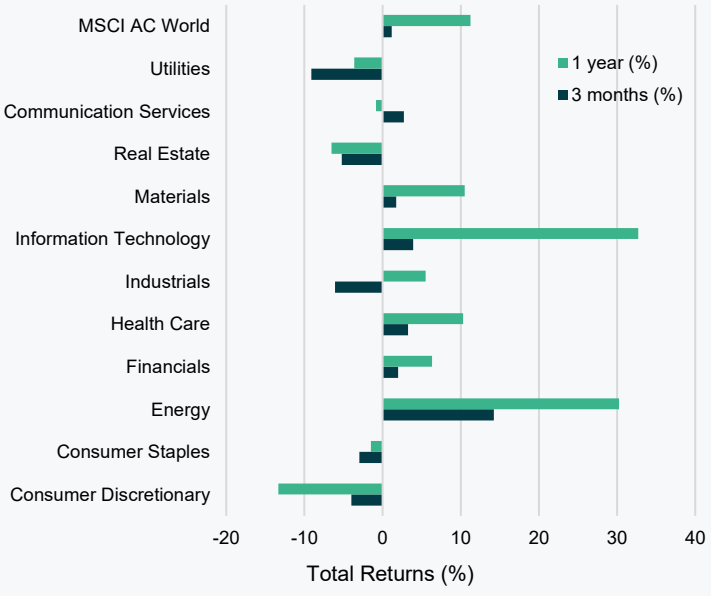
A superficial review of investment market returns over the third quarter would be unlikely to encourage further analysis. Our local stock market delivered a benign but solid 1.3%[1], whilst global equities were not too far behind, with a gain of 1.2%[10]. That domestic shares outperformed their international peers is unusual when compared to recent years, but relatively unremarkable in its own right. Whilst these figures suggest run-rates that are lower than their post-COVID trajectory, they're positive, and comfortably within the margin of error we expect in our Capital Market Assumptions.

It takes only a slightly closer look at the data however, to see that this seemingly calm surface hides a complex investment landscape. This shouldn't be surprising. Indeed, one could look at the current state of oil, inflation, geopolitics, and government debt (to name but a few consternations), in a period when the emergence of artificial intelligence (AI)[31] has the promise of delivering a technological step-change; and think that markets were under-pricing risk.

With that said, markets have generally been in a buoyant mood since the AI thematic emerged in early 2023. We noted last quarter that markets had been remarkably resilient – a sentiment echoed in the title of the IMF's World Economic Outlook[32] 'Resilient Under Strain, Urgent Choices' – and that resilience continues. We would caution though, now is not the time to become complacent.

Whether by casting your eye across interest rate sensitive asset classes, or simply looking below top-line equity market performance into the diverging fortunes of different industry sectors (Chart 4), there are signals abound that suggest a growing vulnerability in the current market backdrop.

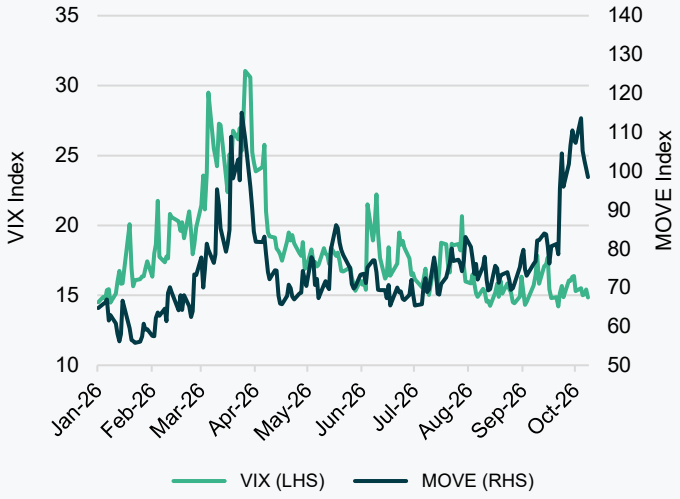
Chart 4: MSCI AC World Index - Sector Returns (AUD)



Source: Factset, Perpetual Private. As at 30 September 2026.

I've got a feeling something ain't right

Chart 5: Equity volatility (VIX index) vs bond volatility (MOVE index)



Source: (LHS) FactSet; (RHS) ICE BofA US Bond Market Option Volatility Estimate (MOVE) Index via Reuters. Data as at 9 October 2026.

Forewarned is forearmed. Whilst our discomfort with certain emergent market characteristics has been building for some time, we have also been comfortable in acknowledging that with the immense wall of capital that is being thrust into data centres and their infrastructure, asset prices were likely to continue to march upwards. It was this very feature that we were alluding to when we titled our December 2025 edition of this publication 'Go with the Flow'.

This current trend will continue until it doesn't, and any rational investor should be doing their utmost to capture that upside whilst it's there. However, as stewards of capital we know that managing risk, particularly during the good times, is a key ingredient in delivering a wholesome return profile.

We must therefore, consider the locations of the deepest potential faultlines in order to best position portfolios for the future.

Middle East

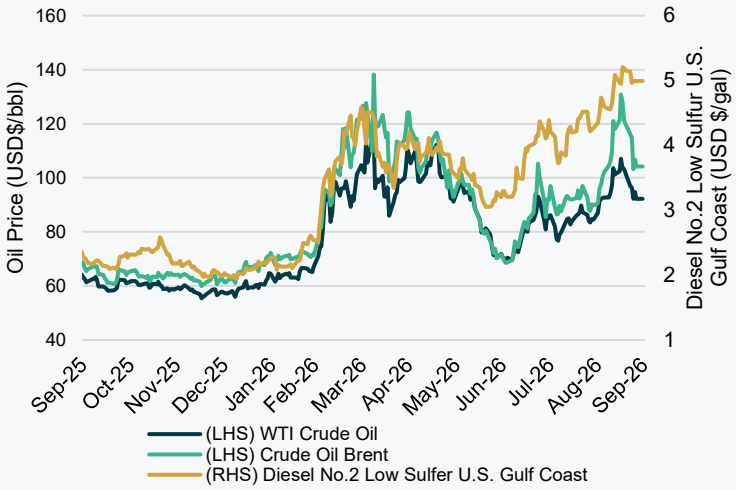
It is impossible to ignore the ongoing conflict in the Middle East. Whilst Iran has now been 'defeated' many times, the conflict continues to disrupt shipping and constrain the movement of key commodities. Oil, natural gas and urea (fertiliser) are all impacted and are feeding into global inflation.

Curiously, recent reports suggest that in spite of the fact the Strait of Hormuz is in many ways still closed, oil via various workarounds is making its way out of the region at levels approaching those that existed pre-conflict. This though, is at an elevated price as the heightened cost of shipping insurance, as well as an assortment of other costs, have gone from just a couple of dollars per barrel of oil, to what some research suggests is approximately $33 per barrel.

If we assume this number is correct, it goes a long way to explain the differential between oil prices prior to March and today. Our rationale as to why oil prices have only recently escalated back above $100, is related to two factors:

1. The Houthis entrance into the conflict and most specifically their attacks on Saudi's East-West pipeline and their threat over the Bab al-Mandab Strait, disrupting the route of oil out through the Red Sea into the Indian Ocean.
2. Commodities traders are no longer trusting the US president's proclamations of cease fire, peace or ultimate victory.

Chart 6: Oil (Brent and Crude) & US Diesel Prices

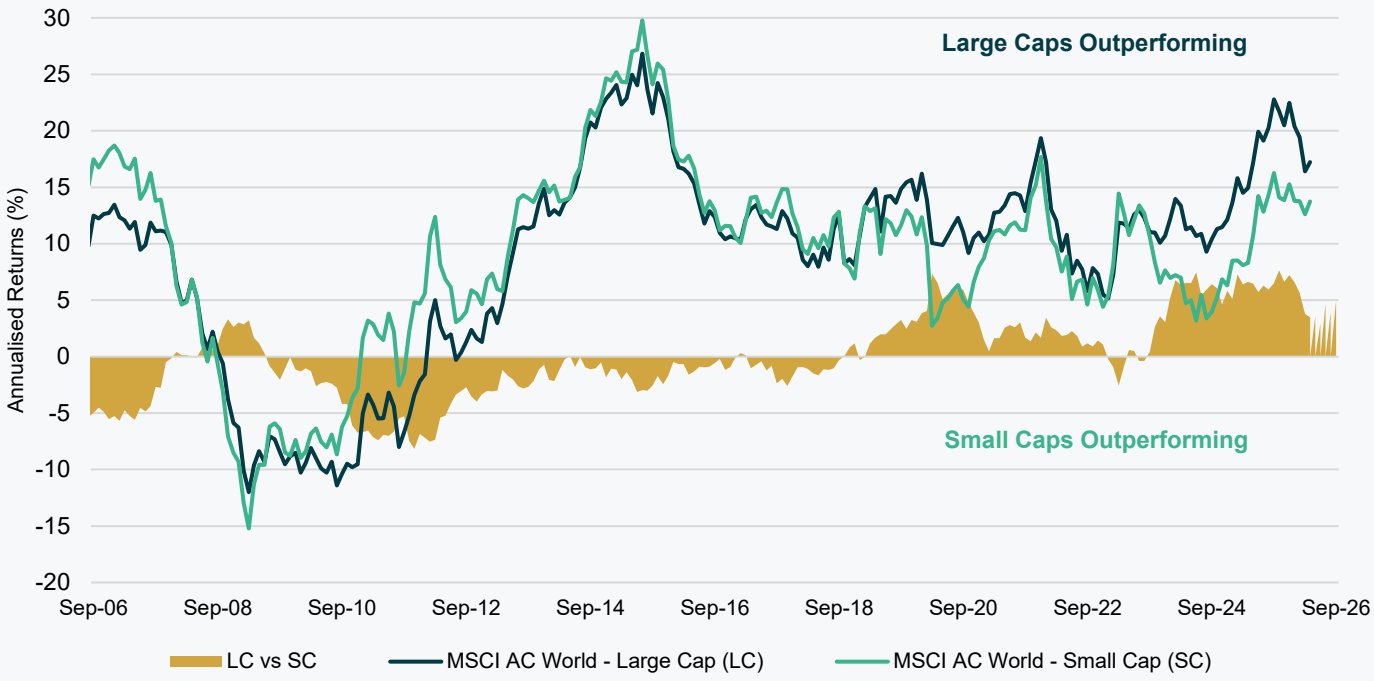


Source: (LHS) FactSet. Data as of 30 September 2026. (RHS). FactSet Economics Standardised Database; Amundi Investment Institute, Bloomberg (as of 30 September 2026).

Large-cap dominance

A curious feature of the past decade and one that has accelerated as a result of AI, is the outperformance of larger companies versus their smaller company peers (Chart 7). This might seem on the face of it to be a relatively innocuous problem but it is not. It has two primary impacts; market structure and economic dynamism. Whether it's immediately apparent or not, many of us have already experienced the former. Unless you were either wise enough or lucky enough to be overweight the 'Magnificent 7' stocks, this development has meant that you have likely lagged the index for the past 3 years. That the largest companies in the global economy have been the fastest growing, is highly unusual against the historical context – smaller companies are typically capable of the fastest growth rates. The other problem with the 'big' getting bigger, is that it tends to stifle entrepreneurialism. When established companies with large amounts of cash flow and low borrowing costs begin to compete with new entrants, they ultimately win. If this isn't managed carefully, it can severely stifle competition whilst also driving up consumer prices.

Chart 7: MSCI ACWI Large Caps vs Small Caps Rolling Annualised 26-month returns (AUD)



Source: FactSet. Data as of 30 September 2026. All returns are in AUD (unhedged).

Inflation vs interest rates

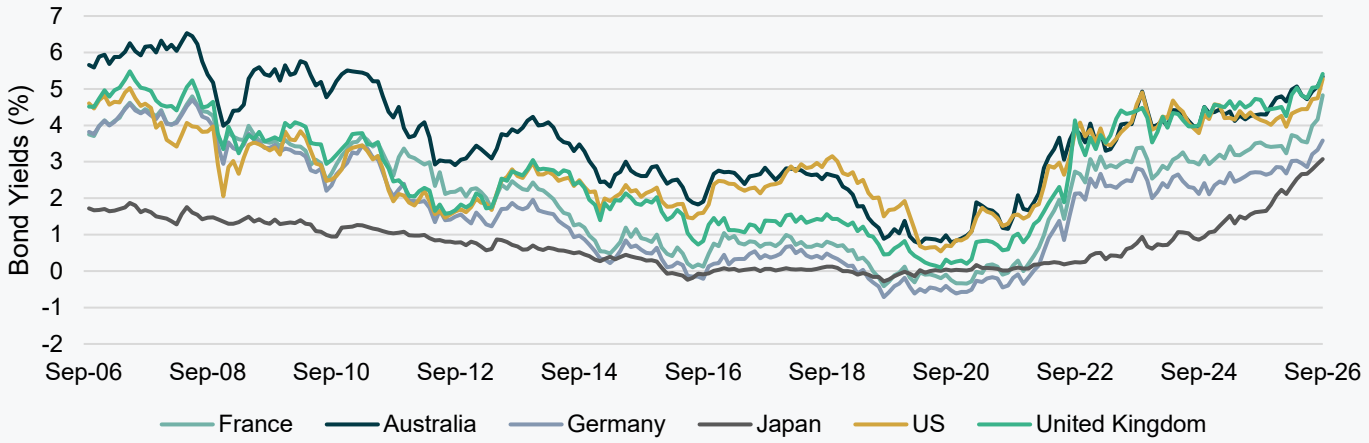
Inflation, after more than a decade of lying dormant, has become a persistent presence since the COVID-19 pandemic. Whilst initially triggered by supply shocks borne out of lockdowns, it has proven itself to be anything but 'transitory'.

Add into the mix the heightened oil price, and we find ourselves again in a monetary tightening cycle, as central banks attempt to tamp down demand and restrain price increases. Whilst this is an impost on the cost of borrowing for the public and private sectors alike, we are also seeing increases in excess of the cash rate rises, out through longer maturities. There are many reasons for this; the sheer amount of government debt (the US recently passed $40,000,000,000,000 - $40 trillion - whilst Australia passed $1,000,000,000,000 - $1 trillion), concerns about central bank ability and indeed willingness (particularly given the growing political pressure they are facing) to address inflation, as well as the competition for capital that is now pitting the AI thematic against government borrowing. Interestingly, because data centres are deemed to be 'infrastructure', and infrastructure is typically classed as low risk, investors have been attracted to the bonds issued by these companies, seeing them as proximate to the risk of government bonds, whilst offering substantially higher yields. We are sceptical about this risk assumption, but regardless, the significant amount of issuance is helping to lead bond yields higher. Given the clear ability of higher yields to drag on economic growth, corporate profits and government budgets, further escalation of this issue could translate into an increasingly difficult economic environment.

US Mid Term Elections

Whilst the three risks above are meaningful, the most proximate whilst also having the ability to seriously derail the global economy, is the upcoming US midterm elections. This is a feature that is somewhat unique to this point in history. Typically, midterms see the opposition party gain ground and the ability to rein in the President's party. This time is no different. What is different however is that President Trump has like no other President in history, attacked the validity of election results. Given his behaviour following his 2020 election loss, the ongoing rhetoric since, and his recent moves to 'nationalise' election processes, means that the potential substantial losses for the Republican party (Trump's approval ratings are currently lower than Richard Nixon's after he was found guilty of the Watergate scandal) may see an attack on the sanctity of the results with potential claims of fraud or invalidity. Whilst the President doesn't actually have the power to overrule the results, litigation and other measures to circumvent the transfer of power, are a real risk. This matters for the global economy. Not only because the US economy is the world's largest and so what happens there matters for us all. What really matters here and what we think we detect in rising US bond yields, is the degradation of the general rule of law. Notably, there are growing suggestions that corruption in the US is particularly high, including in an opinion piece penned by our former ambassador to the US, Joe Hockey. Should there be the impression of impropriety, the strength of faith in US treasuries is likely to meaningfully fall. If this were to happen, we could see bond markets riot, with the potential to dramatically disrupt global financial markets en masse.

Chart 8: Global 10-yr Bond Yields

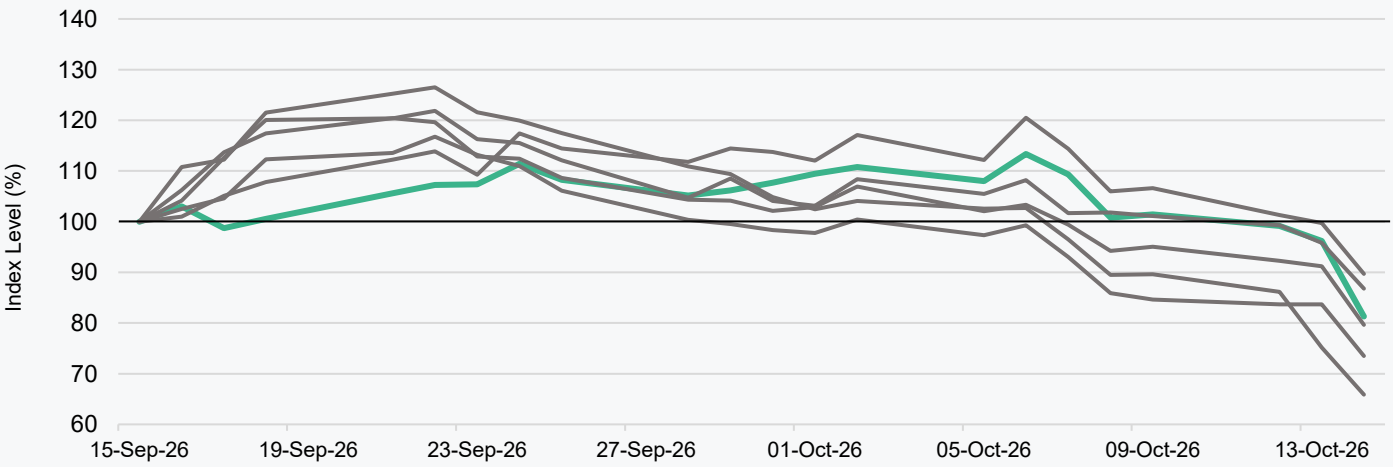


Source: FactSet, ABS, BLS, ONS, Eurostat. Data as of 30 September 2026.

Clowns to the left of me, jokers to the right

These risks above are meaningful, but have varying degrees of likelihood, and pleasingly are rather obvious to most market participants. This is important because 'known unknowns' are far less threatening to market stability than 'unknown unknowns' ("black swans"). Additionally, we are seeing growing trends of investors becoming more sensible in the face of the growing risks. We appear to be out of the period where any company associated with the AI thematic receives unrestrained investor demand. The recent failure of the Firmus IPO here in Australia is a great example of this sensibility. Whilst there were many aspects to the Firmus offering that made it uniquely unattractive, we are also seeing encouraging signs that investment into AI associated assets is becoming more rational and born out of fundamentals rather than hope and hype. Of particular note is the recent developments at CoreWeave, a 'neo cloud' (data centre provider). CoreWeave is undergoing a sharp credit-driven repricing. Shares fell 15.5% on a single day in mid-October and have remained under pressure since. Its 2031 bonds now yield 15.8%, while five-year CDS (insurance against default on the company's bonds) exceeded 1,100bp, levels associated with distressed credit. Investors are questioning whether its heavily debt-funded AI infrastructure buildout can generate cash quickly enough to support the procession of pending interest rate payments. Management counters that its $104bn+ contracted backlog supports the debt obligations, but refinancing risk and negative free cash flow dominate sentiment.

Chart 9: CoreWeave and Neoclouds Price Fall



Source: Factset. Perpetual Private. Data as of 14 October 2026.

Here I am, stuck in the middle with you

Over the coming months, we are likely to remain 'in the middle' of these concerns, and they all have the potential to significantly impact the tone and tenor of the market landscape. As market operators this is as exciting as it is worrying, as market disruptions typically provide an abundance of opportunity for calm headed investors. We have experience in adding value to portfolios through these periods and would expect to do so again, should any of them come to pass.

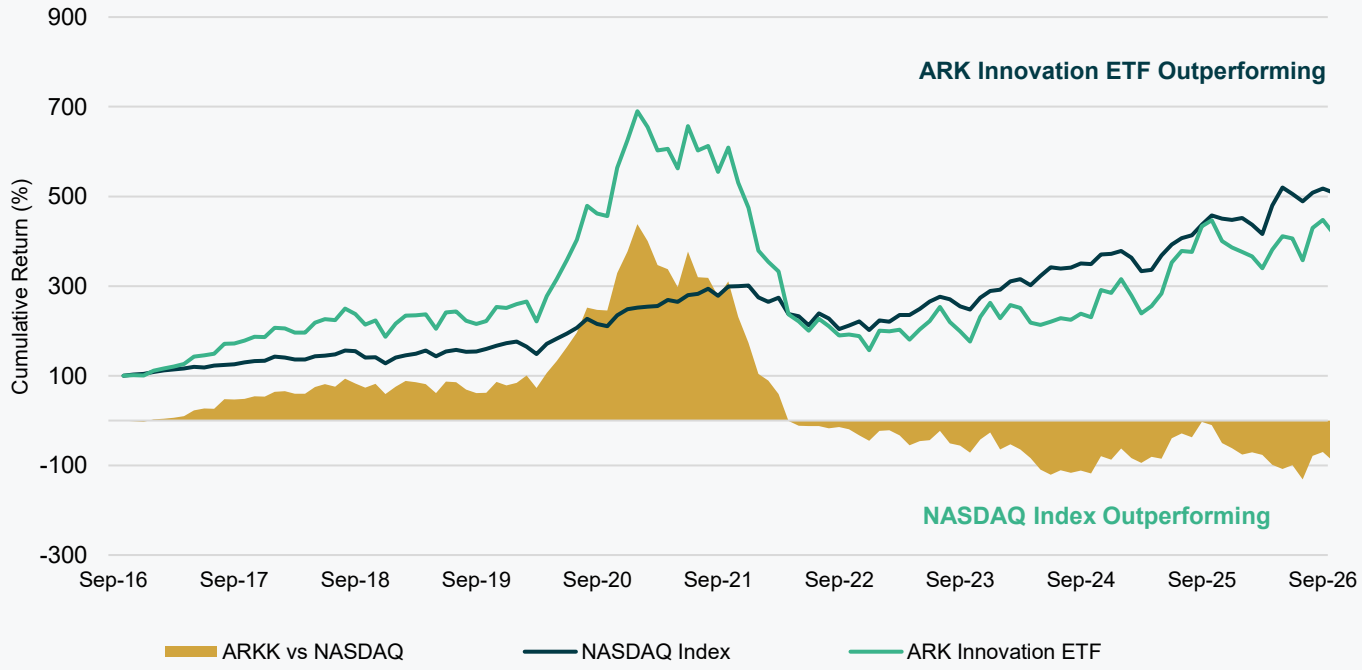
As always, ensuring a broadly diversified portfolio is important. Not only across asset classes, regions and sectors, but also across factors. With AI now pervasive across most areas of capital markets, it's worth contemplating how one might avoid the fallout of a change in sentiment. Whilst we are happy to take returns from this technological revolution where we can find them, we would not be doing our jobs if we weren't also seeking to ensure what we have we hold.

A key cautionary tale here is the story of the ARK Innovation ETF, which performed magnificently well for a number of years through to the pandemic, outperforming the Nasdaq by a margin, before giving it all back and then some, then lagging behind it for the past four years. Capturing alpha is of little use if you cannot protect it when market conditions change.

It can be a hard game remaining patient in frothy markets, but we will, and we think its right to, to prioritise returns over a 'ride'.

As we approach the midterms, expect political rhetoric to escalate, which may also feed into an increase in market volatility. Should they pass in a democratically orderly manner, and none of the other risks noted above come to pass, we may very well enjoy another 'Santa Claus rally' into the end of the year.

Chart 10: ARK Innovation ETF vs Nasdaq Index Cumulative Returns



Source: Factset, Perpetual Private. Data as of 30 September 2026.

Australian Equities

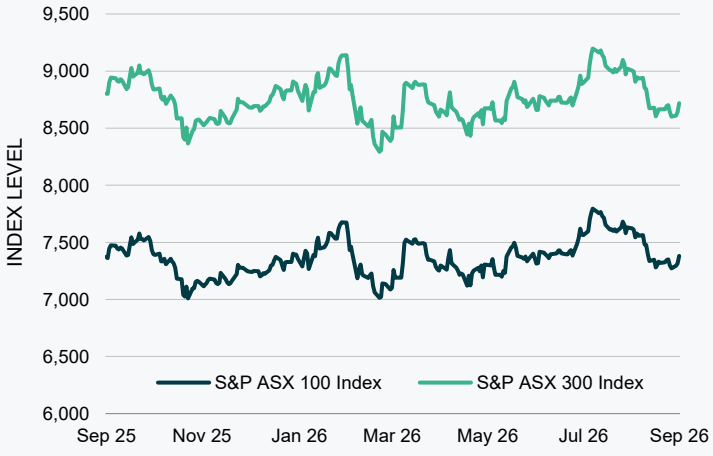
Australian equities delivered modest gains over the September quarter, with the S&P/ASX 300 returning +1.3%[1]. Despite a positive start to the financial year, a resurgence in the oil price and renewed energy security concerns had a dampening effect on returns towards the end of the quarter. Domestically, the August reporting season concluded on a generally positive note, with investors rewarding companies that delivered solid earnings and clear guidance, while punishing those with less certain outlooks. Stronger than expected growth and inflation led the Reserve Bank of Australia (RBA) to raising the cash rate in September.

From a size perspective, small-cap stocks (-0.5%[2]) lagged the broader market, reflecting ongoing investor caution towards businesses exposed to softer domestic demand conditions and higher financing costs. From a style perspective, Value stocks materially outperformed Growth, returning 7.4%[3] over the quarter compared with a decline of -4.3%[4] for Growth. This relative strength has held over the full year, as Value significantly outperformed Growth (22.3% vs -13.0%), reflecting investor preference for attractively valued sectors, particularly those linked to commodities, while Growth experienced continued weakness in high-multiple technology names.

Health Care (+25.4%[5]) was the strongest-performing sector, supported by renewed demand for defensive companies and a positive reporting season with companies such as CSL and Ramsay Health Care delivering outcomes that met or exceeded investor expectations. Energy (+17.3%[6]) also performed strongly driven by higher oil prices and ongoing geopolitical tensions that heightened concerns around global energy supply. Materials (4.8%[33]) generated modest gains but weakened towards quarter end amid concerns around global growth uncertainty.

By contrast, Information Technology (-9.4%[7]) lagged materially amidst the backdrop of rising bond yields which had a negative impact on valuations. Similarly, A-REITs (-8.4%[8]) underperformed over the quarter due to underperformance from Goodman Group. Consumer Discretionary (-9.3%[9]) also lagged driven by weaker consumer confidence and deteriorating spending conditions.

Chart 11: Australian Shares



Source: FactSet, Perpetual Private

Refer to footnotes description on page 30

Australian Equities – Manager Insights and Outlook

Coming into the period, we saw opportunities in Australian equities despite elevated domestic valuations and a difficult economic backdrop. In some parts of the market, share prices appeared to reflect a weaker earnings outlook than company fundamentals suggested. The March sell-off had created opportunities in businesses whose long-term prospects had changed little, particularly across out-of-favour sectors and select smaller company names. We retained these exposures while also expecting further interest-rate hikes and a softer domestic economic outlook.

Our positioning remained broadly balanced across investment styles, while retaining a selective sectoral overweights. Sectors that had earlier de-rated offered attractive valuations, with relatively stable earnings and somewhat stable long-term earnings prospects. In May, we reduced the weights of our concentrated broad-cap managers and increased exposure to large caps, although we continue to remain underweight this part of the market. This moderated our sector biases and reduced the contribution to active risk from concentrated broad-cap strategies. We retained our preference for mid and small-cap companies, where we continued to see better relative valuations and growth opportunities, while bringing overall portfolio risk into a more balanced position.

August reporting season showed that companies were generally managing the difficult backdrop reasonably well, although their outlooks were less assured. Reported company earnings were generally solid, and strong balance sheets supported higher dividends and share buybacks. Management teams were more cautious about FY27 however, and investors were quick to punish uncertain guidance, even where current earnings met expectations. Large share-price moves remained a feature of reporting season, particularly among smaller companies. For us, the important distinction was between businesses facing temporary pressure and those whose earnings outlook had genuinely weakened. A lower share price alone was not enough to make a company attractive.

Heading into year-end, we continue to see attractive company-level opportunities but expect earnings growth to become harder to deliver. The preference for returning capital to shareholders also points to caution about committing to new capital expenditure programs. Pressure on household spending, weaker housing activity and greater regulatory intervention are making growth harder for domestically exposed businesses. For banks, slower mortgage growth and increased competition in business lending may limit the benefit of higher interest rates. In contrast, demand linked to electrification and data-centre investment, alongside supply constraints, continues to support parts of the Resources sector.

We also see a role for value-oriented businesses and select Resources and Energy exposures while supply disruptions and Middle East tensions remain ongoing. Some businesses are cheap for good reason, so our focus is on whether earnings and cash flow support the investment case, rather than expecting lower valuations to reverse on their own. We remain balanced across investment styles, combining greater large-cap exposure to manage near-term risk with selected mid and small-cap businesses offering stronger growth at more attractive valuations.

International Equities

International equities delivered a modest positive return during the September quarter, with the MSCI All Country World index gaining 1.2%[10]. While headline returns were relatively subdued, underlying market leadership shifted as investors reassessed the outlook for artificial intelligence, inflation and interest rates.

Markets entered the quarter on uncertain footing as investors questioned whether the substantial investment flowing into artificial intelligence infrastructure would translate into sustainable earnings growth. Concerns that spending on data centres, semiconductors and advanced AI models was running ahead of near-term economic benefits contributed to weakness across parts of the technology sector during July. However, stronger-than-expected earnings results and ongoing investment within the AI ecosystem helped restore confidence later in the quarter, supporting a recovery in technology shares and broader equity markets.

Investors also faced a renewed inflation shock driven largely by higher energy prices. Escalating tensions in the Middle East, disruptions to global shipping routes and concerns around oil supply pushed Brent crude oil above US$100 per barrel during parts of the quarter. Tightness extended beyond crude markets, with diesel prices rising sharply and increasing costs across transport, manufacturing and logistics. As a result, concerns grew that inflation could prove more persistent than previously anticipated. Reflecting these pressures, both the US Federal Reserve and Bank of Japan tightened monetary policy, while government bond yields climbed to their highest levels in more than a decade across developed markets.

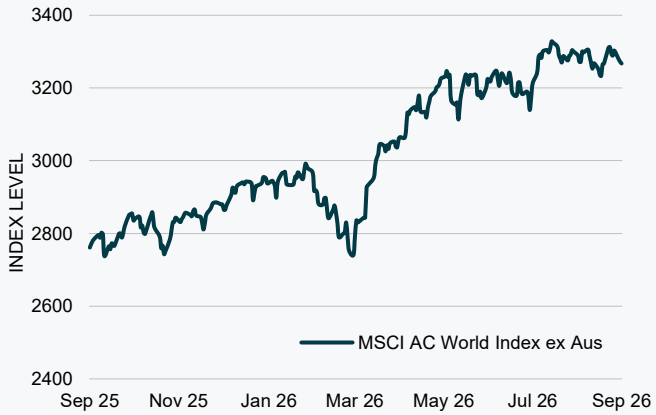
Despite rising interest rates and higher bond yields, economic conditions remained relatively robust. US employment, consumer spending and corporate earnings generally exceeded expectations, helping to alleviate concerns that tighter monetary policy would trigger a significant slowdown in growth. While higher yields weighed on interest rate-sensitive sectors, ongoing investment in the AI-related buildout continued to support parts of the Technology sector, helping the S&P 500 (+1.8%[34]) and Nasdaq Composite (+2.2%[35]) to finish the quarter with positive returns.

Performance across sectors reflected the quarter's changing macroeconomic backdrop. Energy (+14.2%[14]) was the strongest-performing sector as higher oil prices and supply concerns boosted earnings expectations. Information Technology (+3.9%[15]) rebounded following a difficult start to the quarter while Communication Services (+2.7%[36]) and Health Care (+3.3%[37]) also recorded gains. In contrast, Utilities (-9.1%[16]) and Real Estate (-5.2%[17]) were pressured by rising yields and higher financing costs, while Consumer Discretionary (-4.0%[18]) weakened amid pressure on household spending. Value stocks (+3.4%[11]) outperformed Growth (-0.4%[12]) while small-cap equities (-3.6%[13]) also underperformed their large-cap peers.

Regional returns remained mixed. The United States continued to be a key driver of global performance gaining 1.8%[34], while Japan's TOPIX index rose 6.8%[38] as corporate governance reforms and an increased focus on shareholder returns remained supportive. China's Hang Seng index appreciated a healthy 8.1%[39] , recovering some of its previous weakness, while European equities were generally softer amid rising energy costs, higher bond yields and less direct exposure to the AI investment cycle.

Refer to footnotes description on page 30

Chart 12: International shares (local currency terms)



Source: FactSet, Perpetual Private

International Equities – Manager Insights and Outlook

Coming into the September quarter, we expected markets to remain focused on valuations and earnings delivery. The June-quarter rebound had pushed global equities back toward elevated valuations, with leadership concentrated in large technology companies and AI infrastructure. While the rally could continue, we remained focused on whether substantial AI-related capital expenditure was translating into sustainable revenue, margins and cash flow. Geopolitical and energy risks also remained important, as higher oil prices could challenge the inflation outlook, delay policy easing and pressure consumers and corporate margins.

For the portfolio, we continued to favour balance across styles rather than positioning for a single outcome. Growth exposure was positioned to benefit where durable earnings and credible AI monetisation were rewarded, although elevated multiples increased downside risk. Our Value manager provided exposure to more attractively priced businesses and is expected to benefit from firm energy prices and bond yields. Our quant strategies offered diversified multi-factor exposure, though smaller companies remained more sensitive to financing costs and economic activity.

Performance within the Technology sector remained uneven, reinforcing the importance of identifying where sustainable earnings are being generated across the AI value chain. Our Value manager used the July technology sell-off to add to cheaper names including SK Hynix, Oracle and Amazon. Its overweight to Energy was beneficial, but this was offset by overweights to interest-rate-sensitive Utilities and Real Estate, which came under pressure as bond yields rose. The same backdrop challenged our Small-cap Quant manager, while Large-cap Quant strategies were better supported by the stronger earnings of larger companies. For our Quality Growth manager, the recovery in software helped, although higher discount rates and continued scrutiny of AI returns remained headwinds for more expensive companies.

Looking ahead, we remain focused on whether earnings can withstand higher energy prices, tight monetary policy and elevated bond yields. Corporate results have so far been resilient, but the margin for error remains narrow. We expect investors to increasingly favour companies with strong cash generation, genuine pricing power and clear returns from AI investment. More broadly, the outlook will depend on whether persistent cost pressures and higher rates begin to weigh more meaningfully on economic growth and earnings.

From a portfolio perspective, we continue to see merit in maintaining complementary style exposures through our levers-based approach, rather than making wholesale changes in response to short-term market rotations. Our focus remains on concentration risk, earnings resilience and whether each manager continues to fulfil its intended role. Volatility may remain elevated, but it should also create opportunities for disciplined managers able to distinguish temporary price weakness from a genuine deterioration in fundamentals.

Real Estate

The September quarter was broadly challenging for Listed Real Estate as inflation risks materialised across major economies. Improved conditions seen through the June quarter faded quickly as pressures stemming from the unresolved stalemate in the Middle East prompted global yields to rise and central banks to tighten, constraining the rate-sensitive sector.

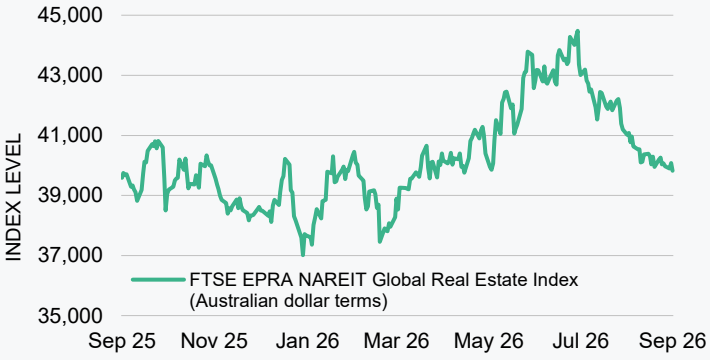
Australian REITs (A-REITs) slid 8.4%[19], dragged down by index heavyweight Goodman Group which fell 12.3% over the period as more conservative FY27 guidance overshadowed an FY26 earnings beat. Residential-exposed developers were also among the hardest hit, with investor demand and in turn sales volumes dampened on the back of earlier changes to negative gearing and capital gains tax rules. Sub-sector woes were further compounded by falling prices which ate into development margins, as did building and financing costs which remained elevated. Office showed signs of stabilisation, while activity in Retail was more constructive, aided by lease structures that often tie rental growth to inflation.

Global REITs (G-REITs) suffered under similar circumstances, finishing 6.1%[20] lower over the quarter. Asia was most resilient with Hong Kong the only market to post gains (5.6%) [21] as improving fundamentals and deeply discounted valuations buoyed a rebound in investor sentiment. Japan fell 2.9%[22], supported by organic rent growth amid ongoing rate normalisation and low vacancy rates, helping to offset the impact of rising bond yields. The US (-6.7%[23]) fared worse, with losses concentrated in areas such as office, residential, and real estate financing as Treasury yields moved higher. Though none were worse off at the hands of rising yields and a deteriorating rate outlook than Europe (-9.6%[24]), weighed particularly by the downturn of German REITs (-21.5%[40]).

Chart 13: Australian real estate trusts (A-REITs)

Source: FactSet, Perpetual Private

Chart 14: Global real estate investment trusts (G-REITs)



Source: FactSet, Perpetual Private

Refer to footnotes description on page 30

Real estate – Manager insights and outlook

Entering the quarter, we remained constructive on real estate. Despite present geopolitical and inflation-related risks and their potential impact on interest-rate expectations, REITs remained relatively attractive, supported by their income-generating characteristics and improving property market fundamentals. Following a broad rerating across listed property, confidence that financing costs were peaking had grown, valuations appeared to be stabilising, and transaction activity was showing signs of recovery. Dispersion in performance was expected with conditions suiting those segments of the market leveraged to structural growth forces, such as industrial property, logistics, data centres, senior housing and selected retail assets.

Over the period, many of the fundamental themes anticipated at the start of the period remained intact; however, macroeconomic developments became the dominant driver of returns. Within Australia, Data Centre and Office exposures represented two of three sub-industries with positive performance despite the challenging environment. Overweight data centre positions (Digico) added value over the quarter, and within Office a selective holding in GDI Property and an overweight position in Dexus, the latter being the primary contributor to the Office segment's positive return, both added to excess returns. A moderate underweight to Goodman also benefited relative performance, with the stock retracing after a prolonged period of strong share-price growth. Given its significant index weight, weakness in Goodman was a major contributor to the decline in the broader Industrial REIT sector.

Global Real Estate market losses were marginally softer than domestic counterparts in aggregate and whilst fewer segments of the market provided absolute positive performance, dispersion across sectors was less pronounced than in Australia. Pleasingly, Data Centres, experienced smaller drawdowns than many other segments of the market. This, combined with significant overweights to several of the sector's stronger-performing securities, supported relative returns. Outside of this theme, performance was more mixed, with stock-specific results across Office, Retail and Industrial property highlighting the ongoing importance of active security selection. North American and European Real Estate were the primary contributors to performance headwinds. However, UK securities to which we ran a moderate overweight, experienced comparatively smaller drawdowns, helping dampen wider index losses.

Looking ahead, while our near-term outlook has become more cautious given a more challenging macroeconomic backdrop, we continue to believe REITs remain relatively attractive due to their income-generating characteristics and improving property market fundamentals. While we anticipate interest-rate expectations remaining an important driver of near-term returns, recent market weakness has improved valuation support across parts of the asset class.

Growth alternatives

Financial markets remained resilient through 2026 and into the third quarter. Investors generally looked beyond heightened geopolitical uncertainty and changing interest-rate expectations, which helped sustain risk appetite across most major asset classes.

Against this backdrop, Private Equity activity improved modestly during the quarter. Global deal value and exits were supported by several large transactions, alongside steady middle-market and add-on activity. Fundraising remained selective and concentrated among larger managers, while subdued distributions kept the focus on disciplined deployment and credible pathways to liquidity for investors.

A combination of selective megadeals and ongoing mid-market and bolt-on activities lifted deal value despite broadly flat transaction volumes. Notable transactions included Apollo's acquisition of a significant interest in Atlantic Aviation at a valuation of nearly US$10 billion, and Apollo and KKR's €3 billion capital solution for Bayer's long-acting contraceptives business. These transactions also illustrated the increasing use of partnership and structured-capital solutions alongside conventional buyouts. Operating conditions across portfolio companies were mixed: modest revenue growth and higher wage, input and financing costs kept management teams focused on margin protection, pricing, procurement and working-capital discipline. Practical applications of AI also advanced in customer service, software development and back-office functions, with implementation centred on measurable productivity gains. Valuations remained an important consideration. Private transaction multiples remained above those of many listed-market comparables, particularly for high-quality assets, requiring stronger growth, resilient margins and reliable cash generation to support a private-market premium at exit. Longer holding periods continued to defer distributions and increased the importance of operational value creation. Institutional investors therefore remained selective, concentrating commitments with established managers and favouring small and mid-market buyouts, sector specialists, co-investments and secondaries. Liquidity and demonstrated distributions remained central to renewal decisions as fundraising consolidated among fewer, larger funds.

Private Equity Real Estate activity also continued to recover across the US and Europe, although transaction volumes remained below prior-cycle levels and capital was directed towards sectors offering resilient occupancy and visible rental growth. In the US, multifamily fundamentals remained broadly sound, supported by limited housing affordability and higher mortgage rates in the owner-occupier market. Outcomes varied by location, however, as elevated supply moderated rental growth and increased concessions in some Sunbelt cities. The sharp decline in construction starts should create a more supportive medium-term environment once existing supply has been absorbed. In Europe, living assets continued to attract capital because of structural housing shortages, while valuations were broadly stable to modestly higher following the earlier repricing. Uncertainty around inflation and long-term bond rates continued to constrain transactions and financing, making income growth, asset selection and active management more important drivers of returns. Acquiring assets below replacement cost should provide an additional margin of safety, although allocator demand remained weak, particularly for commingled funds.

Infrastructure investment continues to be concentrated in digital infrastructure, power and the energy transition, where investors favour scaled platforms and assets supported by contracted or regulated cash flows. Key transactions included Brookfield's reported US$7 billion acquisition of battery-storage developer Aypa Power from Blackstone, Harrison Street's US$2.9 billion acquisition of Antin's US district-energy platform, and CVC DIF's acquisition of German data-centre operator Firstcolo. Capital raising remained selective and favoured established managers, while substantial debt and equity funding continued to support data-centre development. Valuations remained firm for scarce, high-quality digital and power assets. At the same time, closer scrutiny of leverage, power availability, development risk and customer concentration reinforced the need for disciplined underwriting.

The UK water sector remained an area of particular pressure. The sector continued to grapple with ageing networks, substantial environmental and service-quality investment requirements, affordability constraints and highly leveraged capital structures which have created a difficult operating environment. The planned replacement of Ofwat with a single integrated regulator is expected to bring more intensive, outcomes-based supervision and stronger enforcement, with greater emphasis on long-term asset resilience and sustainable capital structures. The challenge will be to balance customer affordability with returns that remain sufficient to attract private investment. Implementation is likely to take time, and further challenges may emerge across other assets in coming periods.

Hedge funds maintained positive momentum through the third quarter, supported by elevated market dispersion, resilient risk assets and stronger opportunities for active security selection. Equity Long/short, Quantitative Macro, Multi-strategy and Relative Value approaches led performance and supported industry inflows. Regional demand was strongest in Europe and Asia, with Asian equity managers benefiting from exposure to AI-related supply chains, while North America continued to dominate new fund launches. Allocator interest remained focused on Equity Long/short, Multi-strategy and Global Macro, with selective demand for systematic and event-driven strategies positioned to benefit from volatility and corporate activity. One notable event was the sharp unwind of Situational Awareness, an AI-focused hedge fund with concentrated and highly leveraged positions. The resulting forced selling across semiconductor and AI-infrastructure stocks showed how leverage and crowded exposures can amplify otherwise contained market moves. Our portfolios had no exposure to the fund. Given this environment, we continue to favour hedge fund strategies offering asymmetric return profiles, relative value opportunities and exposure to higher market dispersion.

Income alternatives

Performance for the Fund has been disappointing over the last 12 month, off the back of some subdued performance from the Broadly Syndicated Loan (BSL) market and Foreign Direct Lending allocations.

Earlier this year it seemed as though the investment world discovered vibe coding and then decided that software-as-a-service was broken. The theme caught on and even ended up with its own nickname: SaaSpocalypse.

Whilst quite a clever nickname, caution should be taken against the overuse of "-pocalypse" in portmanteaus. For example, recently RAMpocalypse was being used to describe a spike in memory prices. At this rate we'll be declaring an ‘apocalypse’ every second Tuesday.

Software is a big part of the US BSL market, representing around 12.5% of the Morningstar LSTA US Leveraged Loan index. SaaSpocalypse was a big contributor to the under-performance of the index, which fell 0.55% in Q1 2026.

The market has recovered, with the same index returning 1.88% in Q2 and 1.64% in Q3. The recovery can be attributed to Private Equity doing less software deals which would be financed by the Leveraged Loan market and a general tightening of spreads.

We are diversified across region and debt types, with a software exposure of less than 5%. However, we were not immune from the pain with our US Leveraged Loan and US Private Debt exposures suffering software related falls in Q1 and then recovering somewhat in Q2 and Q3.

Late last year, the Fund rotated out of Broadly Syndicated Loans and cash to go overweight in Australian Floating-rate credit, Catastrophe Bonds and Australian Insurance Premium Funding.

The year earlier, we expanded into Speciality Finance focussed on providing capital solutions to 2nd tier banks and non-bank lenders. We would later add two global exposures, one a large company generalist asset backed lender and the other, a middle market asset backed lender. 2025 was also the year the Fund ramped up its exposure to private Insurance-linked assets.

These new exposures are not reliant on Private Equity market deal flow, like Broadly Syndicated Loans and Sponsor-backed Direct Lending are. All four have since been the strongest performers in the Fund.

The performance of our older vintage investments in Special Situations, Core Property and Commercial Real Estate Lending continue to lag expectations.

Private markets survived the post COVID tightening cycle but are now facing another tightening cycle in a few short years. The market had anticipated an easing cycle in 2026 and that deal flow would improve because of the lower borrowing costs. That was not the case. In fact, what we witnessed was actually the opposite. Private Equity companies may hold on to their companies longer, which reduces their IRR and reduces the velocity of capital for the Direct Lending market that supports it.

The increased borrowing costs flow on to specialty finance and direct lending. Large banks will often provide the senior layer of a credit facility. Think of this as a short to medium term loan facility helping originators to issue loans to borrowers.

In the US, large banks are already being more selective of the direct lenders they provide leverage to. This is reflected in reporting from Bloomberg, that showed big US banks are being more nuanced about which asset backed lenders they deal with.

There has been a lot of news around Bathla and redemption gates for Australian funds. In the case of Bathla, from our knowledge some lenders have foreclosed on assets and are in the process of selling. This is the test for recovery rates for these deals. The good part is that these funds were able to exercise their rights over assets.

Redemption gates should be part of a fund if it has illiquid or semi liquid assets. This helps reduce the "last man standing risk" where all the high value liquid assets are sold first, leaving the less liquid assets for clients that stayed. In the US, we've seen non-traded business development companies gate for 2 quarters in a row. In Australia, we've seen this happen more recently with property heavy private debt funds.

We've managed to avoid both non-traded BDCs and only have a small exposure to property heavy private debt through our specialty finance exposure. We hold some of the same economic risks as property backed private debt through our floating rate note investments. Fortunately, these are liquid. Something we tested during the COVID period.

Fixed Income

Surging global yields eroded fixed income returns through the September quarter, with concerns over higher-for-longer inflation, ballooning fiscal deficits, and ongoing geopolitical conflict placing upward pressure along global yield curves. While energy price pressures eased through the second quarter, the absence of a lasting resolution to conflicts across the Middle East and Eastern Europe saw renewed strength in oil prices, complicating the global inflation outlook and reinforcing a tighter policy agenda for many central banks.

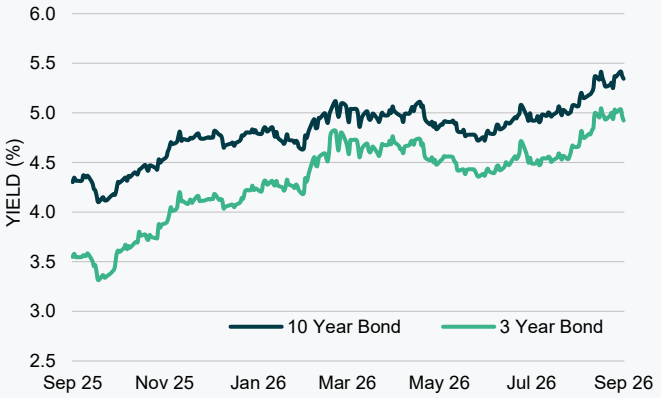
With another rate hike to close out the quarter at its September meeting, the RBA lifted the official cash rate to 4.6%, a full 100 basis points higher than at the beginning of the year. Against this backdrop, Australian government bonds weakened by 1.5%[25] over the period as domestic yields climbed higher. While global forces played a significant role, elevated public spending and persistent supply constraints continue to complicate the inflation outlook, with hopes for improved productive capacity increasingly resting on the successful adoption of AI. Investment Grade credit also declined modestly, down 0.7%[26], as relatively attractive spreads and outright yields cushioned losses as bond yields rose. Meanwhile, Floating-rate credit gained 1.2%[27], demonstrating the benefits of reduced duration exposure in a rising yield environment.

Many of the forces shaping domestic markets were echoed abroad, as global bond markets retraced 2.4%[28] through the quarter. In the US, buybacks of long-dated Treasuries did little to alleviate pressure at the long end of the yield curve. A widening fiscal deficit and increased government debt issuance lifted funding requirements, while hyperscaler borrowing and AI infrastructure investment competed for the same pool of investor capital. Compounding these pressures was the gradual withdrawal of traditional sovereign debt buyers, alongside uncertainty surrounding Japanese capital flows amid the ongoing carry-trade unwind. Together these factors pushed term premium higher and contributed to a 3.4%[41] decline across the broader US bond market.

Corporates were also weak, particularly through September as rate expectations shifted. Global Investment Grade credit lost 3.0%[29], while the shorter-duration High Yield segment fell by 2.0%[30]. The relative outperformance of high yield suggested duration, rather than corporate fundamentals, remained the primary headwind for credit markets during the quarter, though the higher-rate environment continued to expose vulnerabilities across more leveraged and illiquid segments of private credit.

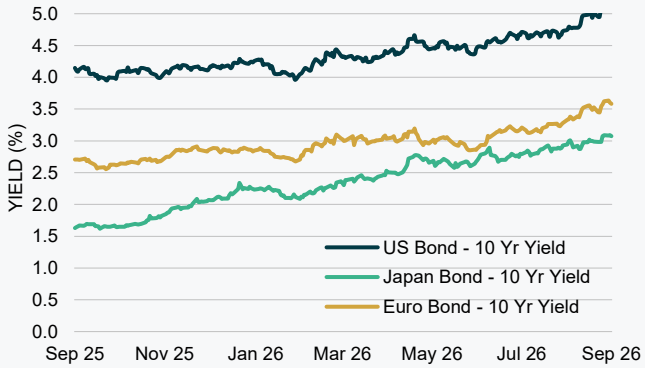
Refer to footnotes description on page 30

Chart 15: Australian government bond yields



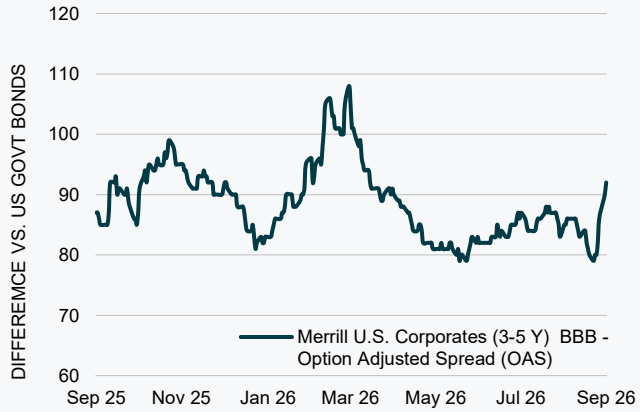
Source: FactSet, Perpetual Private. Note: Bond prices are inversely correlated with bond yields.

Chart 16: Global government bond yields



Source: FactSet, Perpetual Private.

Chart 17: Global credit markets



Source: FactSet, Perpetual Private.

Fixed income – Manager insights and outlook

The same driving market factors have been recurring for some time now with slight variations. Inflation is high and sticky. Energy prices are a concern. Credit spreads are tight. This consistency saves us effort on identifying these structural components, but is not so great for positions which are long duration. It is however, surprisingly good for credit markets, relatively speaking.

There has been a lot of press about the US 30-year Treasury yield reaching levels not seen for decades, affecting anyone who uses it as a reference rate, including prospective homeowners in the United States. The US 30-year Treasury yield approached 5.4% during the quarter, near the highest levels seen since before the Global Financial Crisis in 2007/08.

Our Fixed Income funds are benchmark focused, meaning we're generally more affected by moves in the 5 and 10-year parts of the curve. By quarter-end, the US 10-year Treasury yield had risen to approximately 5.3%, while the Australian 10-year Commonwealth Government Bond yield had reached approximately 5.25%.

The moves are attributable to the market's view on inflation and growth. You could blame the rising yields on several things, including, but definitely not limited to rising energy prices and rising labour costs. Some of these might be short lived but we're not counting on it. The moral of the story is that inflation is a thing again and with it, more historically 'normal' bond yields.

In 2008, markets had more than a bit of a shake-up. The Federal Reserve, European Central Bank, Bank of England and Reserve Bank of Australia all moved towards what they described as highly accommodative monetary policy settings. In the United States, policy rates ultimately fell to effectively 0%-0.25%, while Australia eventually reached a cash rate of 0.10%. Central banks did not pursue these policies because economic conditions were strong. The RBA later described the subsequent increase in rates as a process of "normalising monetary conditions".

Having super-low interest rates is not a sign of a healthy economy, regardless of what politicians, equity strategists or property spruikers might tell you. The fact that those settings persisted for more than a decade does not make them normal. It may simply mean the emergency lasted longer than widely understood.

If that's true, then today's bond yields may be closer to the long-term baseline than many investors appreciate.

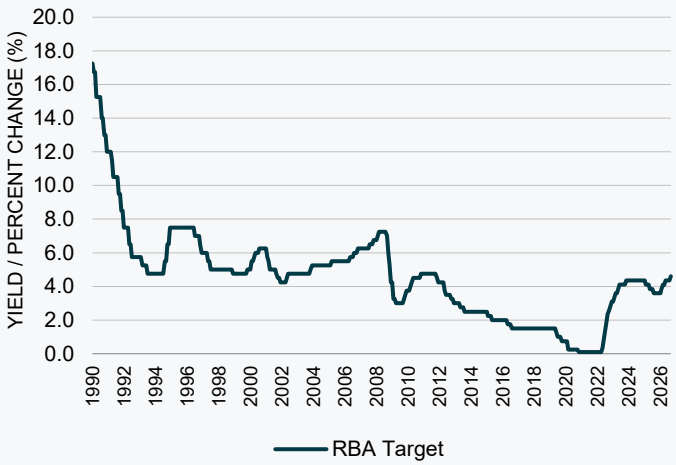
Australian Cash Rate

The September quarter marked a return to the RBA's tightening cycle with the Reserve Bank of Australia (RBA) increasing the cash rate to 4.6%. In the first two months of the quarter, the RBA left the cash rate unchanged at 4.35%, citing evidence that earlier policy tightening was continuing to moderate demand and that inflation had eased modestly from recent highs. June quarter inflation data came in slightly below expectations, prompting markets to scale back near-term pricing for additional rate increases.

However, the outlook changed materially through September as inflationary risks re-emerged. Higher global energy prices, rising costs for technology-related goods and ongoing domestic capacity constraints contributed to stronger-than-expected inflation outcomes. At the same time, businesses continued to indicate they were facing cost pressures and were either increasing prices or considering doing so, raising concerns that inflation could prove more persistent than previously anticipated.

Against this backdrop, the RBA increased the cash rate by 25 basis points at its September meeting, taking the policy rate to 4.60%, the highest level since 2011. The Board noted that some of the upside inflation risks previously identified had begun to materialise, while growth in economic activity had proven more resilient than expected despite tighter financial conditions. Although housing prices and lending activity weakened over the quarter and labour market conditions softened modestly, the RBA judged that further policy tightening was warranted to ensure inflation returns to its target range.

Chart 18: Long-term cash rate



Source: FactSet, Perpetual Private.

Australian cash rate – Outlook

Heading into the final months of 2026, the RBA's focus remains firmly on ensuring inflation returns sustainably to its 2-3% target range. While higher interest rates have helped moderate housing activity, lending growth and consumer spending, recent inflation prints suggest that inflation is proving more stubborn than expected. Persistent services inflation, weak productivity growth and ongoing capacity constraints continue to limit the economy's ability to absorb demand without generating inflationary pressure, reinforcing the Board's concern that inflation could remain above target for longer.

At the same time, broader economic conditions have remained relatively resilient. Labour market conditions have eased from historically tight levels but continue to support household incomes and spending, while business activity has generally remained consistent with moderate economic growth. This resilience has provided the RBA with greater flexibility to prioritise its inflation objective.

Market expectations for the cash rate outlook shifted materially during the quarter. Investors had been increasingly believing that the RBA had likely reached the peak of the tightening cycle, however stronger-than-expected inflation data and the subsequent rate increase prompted a reassessment of that view. Markets are now pricing roughly one additional 25 basis point increase by early 2027[42].

Looking ahead, the RBA appears comfortable maintaining a restrictive policy stance for an extended period. While future decisions will continue to remain data dependent, the Board is likely to require clear evidence that inflation is returning sustainably towards target before considering policy easing. As a result, even if the current hiking cycle is nearing its conclusion, interest rates are expected to remain higher for longer than markets have previously anticipated.

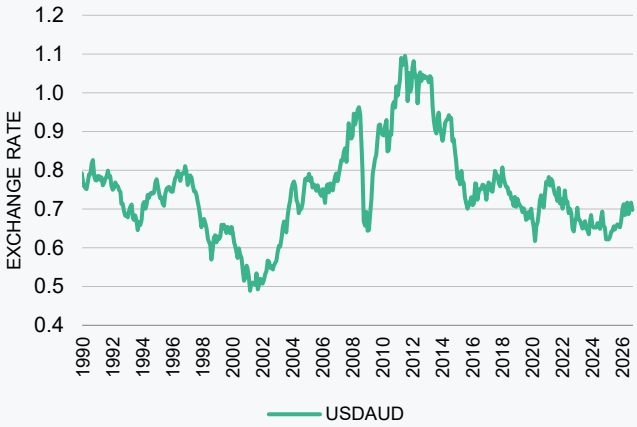
Australian Dollar

The Australian dollar (AUD) experienced considerable volatility during the September quarter, strengthening from around US$0.69 in early July to trade above US$0.72 by early September before surrendering those gains to finish the quarter near US$0.70.

The AUD's rally through July and August was underpinned by growing confidence that Australian interest rates would remain elevated. Persistent inflationary pressures and resilient domestic economic activity led investors to increasingly price the possibility of further policy tightening by the Reserve Bank of Australia (RBA), while expectations for US rates remained broadly stable. As Australia's projected interest rate advantage widened, capital flows supported the AUD, lifting the currency to its highest level in several months.

The AUD's rally proved short-lived, however, with the currency retreating through the second half of September as expectations for US interest rates shifted higher. Strong economic data and renewed concerns around inflation persistence led investors to reassess the US policy outlook, prompting Treasury yields to rise and supporting broad-based US dollar strength. While the RBA delivered a rate increase in September, markets increasingly concluded that US rates is likely to rise further through to mid-2027. As relative interest rate expectations moved back in favour of the US dollar, the AUD ceded its earlier gains to finish the quarter near its starting level.

Chart 19: Australian dollar US dollar (daily) long term



Source: FactSet, Perpetual Private

Australian dollar – Outlook

The outlook for the Australian dollar remains finely balanced and is likely to be driven primarily by changes in relative monetary policy expectations. While the RBA has continued to confront persistent domestic inflation pressures, signs of softer household consumption and a gradually easing labour market have added uncertainty to the domestic outlook. Policymakers face a delicate balancing act between returning inflation to target and avoiding an unnecessary slowdown in economic activity. As a result, the future path of Australian interest rates remains uncertain, with markets continuing to debate whether further policy tightening will be required.

The US outlook may prove equally important. Strong economic data, resilient employment conditions and renewed concerns around inflation have led investors to materially revise their expectations for Federal Reserve policy rate. Markets currently anticipate at least one further rate increase by early 2027.

Against this backdrop, we expect Australian-US interest rate differentials to remain the dominant driver of AUD performance over the coming quarter. While supportive commodity prices and Australia's relatively attractive yield profile may provide periods of strength, a sustained appreciation in the currency is likely to require either a moderation in US growth and inflation expectations or evidence that Australian economic conditions remain sufficiently resilient to keep domestic policy settings restrictive for longer. Until greater clarity emerges around the respective policy paths of the RBA and Federal Reserve, the AUD is likely to remain sensitive to incoming economic data, shifts in interest rate expectations and broader changes in global investor sentiment.

1. As measured by the S&P/ASX 300 – Total Return index
2. As measured by the S&P/ASX Small Ordinaries – Total Return index
3. As measured by the MSCI Australia Value – Net Return index
4. As measured by the MSCI Australia Growth – Net Return index
5. As measured by the S&P/ASX 300 Health Care (Sector) – Total Return index
6. As measured by the S&P/ASX 300 Energy (Sector) – Total Return index
7. As measured by the S&P/ASX 300 Information Technology (Sector) – Total Return index
8. As measured by the S&P/ASX 300 A-REIT index
9. As measured by the S&P/ASX 300 Consumer Discretionary (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 Value index in AUD (unhedged) terms
12. As measured by the MSCI World Growth index in AUD (unhedged) terms
13. As measured by the MSCI AC World Small Cap index in AUD (unhedged) terms
14. As measured by the MSCI AC World – Energy index in AUD (unhedged) terms
15. As measured by the MSCI AC World – Information Technology index in AUD (unhedged) terms
16. As measured by the MSCI AC World – Utilities index in AUD (unhedged) terms
17. As measured by the MSCI AC World – Real Estate index in AUD (unhedged) terms
18. As measured by the MSCI AC World – Consumer Discretionary 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 Global index in AUD unhedged terms
21. As measured by the FTSE EPRA Nareit Hong Kong index in AUD unhedged terms
22. As measured by the FTSE EPRA Nareit Japan index in AUD unhedged terms
23. As measured by the FTSE EPRA Nareit USA index in AUD unhedged terms
24. As measured by the FTSE EPRA Nareit Europe index in AUD unhedged terms
25. As measured by the Bloomberg AusBond Composite (0+Y) index
26. As measured by the Bloomberg AusBond Credit (0+Y) index
27. As measured by the Bloomberg AusBond Credit FRN (0+Y) index
28. As measured by the Bloomberg Global Aggregate (AUD hedged) index
29. As measured by the ICE BofA Global Corporate (AUD hedged) index
30. As measured by the Bloomberg Global High Yield (AUD Hedged) index
31. Or 'Super Intelligence' as the US administration has recently announced
32. International Monetary Fund, World Economic Outlook, October 2026: Resilience Under Strain
33. As measured by the S&P/ASX 300 Materials (Sector) – Total Return Index
34. As measured by the S&P 500 index in AUD (unhedged) terms
35. As measured by the NASDAQ index in AUD (unhedged) terms
36. As measured by the MSCI AC World – Communication Services index in AUD (unhedged) terms
37. As measured by the MSCI AC World – Health Care index in AUD (unhedged) terms
38. As measured by the TOPIX index in AUD (unhedged) terms
39. As measured by the Hang Seng index in AUD (unhedged) terms
40. As measured by the FTSE EPRA Nareit Germany index in AUD unhedged terms
41. As measured by the Bloomberg US Aggregate (AUD hedged)
42. Market implied expectations as at 20th October 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.

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JACARANDA
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