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# Portfolio Perspectives

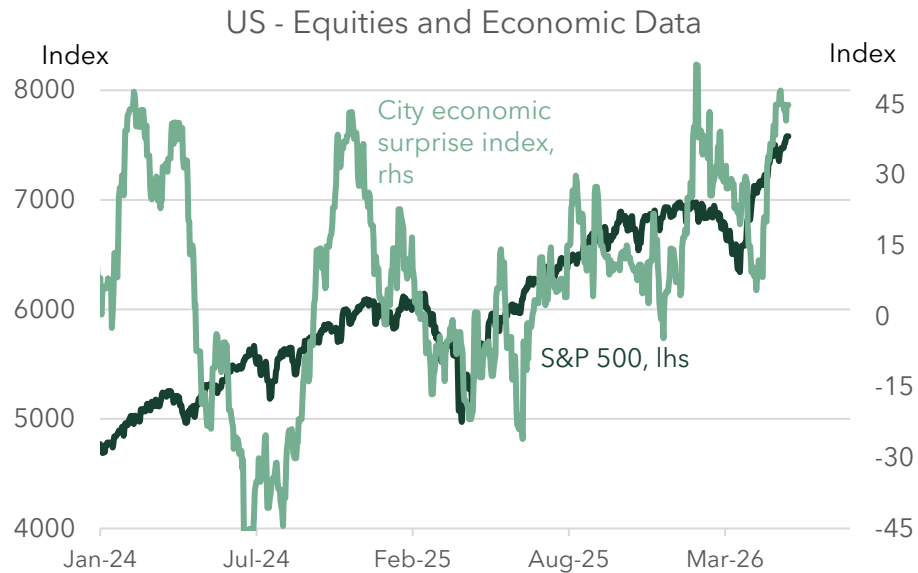
May 2026

# Key Messages for Investors

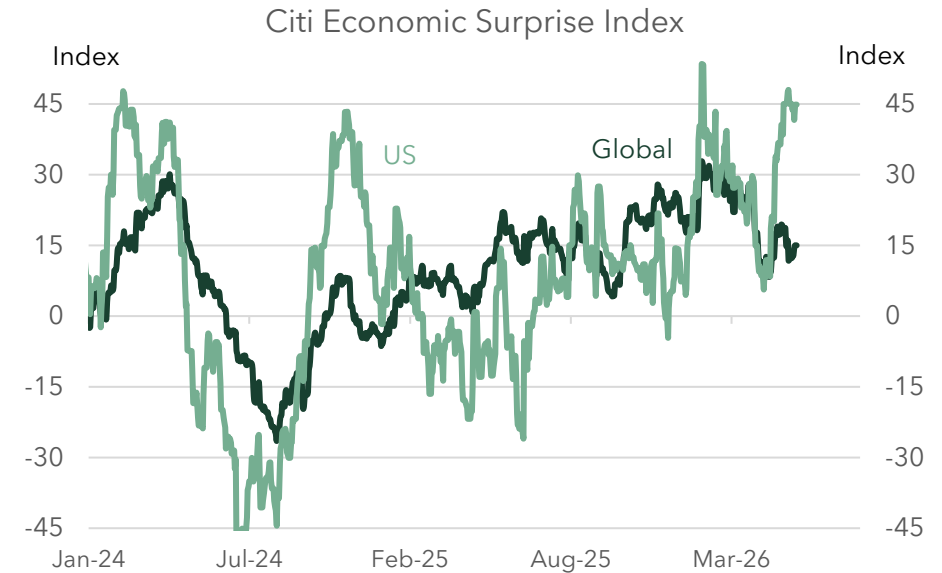
- It is important to distinguish between the cyclical and the structural. Markets will remain more volatile than usual while uncertainty around the conflict in the Middle East persists, but the structural outlook is constructive.
- The US reporting season has been exceptionally strong, the AI capex boom continues, and the consumer remains resilient. Reflecting this, US equities have outperformed and pushed to record highs.
- Domestically, the picture is more complicated. A cyclical slowdown is underway as inflation is too high and the RBA has tightened policy quickly, placing pressure on consumers. Australian equities have consequently underperformed.
- Even so, Australia's structural outlook remains positive, underpinned by balance sheet strength and a globally significant resource endowment.
- There are investment opportunities in this environment and pragmatic portfolio optimisation is warranted. But radical changes are rarely rewarded over the long run.
- We continue to expect near-term underperformance in Australian equities, while opportunities to add domestic duration should emerge over time.

# US exceptionalism continues

## US equities have moved firmly higher, supported by earnings and the economic data



- The S&P 500 has recovered strongly from its April lows.
- Over the first quarter reporting season 84% of companies on the S&P 500 that reported results beat analysts' estimates.
- The US economic data also supports the price action in equities. And it has consistently exceeded analysts' expectations.

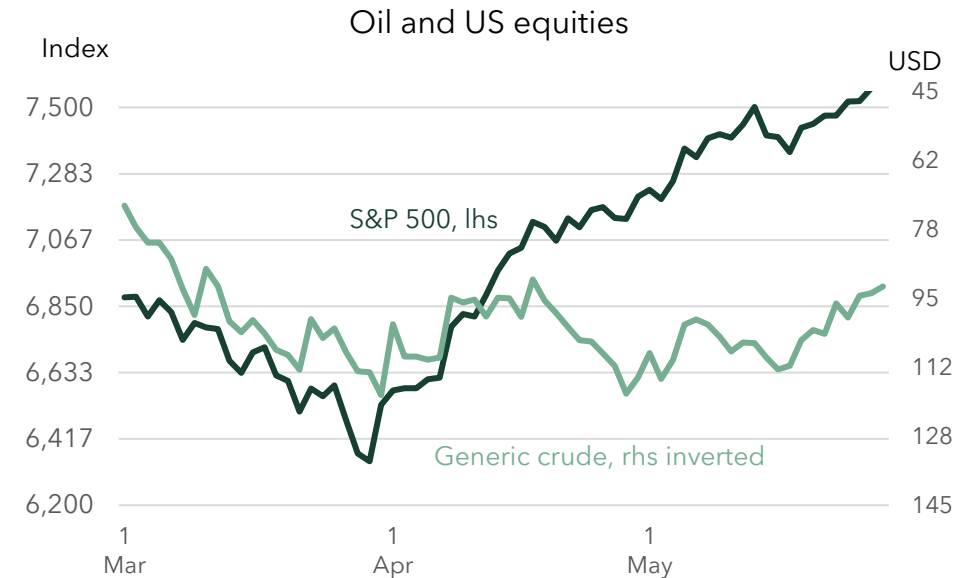
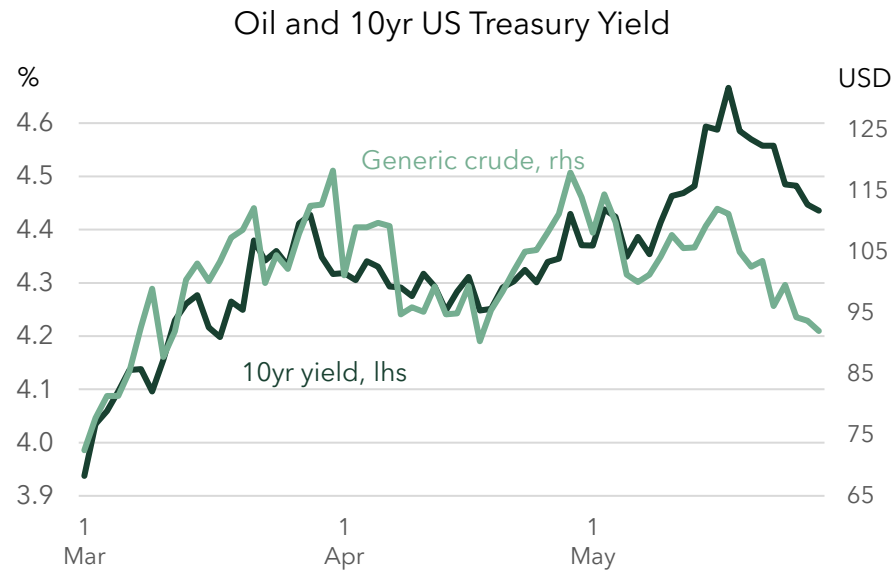


- The US economic data has printed stronger than expectations relative to forecasts for global economic data.
- The US economy to date has been less impacted by the conflict in the Middle East than other jurisdictions.
- The world's largest economy is better placed than most countries to endure an oil supply side shock from the ongoing war in Iran, but it is not immune.

Source: Bloomberg

# There's been a divergence between equities and rates

## The rally in US equities has occurred against a selloff in bonds



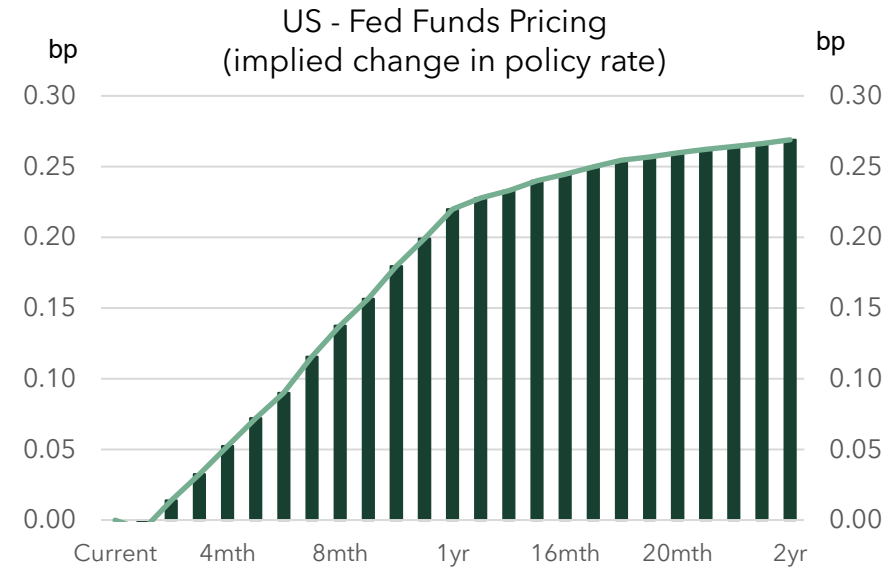
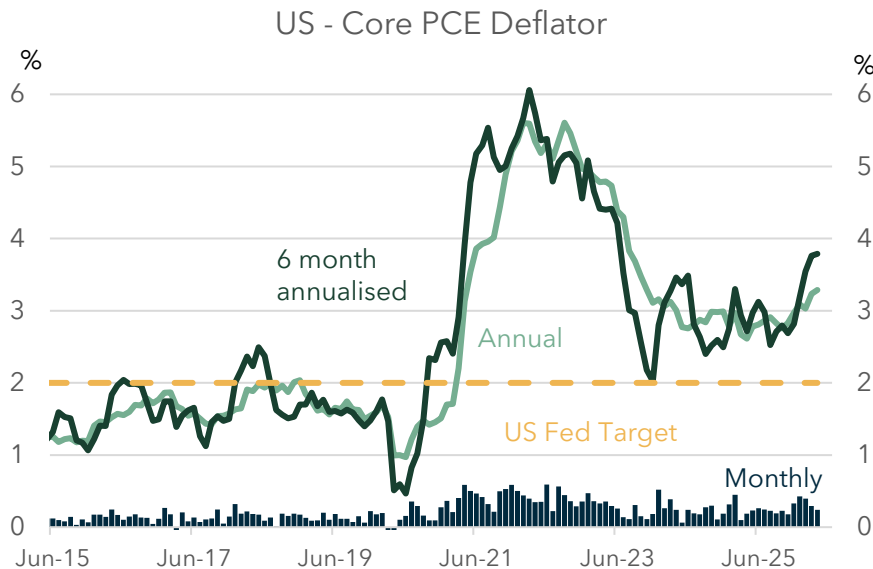
- The US bond market has sold off over the past two months. The key 10yr Treasury yield has increased by ~50bp since early March to now be oscillating around 4.5%.
- The bond market is assigning a higher probability to persistent oil-related inflation risk. And term premia have risen, which reflects investors demanding greater compensation for duration risk.
- Money market pricing for US Fed policy has also shifted over the past month.

- The US equity market is largely looking through the oil shock, at least for now.
- The selloff in US Treasuries has also failed to halt the big lift in US equities.
- Momentum is a powerful force and right now equity momentum in the US is firm, underpinned by solid earnings and a robust consumer.

Source: Bloomberg

# US inflation is well above the Fed's target

## US money markets have priced one 25bp rate hike - new Fed Chair now at the helm



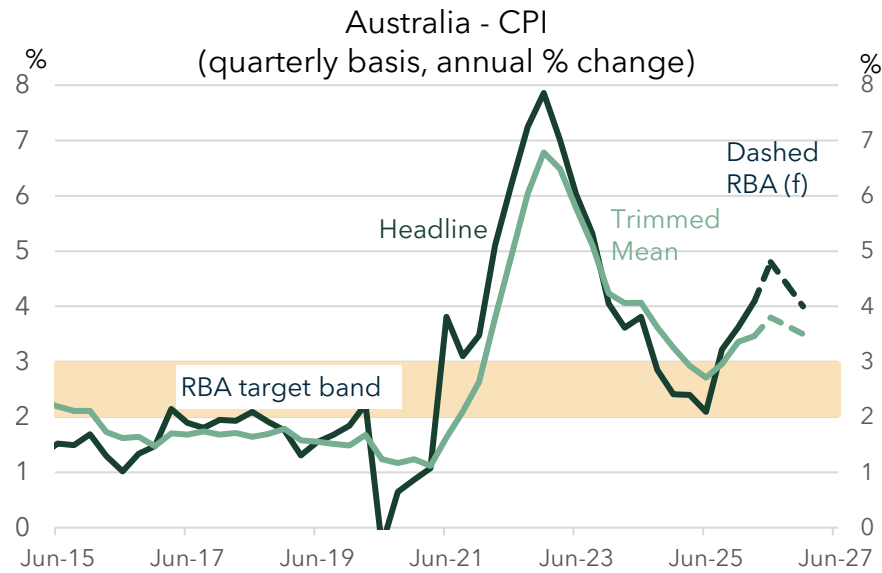
- Inflation in the US has firmed over the last six months.
- The Fed's preferred measure of inflation, the core PCE deflator, was 3.3%/yr in April.
- On a six-month annualised basis, the core PCE deflator rose to 3.8% in April.
- Inflation remains materially above the Fed's target.

- The strength of the recent inflation pulse has seen the US money markets shift over the recent period and one 25bp rate increase is fully priced.
- At the April meeting the US FOMC left the policy rate unchanged and maintained an easing bias. But three voting members of the FOMC did not support the inclusion of an easing bias.
- New Fed Chair Kevin Warsh's first meeting as Chair will be in June.

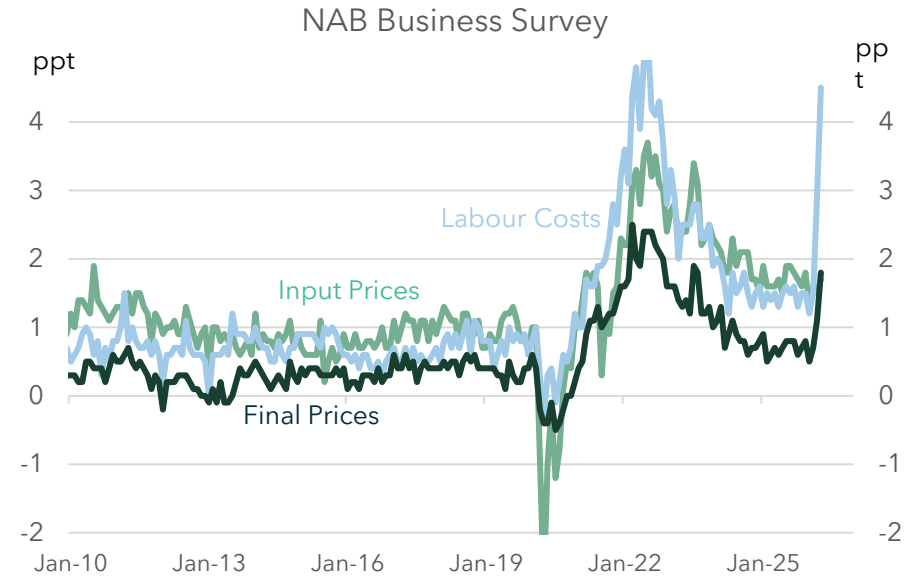
Source: Bloomberg

# Inflation in Australia is simply too hot

Inflation is forecast to peak at 5% - the RBA faces a challenge to return it to the target band



- Inflation in Australia was too high before the conflict in the Middle East started.
- Underlying inflation is forecast to be 1.0%/qtr in Q2 26. That is uncomfortably high and indicates broad-based inflation pressures within the economy.
- Most recently the housing component of the CPI basket has been running too hot (this includes the cost of building a new home, rents, utilities and other property related charges).

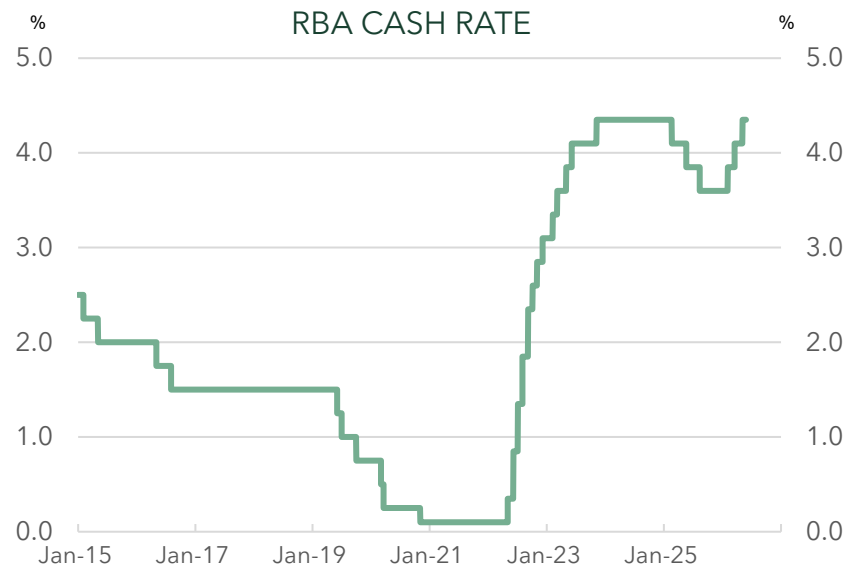


- Input prices have picked up materially.
- Upstream price pressures are normally a precursor to higher inflation if firms can pass higher input costs onto consumers.
- If not, margins are compressed.
- There is evidence of higher input costs being passed onto consumer prices for select goods and services.

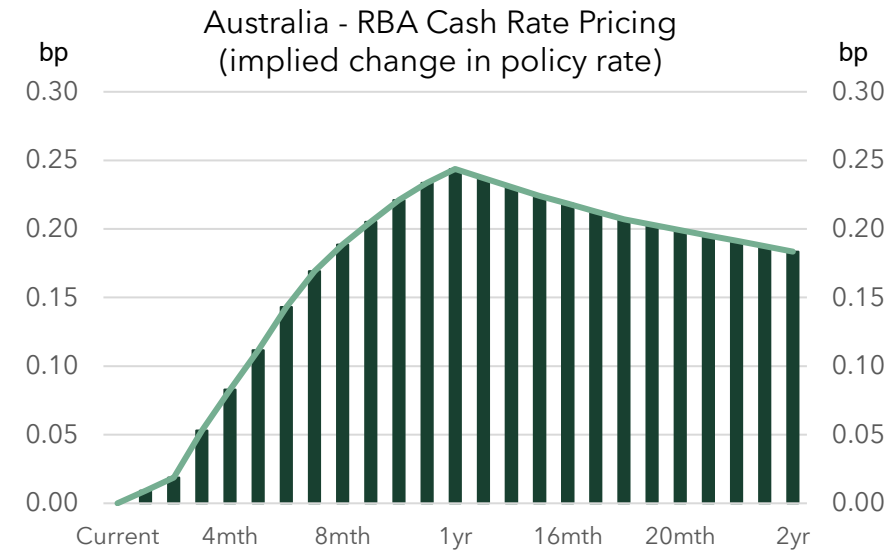
Source: ABS, RBA, Bloomberg, NAB

# Three rate hikes in quick succession by the RBA

The cash rate is back to its previous post-pandemic peak of 4.35%



- The RBA has swiftly reversed its policy easing in 2025 by hiking the cash rate 25bp at each meeting so far in 2026 (i.e. to deliver 75bps of rate increases).
- The cash rate is back to its post pandemic peak of 4.35%. This is a level we consider restrictive, which means the economy will grow below trend and unemployment will modestly rise.

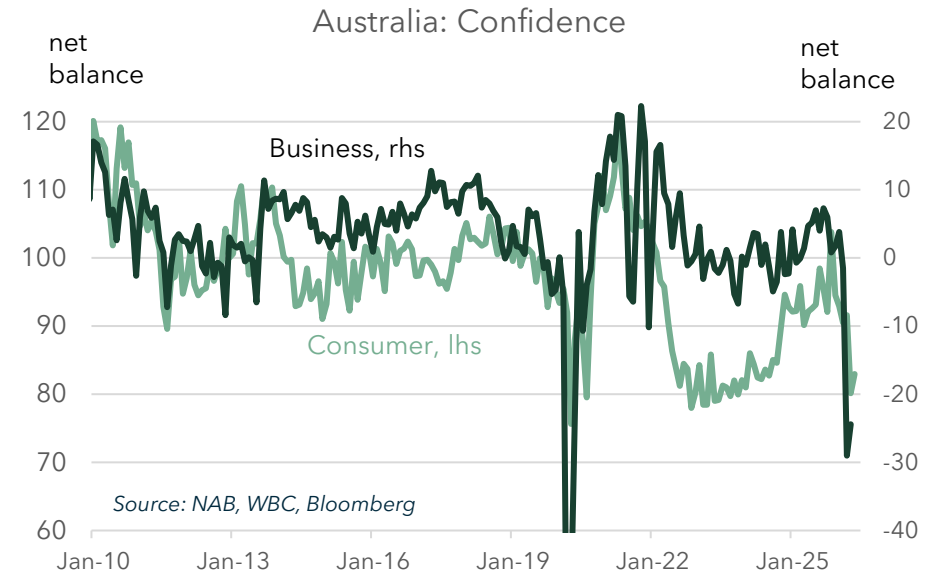
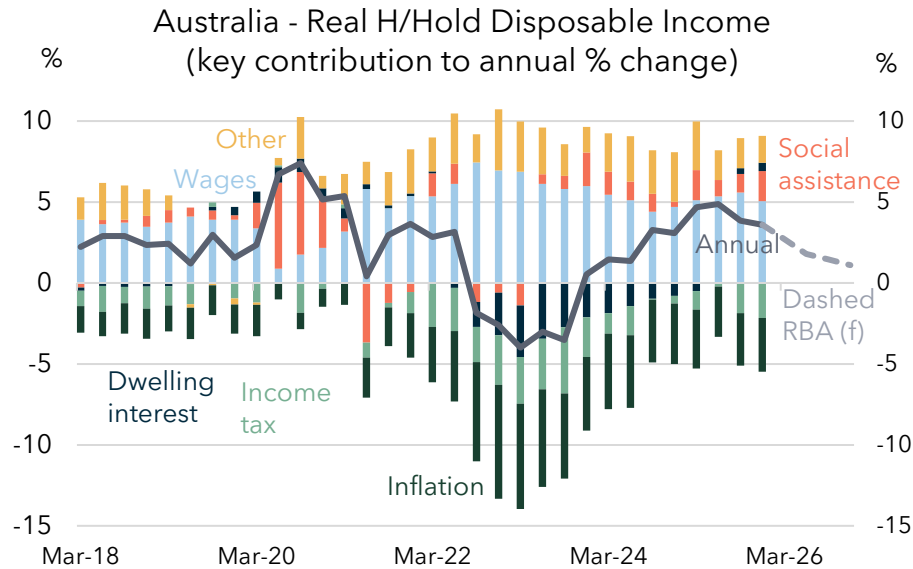


- Money markets have one more RBA 25bp rate hike priced.
- Pricing for the RBA has pared back a little over recent weeks given softness in the economic data has emerged.
- We expect the RBA to keep the cash rate on hold at the June Board meeting.
- August appears the most likely timing should the RBA deem further tightening is necessary.

Source: Bloomberg

# Restrictive policy is weighing on household income

## Growth in real household disposable income to slow, which reduces household spending power



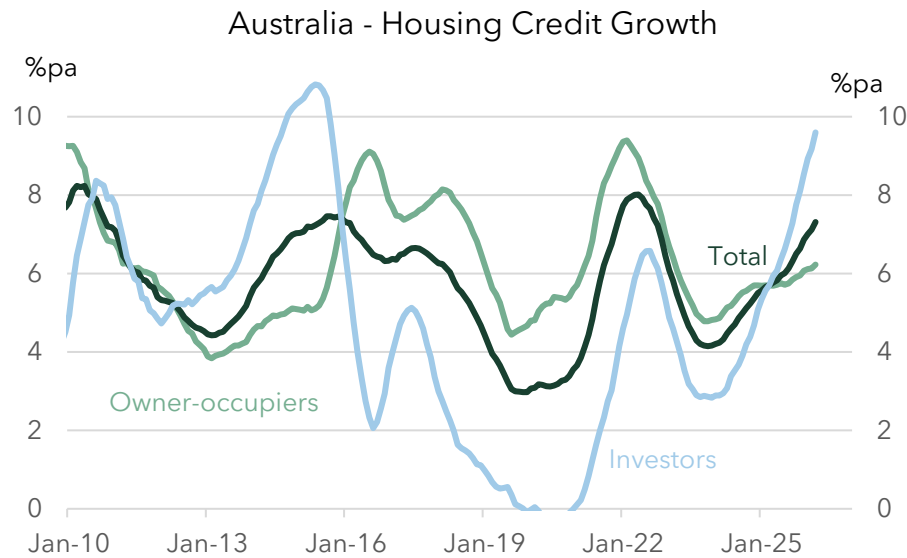
- Higher interest rates and elevated inflation will slow growth in real household disposable income over 2026.
- Slower growth in spending will weigh on Australian corporate earnings in 2026 for those companies that are not export oriented.
- Growth in real household disposable income is forecast to lift in 2027 as inflation moderates and the RBA has completed its tightening cycle.

- Business confidence was materially higher than consumer confidence during the RBA's aggressive tightening cycle between 2022-2023.
- Consumer confidence then lifted to more normal levels over 2025. But in recent months both consumer and business confidence have dropped to levels historically consistent with a recession or major negative economic shock.
- While the cyclical outlook is challenging, Australia's structural position remains sound.

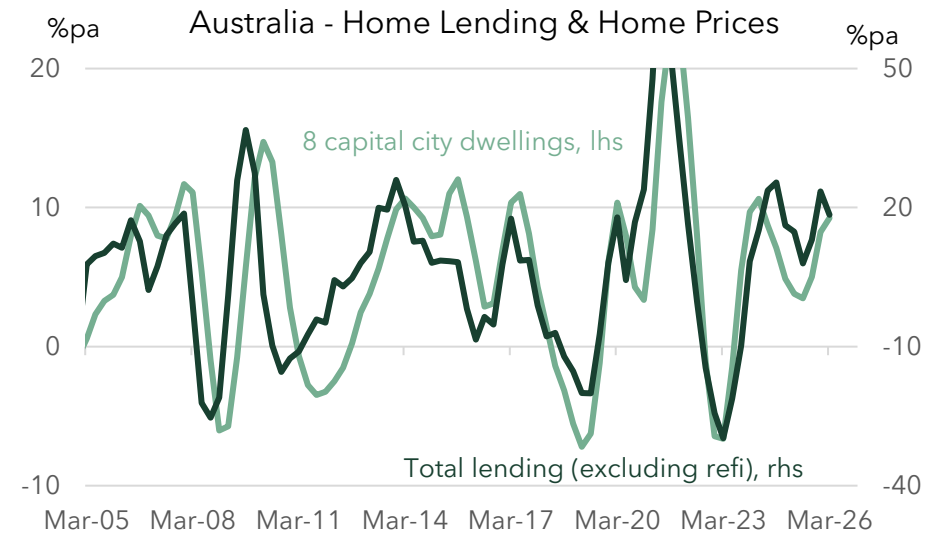
Source: Bloomberg, Westpac, NAB, Evidentia

# Negative gearing changes will mean lower credit growth

## Tax reform around negative gearing will impact credit growth and home prices



- The 2026 Budget announced changes around negative gearing and capital gains tax.
- We expect the flow of new lending to investors will slow and that will contribute to softer credit growth than otherwise.
- Credit growth is a big driver of bank earnings.

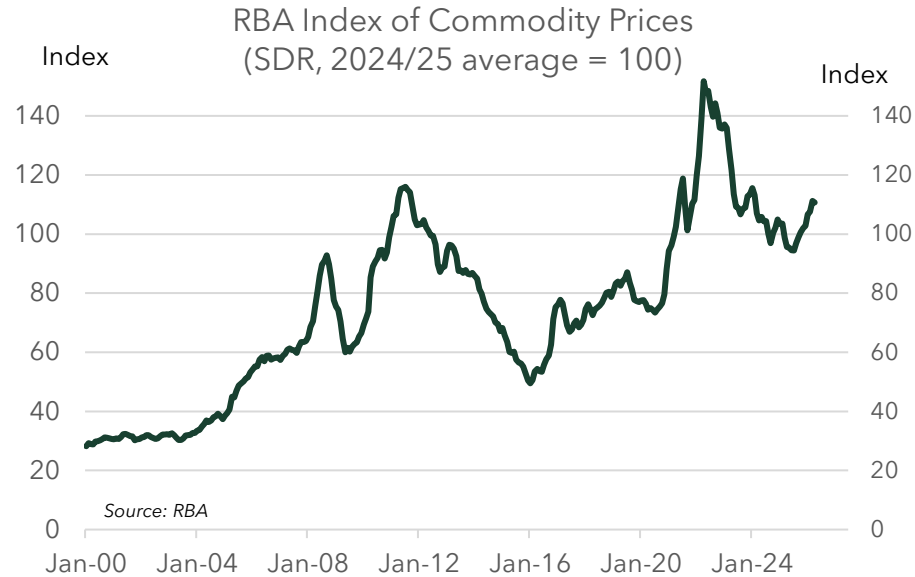


- Growth in home prices is tightly correlated to growth in the flow of new lending.
- Less lending than otherwise to investors will mean slower growth in home prices.
- We expect any correction lower in dwelling prices to be orderly given rental vacancy rates are incredibly low and the rate of home building is not keeping up with growth in the population.

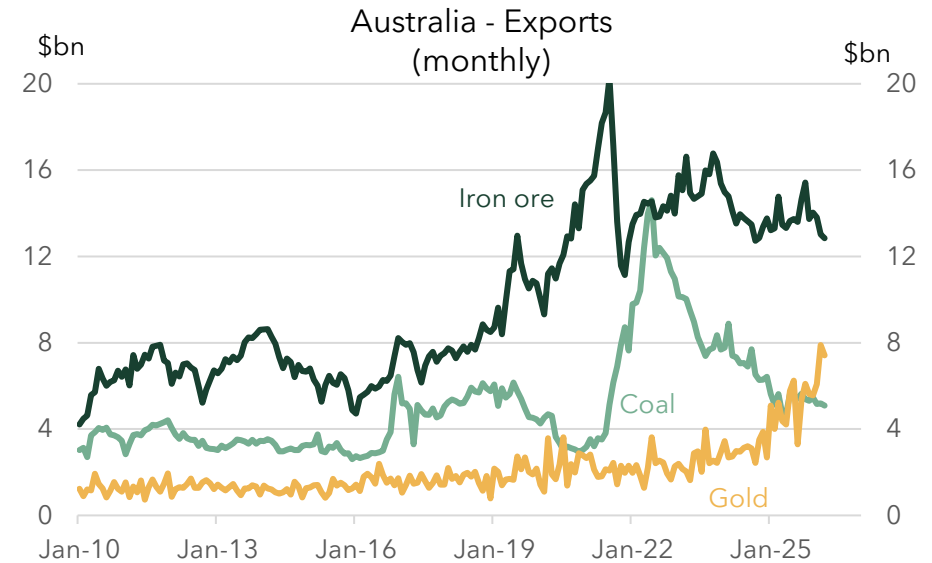
Source: RBA, ABS, Cotality

# External sector performing well

## Commodity prices are at favourable levels for our resource exporters



- Commodity prices have been on an upward trend over the past year.
- Whilst we are well off the peak reached in 2022, the level of commodity prices is favourable for our exporters and is supporting stock prices in the resources sector.



- Gold exports have surged primarily due to the big lift in the price of gold.
- Iron ore still remains our single biggest export. And the spot price of iron ore is well above the marginal cost of production for our biggest iron ore producers.

Source: RBA, ABS

# Dynamic Asset Allocation Summary – Growth

Asset Class	Outlook Negative ← → Positive				Comments
<b>Growth Assets</b>			■		Despite geopolitical risks, the broader macro backdrop remains supportive, particularly in the US. We recommend remaining invested in growth assets but adjusting portfolios for improved inflation resilience if the dispute drags on.
Australian Equities (incl. Australian Smalls)		■			Restrictive monetary policy is weighing on the outlook for Australian equities and earnings. Changes announced in the Budget around negative gearing and capital gains tax will slow credit growth. And elevated inflation is a key risk that could result in further RBA tightening.
Global Equities			■		We remain neutral global equities with strong earnings momentum offset by rich valuations. Sector opportunities within are nuanced by the risk of inflation as conflict continues in the Middle East, and the question of AI disruption to business models over the medium to long term.
Emerging Markets Equities				■	Earnings growth continues to accelerate across emerging markets. The AI capex boom is increasingly providing a tailwind for technology-focused emerging markets, particularly those integrated into the global semiconductor supply chain.
Property				■	Global Listed Property valuations are attractive in comparison to global equities. The challenges on growth and supply are fading.
Infrastructure				■	Structural tailwinds exist leading to an expansion in the asset base. Increased capex sets the sector up for a lower dividend yield but higher growth outlook. We maintain our overweight with the view the sector has further outperformance potential.
Value vs Growth			■		Remain neutral, valuations on growth companies have become closer to fair, however higher rates and the AI disruption theme may provide further downside.
Quality vs Cyclical				■	We observe superior long-term risk adjusted returns from quality companies. The recent underperformance of quality style managers may offer an attractive entry point. An economic slowdown in Australia would see quality outperform. We remain positive Quality.
Global Small vs Large			■		Small Caps represent attractive relative value, have historically delivered strong trend EPS growth, and the recent broadening of earnings growth are all supportive. A higher inflation and rates environment represents a risk, in an otherwise supportive setup for small caps.
FX Hedging (AUD view)			■		At 72c the AUD is near long term PPP. A firmer terms of trade due to higher commodity prices is supportive of the Australian dollar. But that is offset by a relatively weaker growth outlook for Australia vs the US and narrowing in interest rate differentials.

# Dynamic Asset Allocation Summary – Defensive

Asset Class	Outlook Negative ← → Positive					Comments
<b>Defensive Assets</b>						
Australian Duration (incl ILBs)						Australian duration offers attractive value at near 5% YTM. A slowdown in Australian growth would likely see Australian Fixed Income outperform, particularly if the unemployment rate is on a clear upward trend.
Global Duration (incl. TIPS)						Once AUD hedging is included, the all in yield on global fixed income has become attractive. While risks remain for global inflation volatility and lack of fiscal discipline a concern, a YTM of 5.5% for Global Aggregate as fair compensation for these risks. We are neutral.
Australian IG Credit						Credit spreads remain tight. Excess returns are at the lower end of historical ranges. We remain neutral in recognition of more modest forward looking return expectations.
Global IG Credit						Global spreads are at extremely tight levels. We acknowledge less 'spread risk' in IG compared to High Yield and therefore are comfortable to remain at neutral.
Global High Yield Credit						High yield credit spreads are at near all time lows. Historically at spreads this tight, high yield bonds have underperformed cash in the following 1-2 year period.
Absolute Return (Fixed Income)						With cash rates and bond yields above multi-decade averages, we see less need to pursue returns via absolute return strategies.
Cash and Enhanced Cash						Cash can serve as a useful short term tactical defensive exposure while credit spreads are tight.

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