EVIDENTIA GROUP

LIS LONSEC INVESTMENT SOLUTIONS EVIDENTIA PRIVATE Implemented Portfolios

Portfolio Perspectives

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Key Messages for Investors

- Aggregate FY26 earnings growth for the ASX came in at approximately 11%, ahead of both pre-season expectations and the low single-digit growth recorded over the prior three years.
- Resources contributed disproportionately to profit growth, aided by higher commodity prices; earnings growth across the rest of the market was considerably more modest.
- The earnings beat was driven by margins and cost-out rather than sales growth.
- Consumers are still spending but increasingly selective; June and July trading updates point to a slowdown in discretionary sales growth heading into FY27.
- Balance sheets remain a source of strength: capital management was well received by the market, and M&A activity picked up materially across the market.
- Consensus FY27 earnings growth has been downgraded around 3.6% since the start of the financial year to approximately 6.7%, and with the market trading on an 18x forward multiple against a 16x long run average, earnings delivery needs to do the work from here.
- Headwinds remain domestically and we retain our cautious stance on Australian equities. That is a view based primarily on the outlook for the macro economy.

A stronger season, but a narrower one

The dust has settled on the August 2026 reporting season, and this year it tells a different story to the sluggish outcomes of recent years. Aggregate FY26 earnings growth for the ASX 200 came in at approximately 11%, ahead of both pre-season expectations and the low single-digit growth rates recorded over the prior three years.

At the index level, however, the composition of that growth was narrow. Resources earnings rose by roughly 34% over FY26, by far the largest contributor to the aggregate figure, powered by higher commodity prices, with gold alone rallying significantly in August. Stripping out Resources, the pace of earnings growth across the rest of the market was considerably more modest, a pattern consistent with recent seasons in which a small number of large sectors have carried the market.

Volatility was again a feature of the season, with many blue-chip companies experiencing sharp share price reactions to their results, in some cases on a scale more typical of acute market stress than of ordinary earnings surprises. Perhaps more telling, the quality of the beat was narrower than the headline figure implies: companies beat on earnings more often than they beat on sales, with margin expansion, not revenue growth, doing the work.

Cost-out, restructuring and productivity programs were the defining theme of management commentary this season, evident across virtually every sector. Part of this margin strength likely reflects cost forecasts that were set too conservatively earlier in the year following the Iran conflict, which raises a fair question over how much of the beat represents durable operating momentum versus a one-off reversion as those forecasts normalise.

Consumer-facing results told a consistent story: households are still spending, but have become considerably more selective about where. Retail landlords and supermarkets continued to perform well, supported by resilient foot traffic and value-seeking behaviour, while discretionary retailers were squeezed between rising wage costs and a more cautious shopper. Although FY26 reported retail earnings were generally solid, June and July trading updates pointed to a clear slowdown in sales growth heading into the new financial year, particularly in discretionary categories.

Bank results provided the clearest evidence yet of Budget, inflation and interest rate pressures feeding through to the household sector. Mortgage applications across the major banks fell an estimated 12–15% following the May Budget, and competition for the loans that remain is intense. Credit losses remain low in absolute terms, but arrears, SME impairments and interest-accruing card balances have all started to tick higher, and the majors are now flagging further downside to house prices.

None of this appears to be reflected in valuations. The major banks continue to trade at the expensive end of the market on most measures, a combination of a challenging operating outlook and a full share price that we see as an increasingly uncomfortable one for investors relying on the sector for growth.

Despite the slower pace of underlying growth, corporate Australia does not look financially stressed. Dividends beat expectations more often than earnings did, capital management announcements, particularly buybacks, were rewarded by the market, and M&A activity picked up materially through the season, with takeover offers announced for Cleanaway, Reliance Worldwide, Steadfast Group, Accent Group, EQT Holdings and Atlas Arteria. Strong balance sheets give boards genuine optionality heading into a more uncertain FY27.

One of the more notable developments was a rotation into sectors that had underperformed for much of 2026. Healthcare and Technology both outperformed through the season on operating results that came in slightly ahead of expectations, with Healthcare the standout, up 19% in August, driven largely by a near 40% rally in CSL on the back of a clean result and improving sentiment toward a sector previously seen as a laggard.

Guidance for FY27 was a little softer than a typical August, but “less negative” should not be mistaken for clean: consensus next twelve-month earnings estimates have already been downgraded by roughly 3.6% since the start of the financial year, to a current consensus of around 6.7% growth. We see further downside risk concentrated in consumer and real estate exposed sectors, while Materials and Energy earnings remain the wildcard, entirely dependent on where commodity prices settle over the year.

From a valuation perspective, the ASX 200 is trading on a forward price-to-earnings multiple of around 18x, well above its long-run average of roughly 16x. With valuations already elevated, further gains from here are more likely to require earnings delivery rather than multiple expansion. Given the ongoing housing slowdown and the prospect of further rate hikes both locally and in the US into year-end, there is a reasonable case that the much-needed step up in growth the market needs to see gets pushed out into FY28 rather than arriving on schedule in FY27. Corporate Australia came through FY26 in reasonably good shape, but FY27 will demand considerably more. We unpack this a little further below from a macroeconomic standpoint.

The macroeconomic environment ahead and our cautious stance on Australian equities

The domestic economy doesn't look too bad in the rear-view mirror. GDP rose by 0.4% in the June quarter and by 2.1% over the year. The labour market has also remained remarkably resilient despite 75bp of RBA rate hikes earlier this year, falling home prices, elevated inflation and very low levels of consumer sentiment. Part of that labour market resilience reflects strong growth in non-market employment, which is predominantly government funded. Notwithstanding, employment growth has been robust and job vacancies remain elevated.

But the outlook for the economy and corporate earnings domestically is more challenging than the headline growth numbers imply. The six-month annualised pace of GDP growth slowed to just 1.4% in the June quarter. Ordinarily, growth at that pace would be expected to generate sufficient spare capacity to put downward pressure on inflation. But the central problem in Australia is that productivity growth is essentially non-existent.

An economy's speed limit is ultimately determined by growth in the labour force and productivity. When productivity is growing strongly, the economy can expand at a faster pace without generating inflation. But when productivity growth is close to zero, as it is currently domestically, even relatively modest rates of economic growth can be inconsistent with the inflation target. This helps explain why inflation remains too high despite below trend economic growth.

We don't expect a material pickup in productivity growth over the near term. The productivity benefits from AI should ultimately reach Australia and lift growth in GDP per hour worked. But that process will take time and offers little help to the RBA in managing the current inflation problem.

The implication is that we believe the RBA still has more work to do. Another 25bp rate hike is fully priced by markets. And most of the risk sits with a second hike. Further RBA tightening will increasingly bite into household cash flows at a time when home prices are already falling and consumer sentiment is very weak.

We see little evidence that growth in government spending will slow sufficiently to materially assist the disinflation process. The adjustment required to return inflation sustainably to target will therefore need to fall disproportionately on private demand. And we expect some additional loosening in the labour market.

This is important when considering the outlook for Australian equities. Reporting season showed that corporate Australia entered FY27 in reasonable shape. But earnings growth outside resources was modest and margin expansion rather than sales growth did much of the work.

Upstream inflation pressures remain firm. But as the economy cools further under the weight of higher interest rates, falling home prices and stretched household budgets, it will become harder for firms to fully pass higher input costs on to consumers. We therefore see a growing risk that margins for many domestic firms come under pressure. That process should ultimately help consumer price inflation ease. But the adjustment still lies ahead and points to a weaker period for corporate profit growth.

With the ASX 200 trading at an elevated valuation and consensus earnings already being revised lower, we see limited compensation for an increasingly challenging domestic macro backdrop.

As we have covered previously, the economy is going through a cyclical adjustment. The structural fundamentals of the Australian economy remain solid. But equity valuations reflect both cyclical and structural forces. In our view, current valuations do not adequately compensate investors for the cyclical adjustment that still lies ahead. That underpins our current cautious stance in Australian equities.

Growth Assets Outlook

Asset Class	Outlook Negative ← → Positive	Comments
Growth Assets		The strength of earnings growth and the increasing demand created by the AI CAPEX boom are supportive of growth assets. We recommend remaining invested in growth assets in line with long-term strategy.
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 means we expect 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 and the question of AI disruption to business models over the medium to long term.
Emerging Markets Equities		We moved overweight in October 2025 acknowledging the AI capex boom as an opportunity for technology-focused emerging markets, particularly those integrated into the global semiconductor supply chain. This has now played out and we moved back to neutral last month.
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. Driving value vs growth is the AI trade, with CapEx being spent by the hyper-scalers, and being received by the memory and chip producers, datacentre construction, critical minerals, and many other industries. Also remain neutral to Evidentia's AI Risk Measure.
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 have historically delivered strong trend EPS growth, and the recent broadening of earnings growth is supportive. A higher inflation and rates environment represents a risk, in an otherwise supportive setup for small caps. We recommend a modest exposure – depending on your SAA this may involve a modest overweight or neutral position.
FX Hedging (AUD view)		At 72c the AUD is near long term PPP. The AUD has risen a little recently as market pricing for further RBA tightening has firmed. We remain neutral but with increasing caution.

Defensive Assets Outlook

Asset Class	Outlook Negative ← → Positive					Comments
Defensive Assets						
Australian Duration (incl ILBs)						We recommend an overweight in Australian duration despite the recent selloff in bonds as it provides portfolio protection if our view of weaker growth plays out.
Global Duration (incl. TIPS)						Once AUD hedging is included, the all in yield on global fixed income has become attractive at a YTM greater than 5.0%. While risks remain for global inflation volatility and lack of fiscal discipline a concern, current yields offer 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 remain 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 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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