

4Q26 MARKET REVIEW – THE LUCKY COUNTRY

Australian investors navigated another volatile year, with optimism around easing monetary policy and supportive economic conditions giving way to a more challenging environment of higher interest rates, policy uncertainty, and slowing domestic growth. Despite these headwinds, the Australian share market still delivered a positive outcome, with the ASX 200 returning 6.1% including dividends. While respectable, the result was well below the market's strongest years and lagged many major international equity markets benefiting from the global artificial intelligence (AI) investment boom.

A notable feature of the year was the growing divergence across sectors and market capitalisations. Investors once again gravitated toward established large-cap businesses, particularly those offering reliable income streams and defensive earnings characteristics.

The top 20 stocks on the ASX outperformed the broader market, supported by demand for dividend-paying companies at a time when policy uncertainty and rising living costs tempered investor risk appetite.

Smaller companies also performed strongly, particularly resource-focused names, although much of this outperformance occurred during the first half of the year before geopolitical risks and a stronger US dollar created valuation pressures.

Financials Face Policy and Housing Headwinds

Australia's financial sector, which remains the largest component of the local market, faced increasing challenges throughout the year. Sticky inflation and a resilient labour market prompted the Reserve Bank of Australia to resume tightening monetary policy, resulting in three consecutive interest rate increases. Higher borrowing costs weighed heavily on household confidence and housing activity, while proposed changes to capital gains tax and housing-related incentives in the Federal Budget added further uncertainty for investors.



The combination of rising mortgage repayments, declining dwelling approvals, softer auction clearance rates, and weaker housing sentiment created a difficult backdrop for banks and property-related businesses. Given the significant role that housing plays in both household wealth and economic activity, the slowdown contributed to increasingly cautious investor sentiment toward the sector.

Resources Reassert Market Leadership

If one sector defined the Australian market this year, it was Resources. Australia's abundance of natural resources once again proved advantageous as global demand for materials linked to electrification, energy security, and AI infrastructure accelerated. Commodity prices strengthened across several key markets, with lithium, copper, aluminium, uranium, and rare earths all producing strong gains during the year.

Importantly, these gains were not driven solely by speculation. Structural demand from the global energy transition and rapid investment in AI-related infrastructure has created genuine earnings growth opportunities for miners and energy producers.

Resource sector earnings are estimated to have increased by approximately 30%, and the sector is expected to contribute a significant portion of the broader market's earnings growth over the coming year.

While China's economic recovery remains uneven and trade tensions may periodically create volatility, Australian Resources and Energy companies continue to offer investors exposure to some of the most powerful long-term investment themes globally.



Technology and Healthcare Face a Valuation Reset

In contrast, Australian Technology and Healthcare stocks struggled. Unlike the US, Korea, and Taiwan, Australia has limited exposure to semiconductor manufacturers that sit at the centre of the AI ecosystem. Many domestic software companies instead faced concerns about competitive disruption from AI technologies, leading to significant share price weakness across the sector.

Healthcare companies also encountered challenges. Higher valuations left little room for earnings disappointments, while a stronger Australian dollar reduced the translated value of offshore earnings for many globally exposed

healthcare businesses. Combined with softer trading updates and shifting government spending priorities, the sector materially underperformed historical expectations.



Market Leadership Becomes Market Risk

Australia's relative underperformance becomes more apparent when viewed against major overseas markets. Korea surged by 174%, Japan gained more than 75%, and US equities rose approximately 21%, driven largely by companies benefiting directly from AI-related investment. Meanwhile, Europe produced solid returns and Hong Kong remained the notable laggard amid ongoing concerns around Chinese economic growth.

These outcomes highlight the importance of market composition. Australia remains heavily concentrated in banks and resource companies, which together account for around 40% of the index. By comparison, US equity market leadership is increasingly concentrated in mega-cap technology companies, while Korea's market is dominated by memory-chip manufacturers that have become major beneficiaries of global AI spending.

The AI investment theme differs from previous speculative bubbles because earnings growth has largely justified investor enthusiasm.

However, history suggests that periods of extraordinary profitability eventually attract increased competition, regulatory scrutiny, and normalisation of returns.

Investors should remain mindful that even the strongest structural growth stories are not immune to cyclical corrections.

Australia's Soft-Landing Test

Looking ahead, the Australian economy is expected to expand at a below-trend pace as higher interest rates continue to weigh on household spending. However, this slowdown is being partly offset by ongoing government expenditure and increasing private-sector investment, particularly in machinery, equipment, digital infrastructure, and data centres. These investments could become a meaningful source of earnings growth over the next several years.

Investors should continue monitoring wage pressures, inflation trends, corporate earnings guidance, and geopolitical developments. With market expectations elevated following strong gains globally, earnings delivery will become increasingly important in determining future returns.

Value Emerging Beyond AI

While AI-related businesses continue to dominate headlines, we believe attractive opportunities are beginning to emerge in areas of the Australian market that have been largely overlooked.

Following a difficult year, Real Estate, Technology, and Healthcare appear increasingly compelling from both a valuation and risk-reward perspective, particularly if interest rates are approaching their peak.

The key lesson from the past year remains diversification. Leadership rotates between sectors, regions, and investment styles more often than investors expect. Maintaining exposure across multiple geographies and industries, while remaining disciplined on valuations and long-term fundamentals, remains the most effective strategy for navigating an increasingly complex investment environment. As reporting season approaches, periods of market volatility may provide patient investors with opportunities to accumulate quality assets at more attractive prices.

PREPARED BY



Toby Grimm

BCom, ADA2

SENIOR PORTFOLIO MANAGER

Baker Young

Direct (08) 8236 8835

Email tgrimm@bakeryoung.com.au



Matthew Kenny

DipFin, GradDipFinPlan, ADA2

SENIOR PORTFOLIO MANAGER

Baker Young

Direct (08) 8236 8877

Email mkenny@bakeryoung.com.au

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