



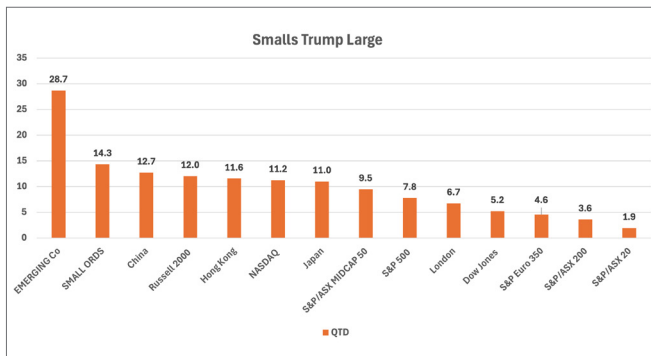
Q1 2026 - SMALL CAP RENAISSANCE

After five consecutive months of gains, the Australian share market paused in September, with the S&P/ASX 200 falling 1.4%. Nonetheless, the quarter ended with a respectable 3.6% gain.

This performance was underpinned by three interest rate cuts earlier in the year and growing expectations of further monetary easing. These tailwinds helped broaden market participation, particularly benefiting sectors and stocks more sensitive to funding costs.

Small Caps, which typically rely more heavily on external financing, surged in response to falling global interest rates.

The Small Ordinaries Index rose 14%, while the Emerging Companies Index—comprising speculative stocks ranked 350 to 600 by market cap—jumped 28%, making it the best-performing index year-to-date. This renaissance in Small Caps was not isolated to Australia; similar trends were observed globally.



Global Equities: Strength in Small and Mega Caps

US markets defied historical norms, with the S&P 500 gaining 3.5% in September—its best performance for that month in 15 years. This contrasts with its long-term average September decline of 4.2%.

The rally marked the fifth consecutive monthly gain, driven by high-beta and momentum strategies. Mega Tech stocks (Mag7) delivered strong earnings, reinforcing expectations for double-digit growth in 2025 and 2026.

The S&P 500 has now rallied 30% from its April lows, trading at 23x forward earnings—a level reached only three times in the past 25 years – so markets are priced for perfection, and so far, they are delivering.

The Russell 2000 Index, representing US Small Caps, outperformed with a 12% quarterly gain, reflecting broader investor confidence and the impact of lower interest rates.

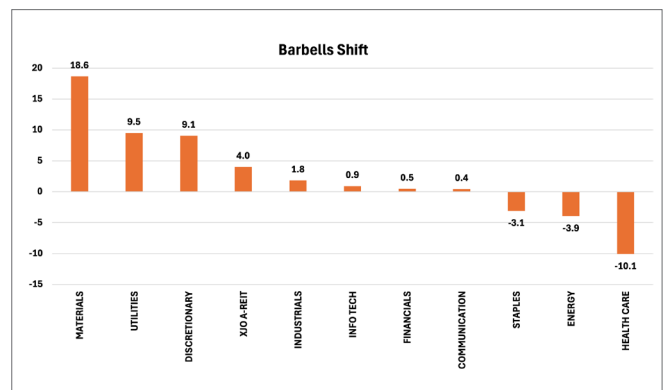
In Europe, the S&P Euro 350 rose 4.6% for the quarter, with a third of the gains coming from the UK. Investors were drawn to the UK's relatively cheaper valuations (12.5x P/E), while strength in banks and miners was supported by a commodity upswing linked to Chinese stimulus hopes.

Emerging markets also outperformed, with Chinese equities up 12.7%, and similar double-digit gains in Hong Kong and Japan, as investors sought returns in undervalued regions.

Australian Small Caps: Resources and Retail Drive Outperformance

The Small Ordinaries Index outperformed its large-cap counterpart due to its sector composition. With only 11% exposure to financials (as it excludes the major banks) and a higher weighting in materials and discretionary retail, the index was well-positioned for the current environment.

Notably, gold stocks—comprising 16% of the Small Ord's index—have rallied 47% year-to-date, significantly boosting performance.



Mid-tier retail stocks benefited from resilient household spending, which translated into positive trading updates. Additionally, the index's underweight exposure to CSL, which issued a rare modest downgrade due to margin pressures and US tariff uncertainty, helped relative performance.

The barbell rotation from large-cap banks to materials narrowed the performance gap, reinforcing the strength of the Small Cap rally.

Reporting Season: Volatility Spikes

August's reporting season was marked by heightened volatility, particularly among Small Caps. Fund manager Firetrail noted the biggest swings in 15 years on reporting day, with earnings revised 7% lower for FY25.



However, optimism for FY26 drove stock performance, as investors looked beyond near-term downgrades and towards easier monetary conditions. While earnings beats outnumbered misses, aggregate earnings per share for the broader market was revised lower for the second consecutive year, largely due to underperformance in large-cap miners.

Companies that avoided large acquisitions and focused on capital management—such as higher dividends—were rewarded.

Conversely, those that missed expectations were punished, as markets are trading near record highs and elevated valuations (20x P/E) leave little room for disappointment.

Commodities: Gold Leads the Charge

Precious metals were standout performers. Gold rose 11.9% in September, reaching record highs above US\$3850/oz—its largest monthly gain since August 2011.

The 47% rally this year positions gold for its best annual performance since 1979.

Drivers include geopolitical tensions, central bank buying, ETF inflows, expectations of US rate cuts, and concerns over a potential US government shutdown.



Safe haven buying extended to precious metals silver and platinum that built on their yearly gains each rising by 15% in September.

The Eastern Young Cattle Indicator also gained 23% over the quarter, supported by restocking demand and favourable weather conditions.

In contrast, oil prices declined modestly due to softer demand expectations and increased OPEC+ production aimed at boosting market share.

Critical minerals such as rare earths, lithium, and new energy uranium rebounded, buoyed by increased government support, and renewed investor interest in clean energy and strategic resources.

Macro Trends: Inflation, Rates, and Fed Uncertainty

The US dollar has weakened by approximately 10% this year, supporting commodity prices. However, a late-September speech by Fed Chair Jerome Powell introduced caution.

He noted that near-term risks to inflation are tilted upward, while employment risks are tilted downward—a potentially stagflationary scenario.

The Fed remains committed to its 2% inflation target, but investor scepticism is growing, given the central bank's failure to meet this goal over the past 11 years. Inflation is expected to rise to around 3% by year-end, well above target.

Despite softer jobs data, strong GDP growth and AI-driven productivity gains suggest the economy remains robust.

Historically, rate cuts during periods of accelerating growth have inflated asset bubbles.

This environment favours hard assets—equities, property, and commodities—while diminishing the appeal of cash until the next growth scare, which may not materialise until 2026.



Australian Economy: Strength and Shifting Rate Expectations

Australia's economic data has surprised to the upside. The June quarter GDP print and household spending data were stronger than expected.



The RBA's September decision to hold rates steady came with a more hawkish tone, noting that inflation in the September quarter may exceed prior forecasts.

Private demand is recovering faster than anticipated, with private consumption picking up as real household incomes rise. Financial conditions are easing, and the housing market is strengthening.

These developments have led markets to reduce the probability of a November rate cut from 66% to 33%, with some analysts now forecasting cuts in 1H26.

Upcoming data releases—the September Jobs Report (October 16) and Quarterly CPI (October 29)—will be critical in shaping the RBA's policy path heading into the Christmas trading season.

Outlook: Constructive Setup Amid Caution

Markets have successfully navigated the traditionally weak August–September period.

Strong US earnings, positive economic data, and ongoing fiscal and monetary support provide a cushion against potential downside risks.

While a US government shutdown looms, historical data suggests such events have often been market friendly. Deutsche Bank notes that the S&P 500 has risen during the last six shutdowns, and 10-year Treasury yields have declined in the last five.



The upcoming US quarterly earnings season has low expectations offering room for upside surprises. In Australia, the AGM season and major bank reporting in November will provide further insights into corporate health and economic resilience.

Valuation concerns persist, with Australian shares trading above historical averages. Investors have rotated into cheaper stocks, but sentiment remains cautious.

The absence of euphoria suggests markets have room to run, provided inflation doesn't derail rate relief and earnings continue to beat expectations.

Technically, markets have broken out of long-term channel trend and may retest highs by year-end. The setup is constructive, with central banks cutting rates and growth accelerating, the environment remains favourable for risk assets.