



Q2 2026 - RESILIENCE AMIDST POLITICAL TURBULENCE

Stellar Year for Aussie Small Caps

Australian equities delivered another strong performance in 2025, with the S&P/ASX200 posting 10.3% total returns, marking the third consecutive year of double-digit gains—the longest streak since 2003–2007.

This achievement came despite a challenging backdrop of geopolitical tensions and shifting monetary policy.

Early in the year, trade disputes triggered a sharp 12% market decline by April, but easing tariff concerns and resilient economic fundamentals fuelled a recovery, pushing markets up more than 12% by October.



December capped the year with a seasonal rally of +1.3%, led by large-cap stocks. The Materials sector surged 6.7%, driven by iron ore giants BHP (+8.7%) and Rio Tinto (+10.3%).

Despite a pause in December Gold delivered a historic 64% annual gain, its best since 1979.

Lithium miners also dominated, with 17 of the top 20 ASX200 performers coming from the resources space. Financials rebounded strongly in December (+3.4%), led by banks (+4.7%) after recovering from November's dividend-related weakness.

Conversely, interest rate-sensitive sectors faced headwinds as the Reserve Bank of Australia adopted a hawkish tone amid sticky inflation and robust consumer spending. IT (-8.7%), Communications (-3.1%) lagged, reflecting investor caution toward growth stocks.

Defensive sectors such as Healthcare and Staples also underperformed, but this may present opportunities in 2026 as valuations normalise.

Small-cap stocks were standout performers, with the ASX Small Ordinaries up 25% and microcaps soaring 36%, supported by commodity strength and prior interest rate cuts.

The Australian dollar advanced 8% to US\$0.67, underpinned by strong employment and economic resilience.

Emerging Markets Catch Up

Global equity markets mirrored Australia's resilience, posting robust gains despite early-year volatility.

The US S&P500 rose 16.5%, marking its third consecutive year of double-digit returns—well above its long-term average of 10.8%.

This strength was driven by exceptional corporate earnings, with 78% of companies beating estimates and aggregate earnings surprises averaging 14.4%, far exceeding historical norms. The AI investment cycle remained a key growth driver, with expectations for 14% EPS growth in 2026, potentially setting up a fourth straight year of double-digit gains.

European equities outperformed, with the European 350 Index up 21%, its best year since 2021.



Financials surged 48%, reflecting investor rotation into undervalued markets outside the US. Emerging Asian markets delivered stellar returns: South Korea (+87%), Hong Kong and Taiwan (+31%), China (+27%), and Japan (+26%) benefited from policy support and booming demand for AI-related semiconductors.

Despite these rallies, Asian valuations remain attractive at 17x earnings versus 22x for the US, suggesting further upside potential.

Commodities Rip Higher

Commodities continued to shine as inflation hedges, with gold and lithium leading the charge. Fiscal and monetary policies remain broadly supportive globally, though at a slower pace than in 2025.



The US “One Big Beautiful Bill” (OBBB), effective January, allows immediate deductions for capital and R&D expenses, fuelling AI-related investment and reinforcing the technology capex cycle. This dynamic could sustain momentum in IT and Communications sectors globally, though selectivity will be critical as valuations rise.

The Last Mile for Inflation

Interest rates are expected to remain higher for longer, reflecting persistent inflation and fiscal concerns.

Historically, equity markets have delivered positive returns ahead of rate hikes, as stronger growth and earnings underpin valuations.



Rotation from high-priced US growth stocks toward lower P/E opportunities in Europe and Asia is likely to continue, favouring markets with commodity exposure and modest technology weightings—such as Australia.

Policies Support further Upside

While risks persist—including geopolitical tensions, uncertain interest rate trajectories, and the upcoming US mid-term elections (November)—the overall backdrop for equities remains constructive.

Global growth is resilient, corporate earnings momentum is strong, and pro-business policies are in place across major economies.

For Australian investors, resource strength, improving small-cap prospects, and selective opportunities in defensive sectors position the market well for another year of gains.

We expect 2026 to deliver positive returns for both global and Australian equity investors, albeit at a more moderate pace than 2025.



Opportunities exist in commodities linked to energy transition, AI-driven sectors, and undervalued regions such as Europe and Asia.

Investors who maintain diversification and adopt a selective approach—focusing on quality businesses with strong earnings visibility—are well-positioned to capture upside in what appears to be a continued, though maturing, bull market cycle.