"Flood the zone"

How do investors navigate the deluge of geopolitical and economic data?

June 2025

Trust is earned.

Contents

Executive summary

The final three months of the 2025 financial year was awash with information for investors to digest. Escalating conflict in the Middle East, a smouldering invasion at the eastern flank of Europe, a clash between nuclear armed India and Pakistan, a mould-breaking US president intent on disrupting global norms, diverging regional growth and inflation prospects, a less-strong US dollar, high levels of government debt, and the rapid emergence and adoption of AI; were just some of the issues that markets had to adjust for.

Coming into the quarter, we had already been given some pretty clear indications that the velocity of news-flow would escalate. The Trump White House had set off at a brisk pace, inserting Elon Musk's tech wunderkinds into government departments, whilst the President flung barbs at friends and foes, almost without distinction. Conflicts around the globe were already at a post WWII high, even before the US began to withdraw from its de facto role as international policeman. All, on top of financial markets and the global economy having to digest the rapid and paradigm shifting emergence of a generational leap in technology.

For those who were braced for some chaos, the period was actually quite interesting with significant market-moving developments emerging to the fore with white-hot menace, before fading into the background noise of the 24-hour news cycle. Market metabolism appeared to increase in response, rapidly digesting each new event, before quickly shrugging it off.

Indeed, markets rode the swell of investment considerations so expertly, that as we came into 30th June, many equity indexes found themselves to be at or near their respective long-term highs.

All of which, leaves investors with a challenging conundrum. On the one hand, there are no shortage of risks, some of which we have listed above, that could significantly impair or disrupt the valuation of assets. On the other hand, likely AI productivity gains, coupled with deregulation in the US, additional fiscal stimulus measures, a recovering Chinese economy, reinvigorating Europe and some resolution of trade tensions, could fuel a period of economic growth that would drive markets higher yet.

For us, the correct approach is clear, even if it isn't comfortable. With the balance of risks evenly shared between upside and downside outcomes, now is not the environment to be bold, nor is it the time to be shy. This period is one in which patience will truly be a virtue. Knee-jerk reactions, into or out of, investments are likely to be punished by markets, in addition to the risk of dissipation of returns via trading costs. Instead, a calm and methodological approach to market developments will be key, whilst we wait for the emergence of a deep economic trend. Volatility is likely to remain a feature of markets for the months ahead, investors who use those periods to get set for the course ahead, will be best placed to weather whatever comes.

Asset class snapshot

Australian equities

Australian shares rebounded in the June quarter, with the S&P/ASX 300 Index rising 9.5%, approaching its 52-week high. Over the financial year to 30th June, the index returned 13.7%, defying global challenges such as trade tensions and Middle East conflict. Investor sentiment improved as inflation eased, and rate cut expectations grew. Gains were broad-based: Large caps rose 9.6%[1], small caps 8.6%[2]. Information Technology led with a 26.9%[3] surge, driven by AI enthusiasm. Financials ex-REITs gained 15.7%[4], with CBA soaring 22%, becoming Australia's "Magnificent 1." Other strong sectors included REITs (+13.4%[5]), Energy (+9.5%[6]), and Consumer Discretionary (+9.4%[7]). Materials fell 0.4%[8] due to weak Chinese demand. Growth stocks (+12.1%[9]) outperformed Value (+6.5%[10]) amid easing rate outlooks and renewed appetite for high-multiple sectors.

International equities

International shares rose strongly in the June quarter, with the MSCI All Country World Index (ACWI) gaining 6.0% in AUD terms, despite global headwinds emanating from renewed trade uncertainty and conflict. Markets rebounded from April's dip, driven by easing tariffs, strong US tech earnings, and expectations of central bank support. Over the year to June, the index returned 18.4%, with a 3-year annualised gain of 19.2%. Growth stocks (+11.9%[11]) outperformed Value (+0.2%[12]), led by tech giants—the "Magnificent 7" surged 21%, with Nvidia up nearly 50% in US dollar terms. US market breadth narrowed, and a weaker USD dampened unhedged returns for Australians. Europe performed well, especially Germany (+11.5%[13]), while Asia Pacific was mixed: Japan rose (+12.1%[14]), China fell (-0.4%[15]). Taiwan and Korea benefited from semiconductor strength. Sector leaders included IT (+17.2%[16]), Communication Services (+12.0%[17]), and Industrials (+9.7%[18]). Energy (-8.5%[19]) and Health Care (-8.4%[20]) lagged due to falling oil prices and policy uncertainty.

Real estate

Real Estate Investment Trusts (REITS) saw mixed performance in the June quarter. European and Asian REITs rebounded strongly, while US REITs lagged due to high borrowing costs and a weaker US dollar. Australian REITs (A-REITs) returned a solid 13.4%[21], outperforming the US (-6.4%[22]) but trailing Germany's 26.6%[23]. Adjusting for currency effects, US returns improved to -2.7%, while Germany's local currency gain was 21.9%, slightly lower than its AUD result. Sector-wise, residential developers, driven by housing shortages in developed markets —especially in Germany and Asia—performed well, as did data centres. Healthcare REITs weighed on performance, and industrial REITs showed mixed results across regions.

Refer to footnote's description on page 30

Alternatives

Infrastructure demand remained subdued in Q2 due to high borrowing costs and cautious pricing, though it remains a core portfolio holding for its stable, inflation-linked cash flows. M&A activity was mixed—volumes declined but deal values rose, with AI adoption driving urgency. We view European private equity is offering attractive entry points, especially with German industrials divesting non-core assets. Real estate markets remained volatile, but discounted fund offerings created opportunities. Credit exposures performed well, though tighter spreads reduced the appeal of new issuances, prompting a shift to hedge fund strategies. Aviation leasing was added to the portfolio to capture supply-demand imbalances. Despite geopolitical uncertainty, including reciprocal tariff threats, investment momentum continued. Private equity firms continue to invest in operational teams, and a new primary fund aligned with this theme is likely to be added to our exposures in the near future.

Over the past five years, floating rate investments have outperformed fixed rate ones of similar risk. However, in the past year, fixed rate assets like High Yield excelled as market focus shifted from inflation to weak growth. Whilst we have historically favoured floating rate assets, it maintains a modest allocation to High Yield. Liquid investments underperformed expectations by 1–2%, while broadly syndicated loans returned 2–3% above cash. A slower pace of deal flow, combined with strong 2024 inflows, has left the portfolio overweight in liquid assets. Specialty finance was a top performer, and the portfolio intends to expand allocations in this area across US and European markets.

Fixed income

Fixed income assets posted a solid quarter despite global volatility triggered by President Trump's "Liberation Day" tariffs. Markets were buoyant before the announcement, and inflation progress had set the stage for monetary easing. However, tariffs complicated the outlook, raising concerns about inflation and even stagflation, delaying potential US rate cuts until at least September. Despite this, global fixed income returned 1.5%[24] for the quarter, with the US delivering 1.0%[25], though longer-term yields rose amid fiscal concerns. Australia's RBA cut rates to 3.85%, and Australian fixed income delivered 2.6%[26] for investors. Credit spreads widened briefly post-tariffs but later normalised. Global High Yield gained 3.3%[27], and corporate bonds rose 1.8% . Overall, fixed income remained resilient, though volatility and policy uncertainty persist.

Australian cash rate

Whilst the RBA surprised the market by holding rates at their July meeting, it is continuing to demonstrate a greater impetus for cuts than it had done at the start of the year. This follows a steady decline in inflation, with May's CPI and trimmed mean both within the RBA's 2–3% target. Economic indicators show slowing momentum: GDP growth was just 0.2% in Q1, retail sales fell in April, and business conditions hit their lowest since 2020. Labour market data also softened, with falling employment and participation. While the RBA sees the labour market as tight, wage growth remains contained. With heightened uncertainty in the global economy and fear of encouraging resurgent inflation, the bank is taking a cautious approach, aiming for gradual easing rather than aggressive cuts.

Australian dollar

The Australian dollar (AUD) rose 5.2% against the US dollar in the June quarter, ending near US$0.66. After dipping below US$0.60 in April due to Trump's tariffs, the AUD rebounded through May and June, supported by easing geopolitical tensions, improved risk sentiment, and broad US dollar weakness. The AUD/USD trading range neared 10%, nearly double the March quarter's volatility. The US dollar was the main driver of FX markets, with the US Dollar Index falling 10.8%—its worst first-half performance since 1973—amid political uncertainty, aggressive trade policies, and fiscal concerns. Despite being down 1.2% over 12 months, the AUD's recent recovery has narrowed the gap.

Refer to footnote's description on page 30

It’s not a house, it’s a home

Introduction

“Home is where the heart is”, “a man’s home is his castle”, “as safe as houses”, “home sweet home”, we could go on. Property, particularly residential property holds an important place in the minds of most people. Indeed, for a vast majority of Australians and indeed the inhabitants of many, if not all countries around the globe, the purchase of a property will not only be, by a significant margin, their largest investment and financial commitment in their life, over recent decades it has also become a significant creator of wealth. Combine this with the simple and primal ‘nesting’ urge to own a place in which one can raise a family, and we have an asset type that is arguably the most politically charged of all. We are regularly amused though unsurprised, when on international research trips we hear the proclamation “what you have to understand about <insert nationality here>, is that it’s really important for us to own our own homes”.

Whilst it may seem that problems of housing supply and affordability are a recent phenomena, our federal government has almost continually produced policy designed to address these issues, since at least the end of Second World War and arguably even the Great Depression. Even since the turn of the century, there have been official inquiries and taskforces into housing affordability in eleven out of twenty-four years (2003, 2004, 2008, 2009, 2012, 2013, 2014, 2015, 2016, 2018 and 2022). Furthermore, our research suggests that at least 4 general elections in the past 60 years have ultimately been won and lost on policy related to housing.

All of which poses an obvious question; in a country that by some measures is the third least densely populated in the world, why has this so acutely impacted Australia?

Background

The average price of a house in Australia is now, as of March 2025, over one million dollars. That is a material increase on the $611,000 it was in September 2015.

Figure 1: Average Australian houses (Thousands)

Source: FactSet. ABS. Data as of 31st March 2025.

Of course, this didn’t happen in a vacuum, so it’s worth exploring the context, it’s also worth bearing in mind that our domestic “common knowledge” of house prices only going up, is not only not necessarily the case globally, but there have also been times in our own history where house prices have fallen dramatically.

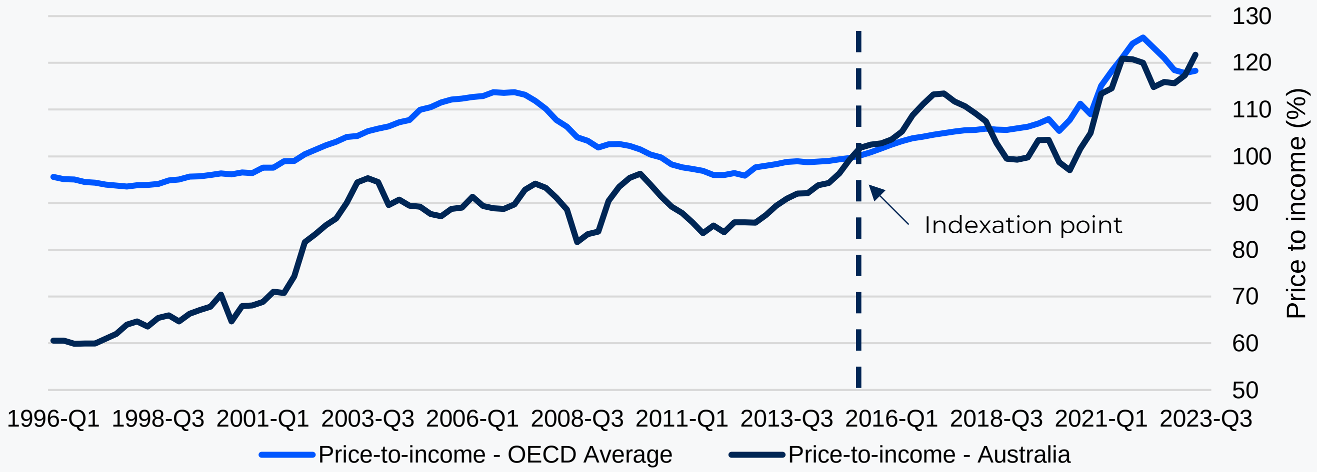
If we reflect back on the late 1800s, just as the gold rush passed its nadir, there are reports of Melbourne house prices rising by 64% in the 9 years to 1889 before falling back by 51% over the following few years. It would take until 1950, some 60 plus years later) for prices to return to that 1889 peak. Sydney suffered a similar fate, though to a smaller magnitude as it was less proximate to the economic growth emanating from the gold rush, nevertheless its gain of 32% before losing 36%, saw both colonies experience their first and what is still their greatest (even including the Great Depression of the 1930s) economic depression.

Of course, the world and its financial systems have developed significantly since the 1800s and importantly, the Australian housing market much like the Australian economy, has been 'lucky' and avoided all but a few significant downturns (1980s recession, 1990s recession and 2017-19 correction), since 1945. The rest of the world, of course, still keenly remembers the Global Financial Crisis of 2007/08, with property at its core. Indeed, if we look at the OECD average, real house prices took nearly a decade to return to their 2007 highs, whilst Australian house prices were reaching new highs in late 2009.

The response to the Global Financial Crisis for the most of the Developed world, lead by then Federal Reserve Chair Ben Bernanke, was to push down interest rates. Through a method called Quantitative Easing, this was extended past cash rates and all the way along each respective country's yield curve, significantly reducing the cost of money. Although the measure was aimed at encouraging investors to move along the risk curve and support risk assets (such as equities), its extended use, long after the crisis had passed, contributed to pockets of economic dislodgment and misallocation of capital. That's not to say that elevated house prices are a misallocation or an economic dislodgement per se, however the crux of the problem we face is that house prices have gone up at a faster rate than earnings, meaning they are by definition, less affordable.

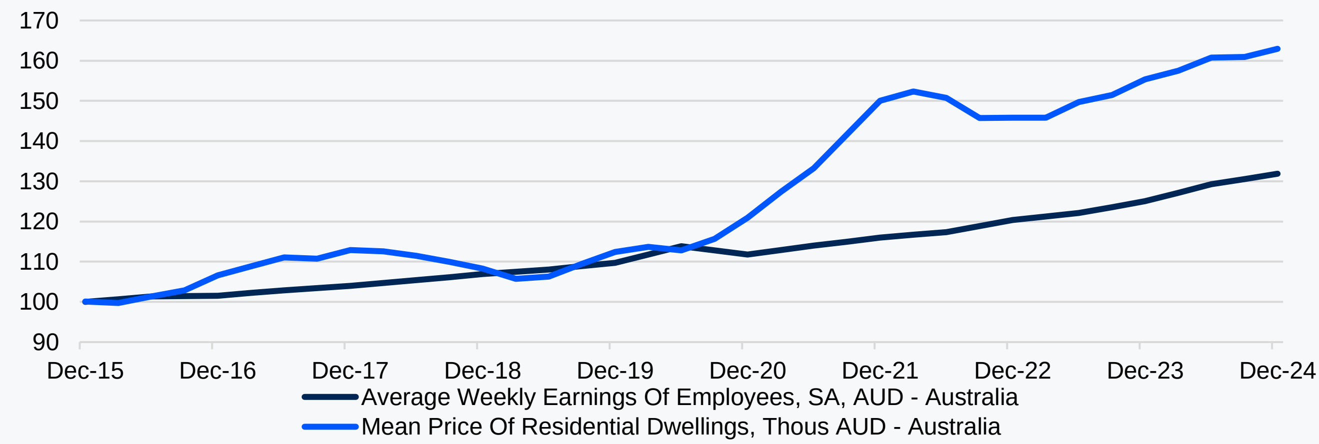
Although China has been suffering from a significant property market correction over the past few years (another reminder that property doesn't only go up), they are one of the exceptions to the rule. If we look at the OECD average, in the past 10 years the rate at which house prices have outpaced salaries is by 18.1%; Australia over the same period saw a widening of 21.7% (Figure 2.). Whilst this would suggest we are simply tracking global trends, taking a wider perspective, we note that the deterioration of affordability here in Australia is significantly worse, effectively halving since 1996, with the OECD average experiencing only about a quarter of that.

Figure 2: Housing affordability, indexed to 100 at Q1 2015



Source: OECD. Perpetual Private. Data as 31st December 2024.

Figure 3: Australian housing accelerating away from earnings

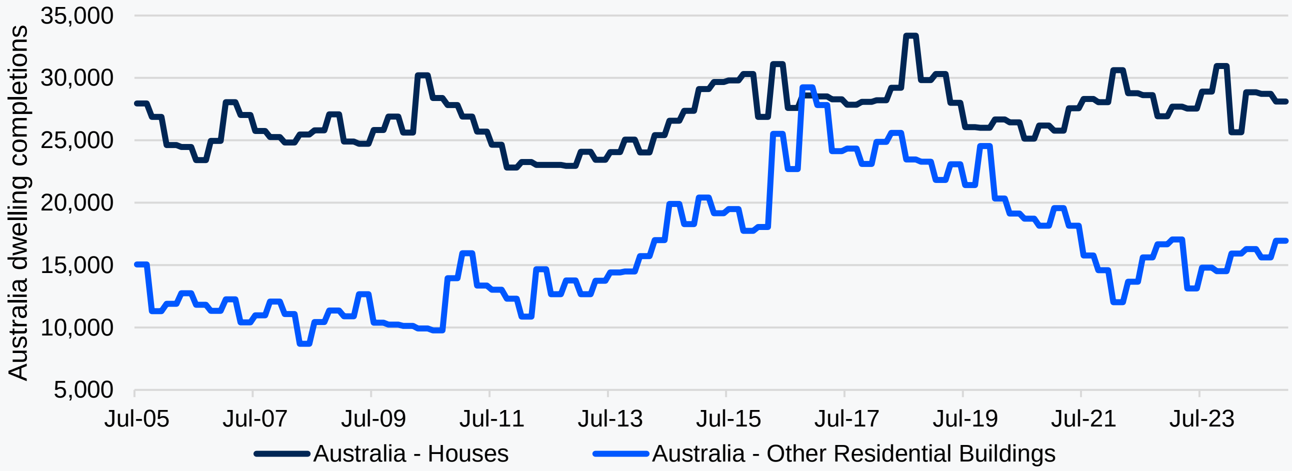


Source: FactSet. ABS. Data as 31st December 2024.

Supply and demand

This brings us back to the question we posed a few paragraphs above; why has this more acutely impacted Australia, particularly given our abundance of space? As with many things to do with asset prices, the clearest lens to consider asset valuations is through the forces of supply and demand. Below we investigate each in turn.

Figure 4: Australian housing completions



Source: FactSet. ABS. Data as 31st December 2024.

Demand – Given the rapid appreciation in Australian house prices, it's pretty obvious that demand for housing is high. The clear indicator of this is that in spite of rapid price increases, the level of completions of new homes has broadly stayed between 25,000 and 30,000 per month for 20 years (Figure 4). Key contributory factors include:

- Tax benefits – We have a long and tumultuous political history of property related tax breaks, with many governments finding their support diminished by their attempts to change them. Negative gearing in particular has more than once proven to be a political landmine for our governments. Additionally, providing CGT relief on property encourages property entrepreneurship, which has proven to be a great driver of private wealth. However, outside of the employment benefits of new builds, this type of activity does not match the economic multiplier that such effort dedicated to a more productive form of economic creation may generate. We are not so bold as to say that these programmes should be removed or even changed, we are simply pointing out that they encourage demand, and insufficient demand would not appear to be a problem in the current environment.

- First home-buyer programmes – A common and politically welcomed housing policy, first home-buyer programmes are popular and so widely used around the world. Sadly though, economic studies tend to show that these programmes tend to have the effect of inflating entry level valuations, up to the limit of the programme's eligibility.

- Foreign investors – Similar to the points above, foreign investors in themselves are not a problem, particularly during periods when demand is muted. Where this can be truly problematic is when properties are bought by foreign investors, but not lived in. Recent times have seen citizens of control-based economies (such as China and Russia) buy swaths of properties abroad, as a way of building stores of wealth out of the reach of their governments. Here again, this is obviously rational behaviour, but it does little to help domestic citizens get onto and move up the housing ladder. Indeed, many regions now apply taxes and/or penalties for properties that are unoccupied for long periods of time, in an attempt to address this. At least if it's not going to be owned by someone living in the country, it should be made available to the rental market.

Supply – Whilst it seems clear that the factors above may arguably heighten an already sufficient level of demand, our investigations suggest that issues of supply are more significant in driving elevated property valuations in Australia. Key factors include:

- Sprawl/tyranny of distance – As the Australian population has grown, the abundance of land meant that suburban sized blocks steadily sprawled outwards from central business districts, really only limited by homeowner acceptance of distance. Unfortunately, this has now led to a situation where we have central points in most capitals where there is a concentration of high-density housing (primarily apartments), surrounded by mile-upon-mile of low-density suburbs.
- Nimby-ism – Whilst most Australians can see the need for increasing housing density, few want it in their area. This means that developers face significant community hurdles to increase the level of shelter in an area, in many cases making it unfeasible and further embedding the problem.
- Planning regulation – Is a bugbear of most people who have had to go through it. Not so much because of ill intent on the part of the relevant planning authority, but more because of the frustrating trifecta of good intentions, bureaucracy and unaligned incentives.
- Labour costs – Australian labour costs, are relatively high, when you benchmark us against other developed countries. A combination of high education levels and crowding out from big infrastructure builds and the mining sector, means that blue collar workers command a premium over many of their peers internationally, when adjusting for currency and purchasing power effects.
- Materials costs – As with labour costs above, recent inflation has increased the cost to build new homes and so places a floor under the property market.
- Empty nesters – With a large cohort of Baby Boomers now becoming empty nesters, there is scope in the coming years for the mix of properties to improve as houses for growing families are again made available to the market, as the original inhabitants downsize. Over the coming years, this trend is likely to accelerate and may help reduce the shortage of three and four bed family homes. We do note however, that stamp duty has the unintended consequence of disincentivising such downsizing.
- Immigration/population growth – Immigration (our main source of population growth) is politically sensitive and profoundly important to the Australian economy. On the one hand, new migrants tend to reduce upward pressure on wages and therefore inflation more broadly, though at the same time, increase the demand for housing.

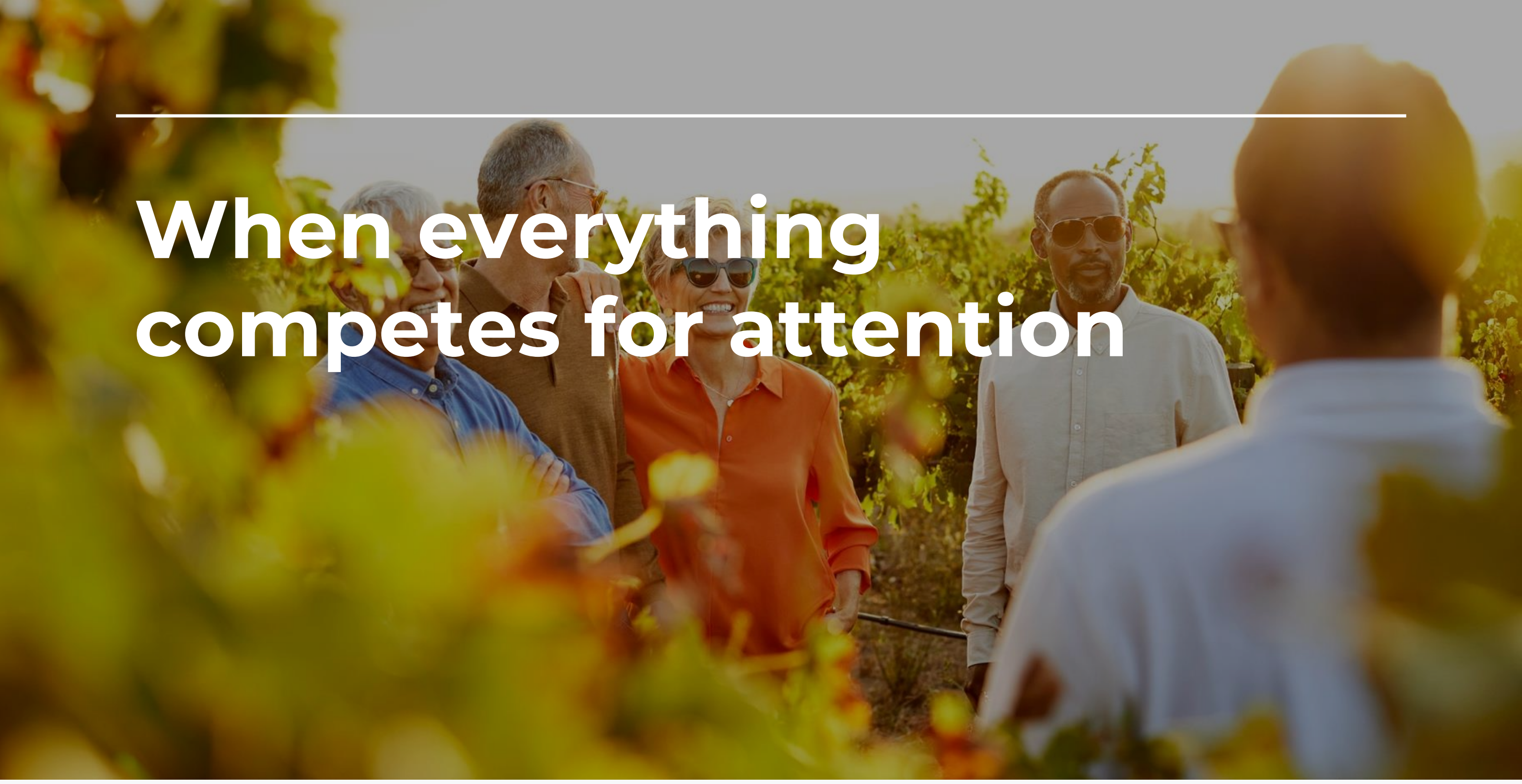
Conclusion

In 1940, in his speech titled “Forgotten People” then Prime Minister Robert Menzies, proclaimed “one of the best instincts in us is that which induces us to have one little piece of earth with a house and a garden which is ours” and it is this sense that resides in most Australians and most likely, most humans. The problem of the Australian housing stock is one that has challenged policy makers for decades. Complicating this further is that there are two motivated and distinct tribes of voters when it comes to housing. On the one side, you have the “haves”. This group typically got onto the ‘ladder’ more than 20 years ago, own their family home and an investment property or two. They rightly want house prices to continue to increase and help them further grow their wealth. Who could blame them?

On the other hand, there are the “have-nots”. This group, many of whom were born after the mid-to-late eighties, have not made it onto the housing ladder and increasingly wonder if they ever might. As property prices continue to steam ahead, this cohort has struggled to even keep up with the deposit required for a suitable home. Some among the have-nots do gain a foothold on the property ladder through the so-called ‘bank of mum and dad’, however, this pathway is only available to those from wealthier families, reinforcing inequality in wealth distribution.

Ultimately, housing affordability has been a problem in Australia for many years, with structural blockages preventing a near-term solution of any substance. Whilst it would be nice to think that such a broad national problem can and will be addressed by our country’s leaders, the politics and vested interests involved make that rather unlikely, due to the extreme levels of associated political risk. Outside a recession where mortgage delinquencies increase dramatically, and create forced sellers, it seems unlikely we might see property prices reduce any time soon.

On the side of hope is the fact historically, in regions when affordability has gotten as stretched as we are currently experiencing, valuations tend to pause until earnings catch up. With the current trade uncertainty in the global economy, and falling growth expectations, this might just be the outcome that manages to bring our property market back to a more economically harmonious balance.



When everything competes for attention

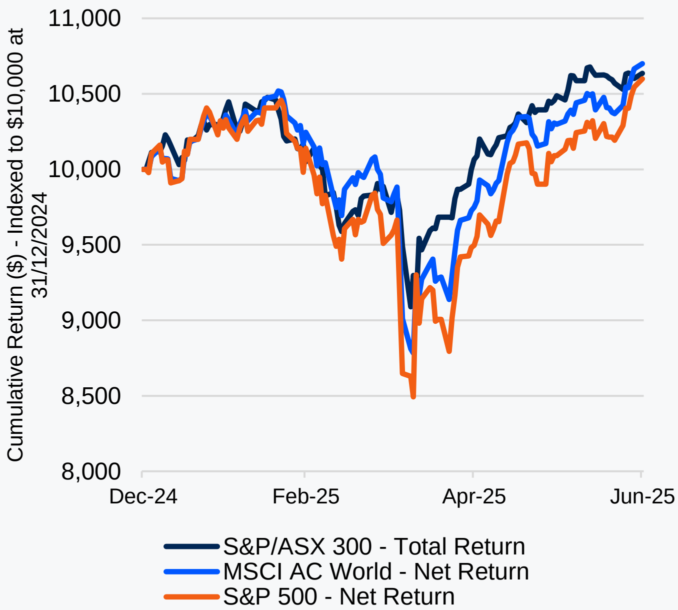
Whilst President Trump's Liberation Day will loom large in the memories of investors, the second quarter of 2025 may not ultimately be remembered for a single defining event, but rather for the relentless pace and volume of headlines that shaped the investment landscape. From aggressive US tariff measures to rising geopolitical tensions, an Australian federal election and a major new fiscal package in the US, the market environment felt like it was in constant flux.

In many ways, it resembled the strategy made famous by former Trump advisor Steve Bannon—"**flood the zone**." Originally a political communications tactic, it describes an approach designed to overwhelm audiences with so much information, disinformation, and disruption that it becomes difficult to discern what matters. That's precisely the challenge facing investors today.

Amid this swirl, equity markets defied expectations. Despite a volatile start, both global and domestic equities ended the quarter at or near record highs (Figure 5). Economic data surprised to the upside. Inflation continued to moderate. Corporate earnings held up. Meanwhile, the long-term promise of artificial intelligence continued to add a powerful thematic tailwind.

But this positive outcome raises a crucial question: has the market come to expect resilience as the default? When every shock is met with a rebound, complacency can quietly set in. And when everything competes for attention, it becomes harder to tell which signals are worth responding to—and which are just part of the noise.

Figure 5: Equity performance year-to-date (AUD)



Source: FactSet. Data as of 30th June 2025

For investors, the challenge heading into the second half of 2025 is not simply absorbing more information, but filtering for what's important, what's already priced in, and what could still surprise. In a world flooded with headlines, staying anchored to fundamentals has never been more important.

The global news cycle

During the first half of 2025, investors were confronted by an unusually fragmented and rapidly evolving news cycle. Inflation and central bank policy, generally considered the two most important economic indicators in a post-Covid world, were frequently overshadowed by political developments and sudden policy changes that tested investors' decision-making capabilities. To make sense of the chaos, let's examine some of the major global trends and moments and their impact on the investment landscape.

Artificial intelligence (AI) and earnings

While macro data remains noisy, one of the clearest structural shifts this year has been the accelerating embrace of artificial intelligence. Across Q1 earnings calls, companies from a wide range of sectors—not just technology—expressed growing confidence in AI's potential to boost productivity, reduce costs, and open new revenue streams.

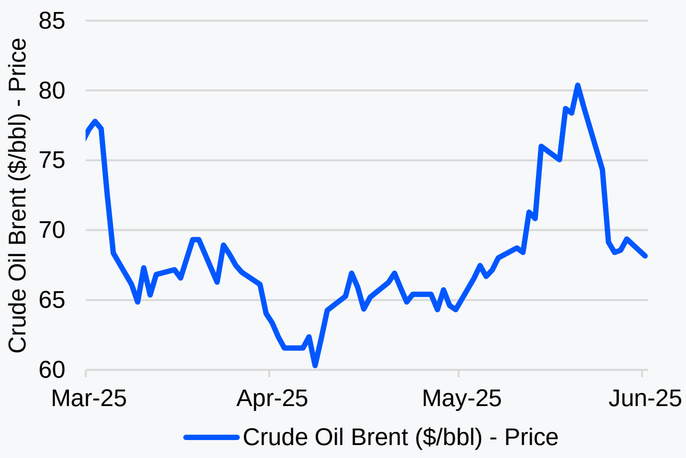
That optimism was supported by results. The "Magnificent 7" tech leaders posted combined equal weighted earnings growth of 27.7%[47], well ahead of the 16.0% expected earlier in the quarter. Investments in AI infrastructure are rising, and the broad adoption across industry will mean demand remains robust.

If AI can deliver on its promise—by eliminating repetitive tasks and enabling higher-value work—it could help lift the global productivity frontier. That would not only support higher trend growth over time but also provide a partial offset to the disinflationary drag from ageing populations and high debt loads. Still, execution risk remains. And with valuations already elevated, markets may demand evidence before pricing in further upside.

Israel-Iran conflict

In late June, tensions between Israel and Iran briefly escalated, culminating in a US precision strike on Iranian nuclear infrastructure. Iran responded with missile attacks on US bases in Qatar, although no casualties were reported. Brent crude spiked to above USD $80 per barrel (Figure 6), driven by fears of a wider Middle East conflict and potential disruption to the Strait of Hormuz, a critical passage through which roughly 21% of global petroleum flows daily.

Figure 6: Oil prices



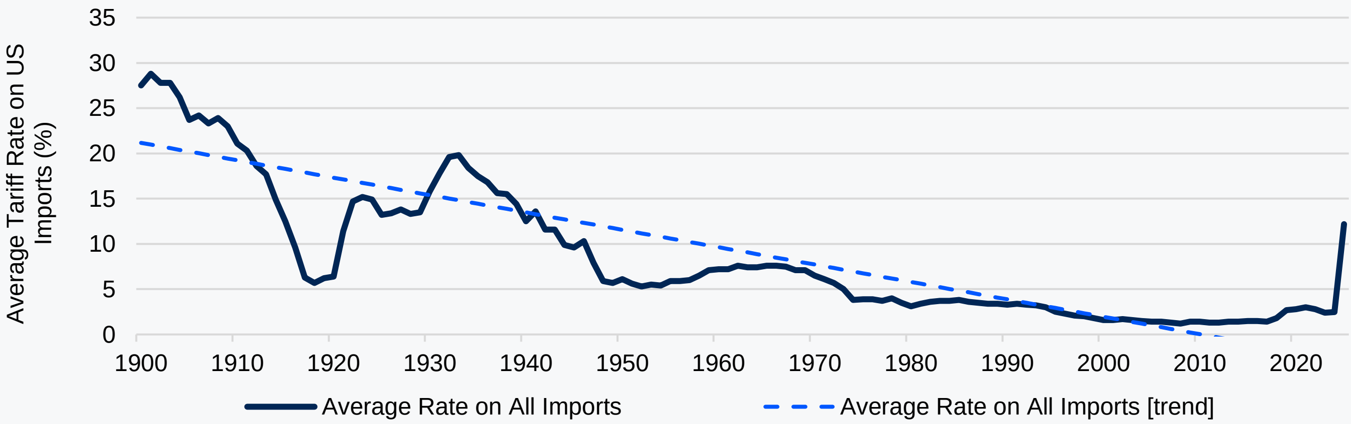
Source: FactSet. Data as of 30th June 2025.

Yet, within days, markets shrugged off the event. The quick de-escalation—helped by limited retaliation from Iran—meant there was little disruption to actual supply chains. Indeed, the signalling from Iran, in that they communicated the target and timing of their attack well in advance, suggested a low appetite to expand the conflict. For investors, this was another example that geopolitical risk is almost never an investable thesis on its own. Unless it intersects with deeper economic vulnerabilities—like elevated inflation or a sharp slowdown in growth—it tends to fade quickly. Trying to trade and time these events correctly generally risks increased trading costs and subpar long-term returns.

Tariffs, "Liberation Day" and the TACO trade

2nd April marked "Liberation Day," when President Trump announced sweeping tariffs on foreign imports. Average tariff rates surged from 3% to over 20%—levels not seen since the 1930s (exhibit 3). Markets initially responded with panic: equities sold off, the USD weakened, and Treasury yields spiked. For a moment, US assets traded more like those of an emerging market than the world's largest economy.

Figure 7: Effective tariff rate since 1900



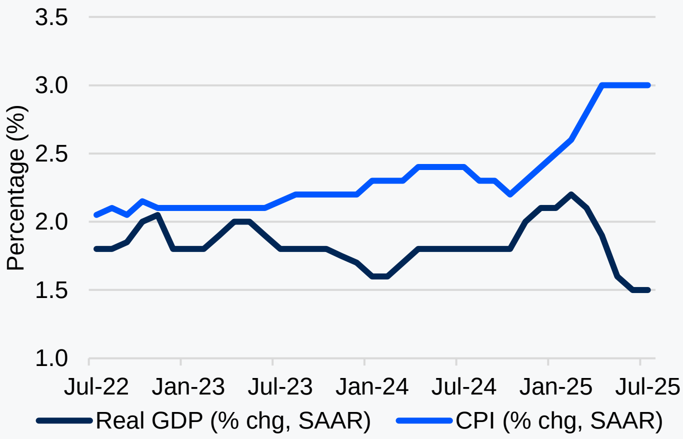
Source: Macrobond. White House. Data as of 30th June 2025.

However, the volatility proved short-lived. A court ruling temporarily invalidated reciprocal tariffs, whilst Trump hurriedly paused retaliatory measures, giving rise to a now-familiar market narrative: "Trump Always Chickens Out" (TACO). It's the idea that Trump will push policy to the brink, but "chicken out" and pull back before the worst damage occurs. Markets, adopting this mindset, quickly rebounded, seemingly ignoring the existence of anything other than the best-case scenario.

However, the risk hasn't gone away—it's merely been delayed. According to our internal research, whilst average tariffs have now stabilised at around 14%, new trade measures are set to be announced from 1st August. These could see tariff rates climb again to 20% or more, particularly for countries that have yet to strike trade agreements. Pharmaceuticals are reportedly facing prospective tariffs of up to 200%, and other sector-specific levies—such as 50% on copper—are under discussion.

The potential economic impact is far from benign. Largely as a result of tariffs, economic forecasts for 2025 now indicate higher inflation expectations and reduced GDP growth prospects (Figure 8).

Figure 8: Inflation and GDP forecasts for 2025



Source: FactSet consensus forecast. Data as of 31st May 2025.

Whilst the impacts of tariffs haven't shown up in the official inflation data just yet, only in economist' forecasts, Gerard Minack, a veteran macro strategist, neatly captures our sentiment, stating "I assume this is largely a delay in the impact, not that the largest tariff increase in the post-war period will barely leave a trace in real world data." With the next round of tariff decisions approaching in early August, the risk of renewed market volatility remains.

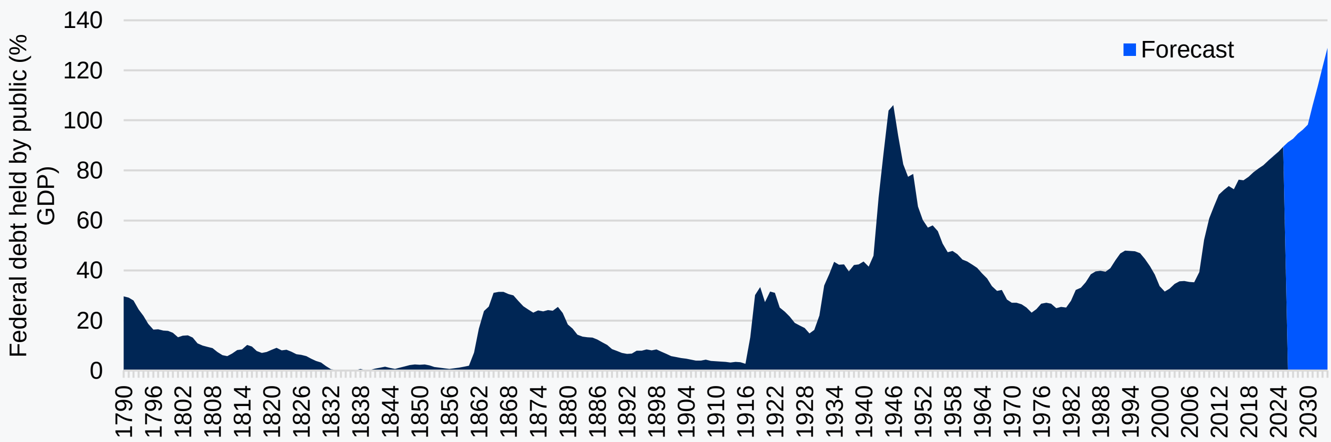
The TACO trade has worked so far, but it may be encouraging market complacency. The pattern—announce, threaten, walk back—has taught investors to look through tariff risk. But with higher base rates, lingering inflation, and a more fragile global economy, the margin for error is shrinking. If the next round of tariffs is implemented without reversal, the market reaction could be more enduring—and less forgiving.

OBBBA: Sugar hit with a dose of structural shock

If tariffs are a drag on growth, then the "One Big Beautiful Bill Act" (OBBBA) is the offsetting push. Passed on 4th July, OBBBA is a sweeping fiscal package that delivers an estimated $300–$400 billion in annual tax cuts—predominantly to wealthier households and small business owners. In the near term, the policy is likely to be quite stimulatory.

But for investors with a longer time horizon, OBBBA raises more red flags than green lights. According to the Congressional Budget Office, the bill will add approximately $5 trillion to US government debt by 2034. And that's on top of the additional structural deficits created by other policies—including the sweeping public-sector layoffs under the Department of Government Efficiency (DOGE). DOGE cut 284,000 federal jobs—roughly 15% of the workforce—but has delivered only modest budget savings to date. Worse, analysts estimate a 5–7% drop in US tax compliance as a result of reduced administrative capacity, which could reduce annual government revenues by $150–200 billion. As shown in the chart below, these policies are expected to lift the publicly held debt-to-GDP ratio from roughly 100% today to 129% by 2034 — a level that surpasses the WWII peak (Figure 9).

Figure 9: US government debt over time



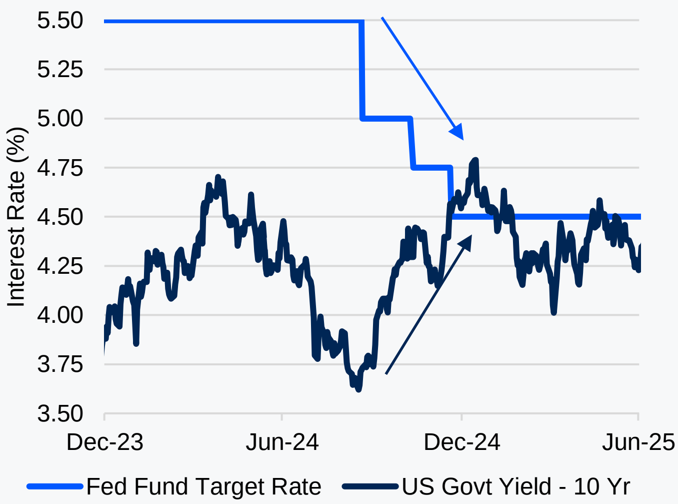
Source: Macrobond. US Congressional Budget Office (CBO).

The cost of debt itself is also becoming harder to ignore. Debt servicing costs are projected to surpass US defence spending by 2028, and interest payments could reach 4.5% of GDP within the next decade. These are not the conditions under which governments typically engage in aggressive fiscal expansion. Yet that's precisely the position the US finds itself in.

The fiscal trajectory raises the spectre of "fiscal dominance"—a condition where high public debt begins to constrain the independence of monetary policy. In theory, central banks should raise rates when inflation is too high and cut them when growth slows. But under fiscal dominance, the cost of servicing the debt becomes so high that raising rates is politically or economically unviable. The central bank is effectively forced to prioritise debt affordability over price stability.

This is no longer just a theoretical risk. We already have a blueprint for what can happen when monetary policy loosens while fiscal policy remains expansionary. When the Fed began cutting rates in late 2024, rather than rallying, the long-end of the yield curve market sold off as investors feared the move would reignite inflation, eroding the Fed's credibility (Figure 10).

Figure 10: Fed Funds rate vs. US 10yr Treasuries



Source: FactSet. Data as of 30th June 2025.

That Fed action and corresponding moves in US Treasuries underscored the danger of easing into a still-hot economy, particularly when fiscal policy is pulling in the opposite direction. President Trump has recently added to that pressure, publicly urging the Fed to slash rates from their current upper bound of 4.5% down to 1.5%. If the central bank were to cave—whether under Jerome Powell or, more likely, a dovish Trump-endorsed successor post-2026—the repercussions for bond markets and the US dollar could be far more severe.

For now, markets have tolerated the pairing of stimulus and elevated debt. But tolerance is not the same as immunity. Eventually, the bond market may push back—and when it does, the adjustment could be abrupt.

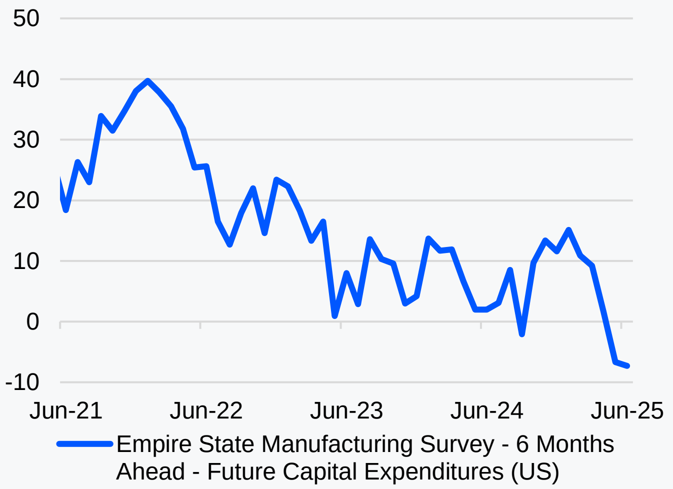
The macro landscape

Amid the flood of headlines, the global economic picture remains mixed. Following a strong start to the year, growth expectations have softened modestly, with consensus forecasts now pointing to global GDP growth of around 2.6% for 2025—down from over 3% earlier in the year, largely due to the substantial increase in tariffs and trade uncertainty. Yet while sentiment has wavered, underlying fundamentals remain intact in many regions.

United States: Soft vs hard data

The US remains the largest engine of global demand, and while recent headlines have focused on slowing momentum, the picture is more nuanced. Soft data—such as business surveys and sentiment gauges—has undoubtedly weakened. Forward-looking indicators like new orders and CEO confidence have slipped, and capital expenditure plans (Figure 11) have been pared back amid uncertainty around trade policy, supply chains, and political direction.

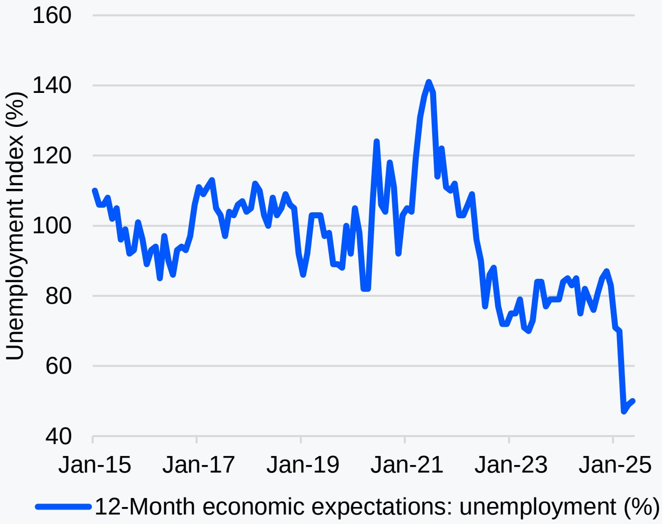
Figure 11: Future capital expenditure plans (US)



Source: FactSet. Federal Reserve Bank of New York. Data as of 30th June 2025.

On the consumer side, survey data also reflects a cautious tone. The University of Michigan's consumer sentiment index remains subdued, with job-loss expectations ticking higher (Figure 12) and many households anticipating deteriorating economic conditions. However, the Conference Board's consumer confidence index did rebound in May, and so far, these shifts in sentiment have not fully translated into a pullback in spending.

Figure 12: 12-month expectations of unemployment



Source: Macrobond. University of Michigan.

Yet the hard data tells a different story. The US labour market continues to exhibit strength: unemployment remains low, real wages are still growing, and initial jobless claims have yet to show meaningful deterioration. Inflation, while sticky, has continued its gradual descent toward the Fed's 2% target. Core inflation measures have softened in recent prints, supporting the case that the broader disinflationary trend remains intact.

Against this backdrop, the Federal Reserve finds itself in a holding pattern. The interplay between tariffs (which hurt growth but increases inflation) and fiscal policy (which supports growth through OBBBA and more spending) has left the Fed between a rock and a hard place. Market pricing still implies rate cuts before year-end, but policymakers have signaled a desire to wait for clearer evidence before acting. With the divergence between soft and hard data persisting, the path ahead for the Fed will likely remain data dependent.

Europe: Policy support

Europe's growth rate remains subdued but is being actively supported by both monetary and fiscal policy. Industrial activity is still soft—especially in manufacturing—amid weak demand and lingering high energy pressures. Fortunately, inflation has continued to moderate, giving the European Central Bank (ECB) further room to ease if inflation continues to print at or below their 2.0% target.

Germany, long the region's industrial bellwether, is leaning more heavily on fiscal policy. A €500 billion stimulus package—targeting defence, infrastructure, and climate-related investments—is expected to offset softness in private sector activity over the coming quarters. While growth remains below potential, the policy mix is turning more supportive, and relative to the US, valuations across European equities look increasingly attractive.

China: Measured response

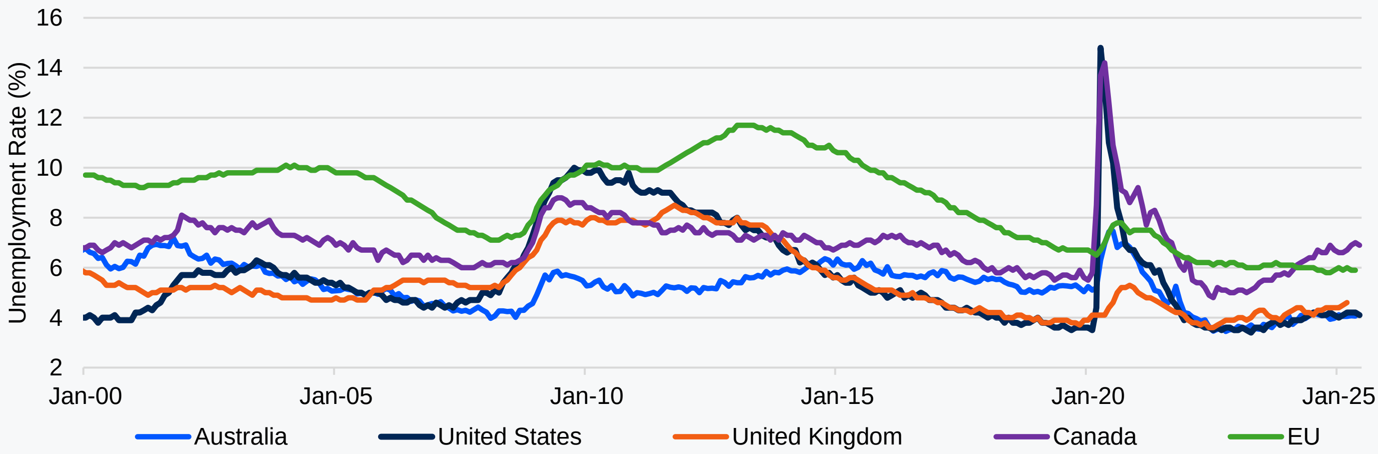
China's economic rebound remains steady, if unspectacular. After last year's stop-start reopening, policymakers in Beijing have adopted a more measured approach to stimulus focused on targeted interventions in high-tech manufacturing, EVs, and regional infrastructure. The days of large-scale credit binges appear behind us, and that may be a positive from a long-term sustainability standpoint.

The more moderate stimulus path suggests China is prioritising quality over quantity of growth. For global investors, it tempers expectations of a broad-based global rebound led by China but still offers support for specific sectors and trading partners—particularly in Asia and resource-heavy economies like Australia. If confidence continues to stabilise and credit transmission improves, upside surprises to Chinese growth remain possible in the second half of the year.

Australia: Stability as a strategic advantage

Australia continues to offer something increasingly scarce in global markets: stability. Growth remains modest but consistent, supported by a still-tight labour market (Figure 13) and gradually moderating inflation. Recent data suggests price pressures are sustainably easing back toward the RBA's 2–3% target band.

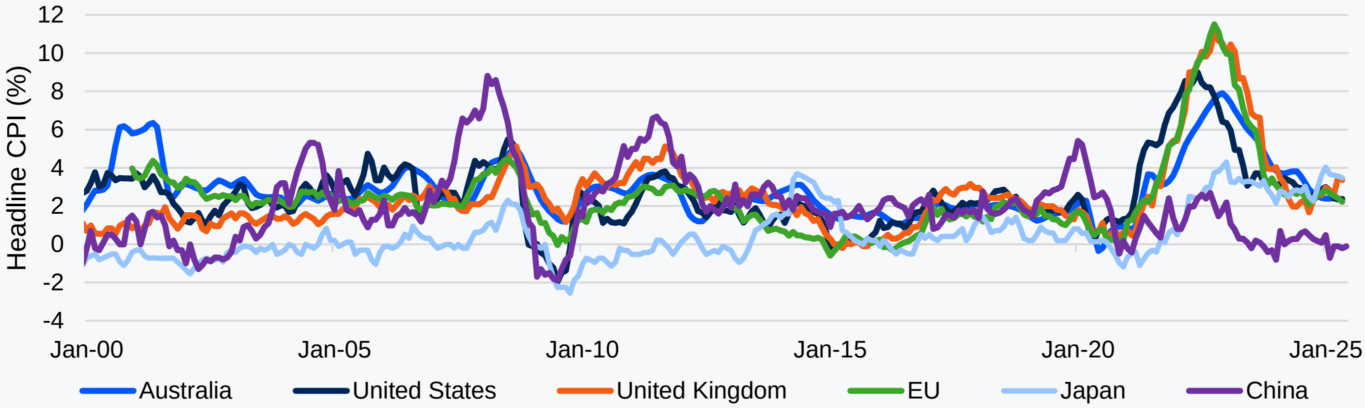
Figure 13: Unemployment remains low



Source: Macrobond, ABS, BLS, ONS, StatCan, SBJ, Eurostat. Data as of 30th June 2025.

In May, both headline and trimmed mean inflation came in below the midpoint of that range (Figure 14), giving the central bank room to continue to ease policy in H2 of 2025, with two to three rate cuts expected over the next six months.

Figure 14: Inflation is back within central banks' target range



Source: Macrobond. Data as of 30th June 2025.

Political stability is also part of the story. The recent federal election result gives the government a platform to pursue tax reform and implement key Productivity Commission recommendations. There's potential for meaningful structural improvement—particularly in areas like housing supply, workforce participation, and productivity. The optimist sees a rare opportunity to confront long-term economic challenges. The realist knows governments often default to incrementalism, with bold reform giving way to political caution.

Meanwhile, capital inflows into the ASX have picked up, supported by a competitive Australian dollar and growing interest in developed markets with sound fiscal management and credible institutions. Passive strategies have helped fuel strong demand for index heavyweights like Commonwealth Bank—Australia's 'Magnificent 1'—which has continued to benefit from stable flows and price momentum. While earnings fundamentals across the market remain mixed, investor demand for perceived quality and yield has kept the broader index well supported.

There are also potential external tailwinds. China's targeted stimulus package could offer incremental support to Australia's export sector, particularly in commodities and services. In addition, if Chinese goods previously bound for the US are redirected to other markets, Australia could also benefit from a degree of "imported disinflation", assisting the RBA in guiding inflation sustainably back towards their target band.

The outlook isn't without risk. China's growth path remains uncertain, and a disorderly selloff in the US would have global ramifications. Like US equities, Australian shares are not cheap—valuations are elevated, and a lot of good news is already priced in. But on a relative basis, Australia still offers a rare mix of consistency, credibility and resilience.

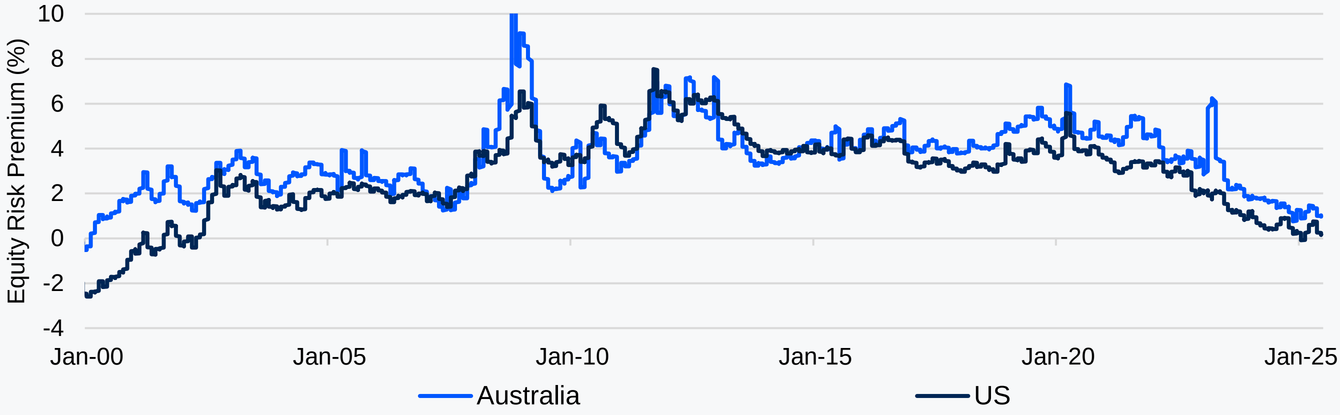
What's priced In — and where caution Is warranted

One of the more perplexing features of the current investment landscape is how optimistic markets appear despite an increasingly complex macro backdrop. Equity markets are pricing in a benign outcome: a soft landing for the global economy, manageable inflation, a productivity boom from AI, and no material policy missteps. That's a high bar—and one that warrants closer inspection.

Valuations

Valuation is the starting point. Both Australian and US equities are trading near record-high forward price-to-earnings multiples, leaving the equity risk premium—the excess return of equities over long bonds—meaningfully compressed by historical standards (Figure 15). In effect, investors are being compensated less for taking on equity risk, even as macro uncertainty remains elevated.

Figure 15: Equity risk premiums remain low in Australia and the US



Source: Macrobond. S&P/ASX 300 and S&P 500. Data as of 30th June 2025.

By contrast, ex-US equities remain far more modestly priced. The MSCI EAFE index (a measure of Developed share markets outside of the US and Canada) trades at around 14.8 times forward earnings—close to its long-run average and at a roughly 35% discount to the US equivalent. That valuation gap has started to matter. So far in 2025, the MSCI EAFE has outperformed the S&P 500 in AUD terms by about 12.7% in AUD terms. While that's notable, it also follows a decade of persistent underperformance, which means European equities still screen attractively on a relative basis.

Currency

Currency dynamics have added another layer of complexity to the market outlook. The US dollar has weakened materially in recent months—down around 10% on a trade-weighted basis, marking its worst start to a calendar year in 30 years (Figure 16)—as political and policy uncertainty in the US prompts global investors to reallocate capital elsewhere. While shifting expectations for the Federal Reserve have played a role, the more significant driver has been the change in how non-US investors are managing their US exposure.

Figure 16: US dollar has fallen ~10% year-to-date vs. a basket of currencies

Source: FactSet. US Trade Weighted Index (TWI). Data as of 30th June 2025.

Historically, global investors—including Australians—tended to leave international equity exposures unhedged, relying on the US dollar's safe-haven status to cushion portfolios during periods of market stress. But that assumption has come under pressure since "Liberation Day," when markets saw the traditional USD-risk asset relationship break down. As confidence in US fiscal discipline and policy stability weakens, and the dollar's safe-haven appeal fades, more investors are increasing hedge ratios on their global exposures. This shift is reducing marginal demand for the USD—placing downward pressure on the currency that is likely to persist over the medium term, even if not in a straight line.

Staying anchored

Markets have absorbed a lot in the first half of 2025—tariffs, fiscal stimulus, geopolitical flare-ups, and AI-fuelled optimism—and continued to grind higher. That resilience, however, may be fostering complacency.

From a macro lens, the divergence between forward looking survey data and asset prices has become increasingly pronounced. Markets are behaving as though the "all-clear" has been sounded—buoyed by resilient hard data—even as numerous key questions remain unresolved.

Questions such as; When will the full impact of tariffs feed through into inflation and margins, and to what extent? Is the labour market as strong as the headline data suggests, or are rising job cut announcements a sign of softness beneath the surface? Will the AI narrative continue to support elevated valuations without broader earnings follow-through? And perhaps most importantly, is the TACO trade—trusting that Trump will walk back policy threats before they bite—still a reliable assumption?

The unemployment rate remains low, but it's a lagging indicator. Forward-looking signals suggest that cracks may be forming. The risk isn't an imminent downturn, but rather that investors are extrapolating recent resilience into the future while ignoring accumulating pressure points.

That doesn't mean abandoning risk—but it does argue for greater selectivity and discipline. The current rally has been powered more by liquidity and momentum than broad-based earnings strength. The "Magnificent 7" in the US—and CBA, Australia's own "Magnificent 1"—continue to carry index-level performance, even as smaller companies face pressure and valuation dispersion widens.

Looking ahead, the next phase of the cycle is likely to be bumpier, with greater dispersion in outcomes. Bearish headlines will continue to dominate, feeding into our human risk aversion. Yet history shows that markets often absorb, adapt, and 'climb a wall of worry'.

In a market environment awash with information, the real challenge isn't reacting faster—it's filtering better. The past three months have been a timely reminder of the importance of focusing on the signal and ignoring the noise.

Which is precisely where a consistent investment framework—anchored in quality, diversification, and long-term thinking—proves its value. It's not about predicting the next headline. It's about staying anchored during the flood.

Australian equities

Australian shares rebounded strongly in the June quarter, with the S&P/ASX 300 Index rising 9.5%, recovering from Q1 weakness and finishing just 1% below its 52-week high. Over the 12 months to 30th June, the index returned 13.7%, capping off a resilient financial year for investors. This came despite persistent global headwinds—including President Trump's "Liberation Day" tariffs, conflict in the Middle East, and diverging growth prospects. Sentiment improved as inflation moderated and expectations for further rate cuts by the Reserve Bank of Australia (RBA) began to build.

Performance was broad-based. Large caps (ASX 100: +9.6%[1]) and small caps (Small Ordinaries: +8.6%[2]) both posted strong gains. At the sector level, Information Technology (+26.9%[3]) led the market, buoyed by renewed enthusiasm for AI and data infrastructure. Communication Services (+14.1%[30]) and Financials ex-REITs (+15.7%[4]) also delivered standout results. Within Financials, index heavyweight CBA rose over 22% for the quarter, earning the title of Australia's "Magnificent 1" and contributing just over a quarter of the S&P/ASX 300's total return. Many valuation metrics now show it to be the most expensive bank in the world.

Several other sectors also contributed meaningfully. Consumer Discretionary (+9.4%[7]), Industrials (+9.0%), and A-REITs (+13.4%[5]) all performed well, with A-REITs strongly benefiting from lower bond yields. Energy (+9.5%[6]) also posted a strong return, aided by corporate activity after Santos received a takeover bid from an international consortium led by Abu Dhabi's National Oil Company (ADNOC). In contrast, gains were more muted in Health Care (+2.4%[32]), Utilities (+2.0%[33]), and Consumer Staples (+3.9%[34]), while Materials declined (-0.4%[8]) , weighed down by weaker Chinese demand and trade concerns.

From a style perspective, Growth (+12.1%[9]) outpaced Value (+6.5%[10]), reflecting renewed investor appetite for high-multiple sectors and expectations of looser monetary policy in H2 of 2025.

Figure 17: Australian shares – Large companies

Source: FactSet, Perpetual Private

Refer to footnote's description on page 30

Australian equities – Manager insights and outlook

As we entered 2025, we anticipated volatility would remain elevated, with equity markets more likely to be driven by macro and geopolitical headlines than company fundamentals. Given the evolving economic backdrop, our positioning was broadly balanced across styles (Growth vs Value). We retained a preference for small to mid-sized companies, where long-term structural growth tailwinds and more attractive valuations remain underappreciated by the broader market and there are greater market inefficiencies for our active managers to target compelling stock opportunities. At the sector level, we continue to favour Tech, Healthcare, and Consumer Discretionary, while remaining underweight Financials and Materials.

A persistent theme has been the continued strength of the Financials sector, which rose 15.7% for the quarter and an impressive 29.2% for the past 12 months—making it by far the best-performing sector for the year and more than doubling the return of the S&P/ASX 300, which was up 13.7% by comparison. Within Financials, the major banks demonstrated notable resilience, with CBA standing out for its exceptional share price growth. Over FY 2025, CBA rose 46%, becoming the first ASX-listed company to surpass a market capitalisation of $300 billion. It now represents approximately 12% of the ASX 300 Index.

Despite such strong equity markets over FY 2025, the Materials sector has been notably weaker and was down 1.9%[8] over that same period. We are increasingly becoming constructive on select areas of the commodities complex. A good example being lithium, where the price has declined more than 30% over the past year on concerns of oversupply and a slowdown in demand for electric vehicles. Despite short term challenges, the long-term outlook remains positive and with the share prices having re-based for a number of the ASX-listed lithium miners, opportunities appear attractive. Conversely, there are pockets within the Materials sector that are perceived as being overvalued. A good example is gold, which has more recently been a safe-haven asset for investors through a period of escalating geopolitical tensions and higher inflation. Despite the robust performance we've seen from ASX-listed gold miners, there are concerns emerging that gold may be at the peak of its cycle, with cash margins at record high levels, while valuations and index representation have sharply increased.

Looking ahead, our outlook remains somewhat cautious for the Australian share market. Falling interest rates tend to be a natural tailwind for equity markets and through the quarter we saw the RBA cut interest rates by 25 basis points to 3.85% in May, in response to subdued inflation and global growth concerns. However, with the market now already pricing in a further two interest rate cuts from the RBA by December this year, and at the same time Trump having also pivoted to more friendly policies and a less aggressive tariff agenda, we hold some concern that the current market pricing appears more optimistic and that share price valuations more broadly are expensive compared to their long-term average. Geopolitical risks (such as ongoing trade tensions, policy uncertainties and war) could impact global growth and investor sentiment, while any delay to the anticipated interest rate cuts from the RBA could also further dampen sentiment. Against this backdrop, we continue to be positioned in a style neutral posture, while being positioned for a rotation away from the banks and larger cap names towards other opportunities further down the market cap spectrum, which will likely be prime beneficiaries from an easing in interest rates and reduced fears of a global recession.

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International equities

International shares delivered strong gains over the June quarter, with the MSCI All Country World Index (ACWI) rising 6.0% in AUD terms. This performance came despite several headwinds, including renewed geopolitical tensions in the Middle East, heightened trade uncertainty following President Trump's April 2nd tariff announcements, and softer global economic data. Markets rebounded sharply from April's sell-off, buoyed by a partial reversal of aggressive tariff measures, a strong US earnings season - particularly in Tech - and growing expectations for central bank easing later in the year. Over the 12 months to June, the MSCI ACWI returned 18.4%, and has delivered an impressive 19.2% annualised basis over the past three years.

Growth stocks (+11.9%[11]) strongly outperformed Value (+0.2%[12]), with tech-heavy names drawing renewed interest from investors following the April dip. Small caps also posted a solid gain (+6.8%[36]) but continue to lag large caps over the longer term.

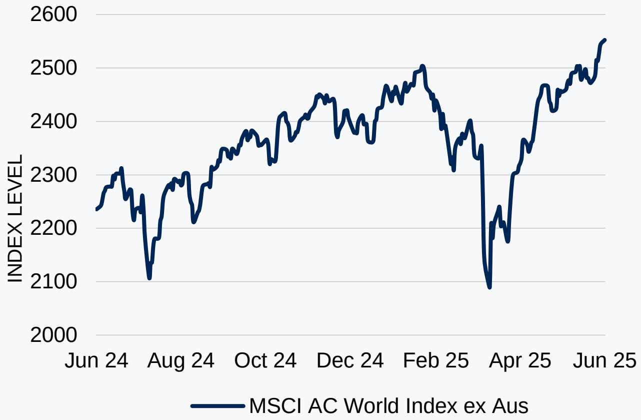
In the US, a rally in mega-cap technology stocks drove performance, with the so-called "Magnificent 7" rising 21% in USD terms and Nvidia alone gaining nearly 50%. Market breadth in the US remained narrow, with equal-weighted indices lagging headline benchmarks by one of the widest margins in a decade. The S&P 500 returned 5.4%[37] and the Nasdaq Composite 12.2%[38]. A weaker US dollar against most major currencies - including a 5.2% depreciation against the Australian dollar - modestly dampened unhedged returns for Australian investors, though underlying local-currency gains remained strong.

European equities also posted strong returns and continued to outperform other major markets on a year-to-date basis. Germany (+11.5%[13]) continued to benefit from fiscal expansion and rising industrial activity, while France (+3.7%[39]) and the UK (+4.2%[40]) also advanced, despite sluggish economic growth. In the Asia Pacific region, performance was more mixed. Japanese equities rose 12.1%[14], while Chinese equities lagged (-0.4%[15]). Elsewhere, Taiwan and Korea outperformed on the back of semiconductor strength, and the MSCI Emerging Markets Index rose 6.5%[41], supported by improving sentiment, a lower USD, and de-escalation in US-China trade tensions.

At the sector level, Information Technology (+17.2%[16]), Communication Services (+12.0%[17]) and Industrials (+9.7%[18]) led the way, buoyed by tariff exemptions, strong earnings, and global demand for infrastructure and AI-linked technology. In contrast, Energy (-8.5%[19]) declined as oil prices ended the quarter lower, despite a brief surge in June driven by supply concerns linked to the Israel-Iran conflict. Health Care (-8.4%[20]) underperformed due to uncertainty around pharmaceutical tariffs and policy proposals. Consumer Staples (-1.6%[42]) and Real Estate (-1.6%[43]) also ended the quarter in negative territory.

Refer to footnote's description on page 30

Figure 18: International shares (local currency terms)



Source: FactSet, Perpetual Private

International equities – Manager insights and outlook

Market dynamics continue to evolve, with our 'shifting sands' thesis continuing to hold through the quarter. After strong outperformance of Value and Quality investment styles in the first quarter of 2025, we saw President Trump's announcement of 'reciprocal tariffs' rock markets in early April. With this came a strong sell off across a range of sectors and regions, however, since the depths of the sell off, markets have rallied strongly, again with notable changes in leadership from week to week.

While many were concerned about the Israel / Iran conflict and the risk that US would intervene (which ultimately it did) combined with the risk it could lead to broader conflict and subsequently a significant sell off in markets; it became clear that the oil and energy complex remains the markets preferred 'tool' for expressing risks as they relate to the Middle East and that for intents and purposes, the Middle East is relatively limited on its impact on the world economy.

Looking forward, we believe that the market views President Trump's ability to negotiate and agree several trade deals with selected trading partners in recent weeks as proof that he will ultimately be successful with all the US's trading partners. This remains to be seen; however, we expect near term progress on trade deals to primarily be with countries who are incentivised to work faster to achieve an outcome with the US i.e. they are heavily reliant on the US consumer demand for their domestic industries.

Furthermore, US tariffs remain at the highest levels in almost a century, and while this will likely result in modestly higher inflation in the near term, we expect the market to focus on what this means for revenue, margins and profits as we come into the next earnings season.

Markets are not 'cheap', with valuations still at or above long-term averages. We believe corporates' 'margin for error' has narrowed, and that earnings misses will likely be met with harsh treatment and sharp price drawdowns. Avoiding names where this risk is elevated will be key to delivering strong outcomes. Further, we expect the market to reward those management teams who demonstrate apt understanding their supply chains and have the ability to adjust in response of tariffs and protect margins.

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Real estate

REITs (Real Estate Investment Trusts) experienced differing outcomes over the quarter, with meaningful rebounds continuing for European and Asian securities, whilst US assets lagged with heightened borrowing costs and a weakening US dollar weighing on outcomes. Locally, A-REITs delivered a respectable return over the period, delivering +13.4%[21] for the three months – significantly below Germany's +26.6%[23] but comfortably above the -6.4%[22] generated by the US.

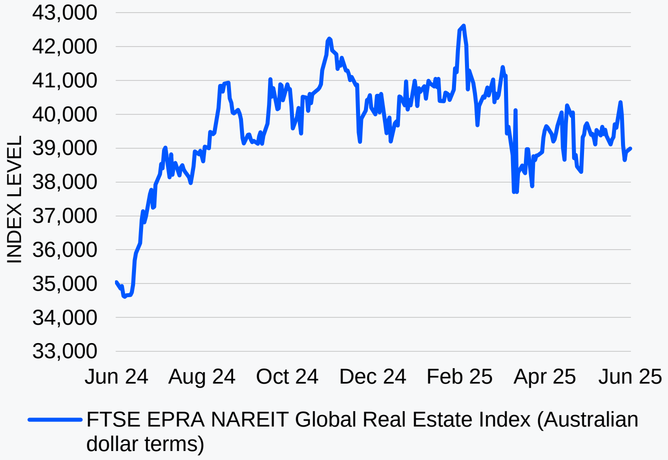
Digging deeper into regional returns, we note that when removing the currency effect, US returns improve to -2.7%, with the US dollar weakening over 5% in the period. Conversely, given the strengthening of the Euro, Germany's outcome in Australian dollar terms was flattered, generating only 21.9% in local currency terms.

On a sector level, residential developers (particularly German and Asian) performed strongly as residential shortages became evident across Developed markets. Data centres continue to be an area of strength due to their proximity to the AI trend, meanwhile Healthcare experienced softer outcomes, whilst Industrial's performance was varied across regions..

Figure 19: Australian real estate trusts (A-REITs)

Source: FactSet, Perpetual Private

Figure 20: Global real estate investment trusts (G-REITs)



Source: FactSet, Perpetual Private

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Real estate – Manager insights and outlook

Last quarter, we raised the threat that tariffs may have on the residential sector despite our view that this is an attractive place to invest for the future due to the widespread imbalance, between demand and supply (primarily a supply shortage). US-based companies within the sector sold off heavily on 2nd April as the US Government announced a suite of global tariffs. Many of these companies have partially rebounded but few were able to recoup all of their losses from that day. This impacted key US businesses including; Essex Property Trust, Avalon Bay, Equity Residential and Invitation Homes, all declining between 9-12% over the quarter in AUD terms. On a more positive note, last quarter we referenced the probable trough in Office as a buffer against losses, and the sector out-performed during the quarter. The Office sector is down to around 5% of the index so its influence is greatly diminished but we believe many of these are very credible businesses with high quality assets and gradually improving prospects.

The second quarter was also notable for a reversal in what had been some of the best performing sectors. Healthcare still represents the best performing sector over the last twelve months but joined the Residential sector in large declines. Ventas and Welltower are the largest listed healthcare companies, with the drawdown over the quarter coming in large part from Ventas. In late April, it announced solid financial results but gave weak forward guidance. The quarter also saw weakness in life sciences with a sell-off in Alexandria Real Estate and Healthpeak Properties. HealthCo Healthcare & Wellness REIT in Australia similarly fell after providing rent relief to Healthscope (hospital operator), which subsequently went into receivership.

The regional disparity in global REIT performance over the quarter has alleviated some of the discount that had been apparent in UK and European companies. It suggests that overall, REIT's are trading around fair value and the future direction for markets will be dependent on the pace of rental growth. We reiterate our comment from last quarter that fundamentals remain supportive. The lack of new supply evident across sectors, excluding data centres which are expanding quickly, and likely to be in effect for at least the next year or longer, will support rent growth for existing landlords. Construction and developers are facing much more challenging conditions including elevated construction costs, higher borrowing costs and less liquid markets. In this environment, we still believe our managers can take advantage of any large shifts in prices or regional dislocations.

Alternatives

Growth alternatives

Infrastructure assets continued to experience muted demand during the quarter, with deal timelines extending and pricing becoming more conservative due to the sustained impact of elevated borrowing costs. That said, infrastructure remains a core holding in our portfolios, offering stable and inflation-linked cash flows. During the quarter we closed on a co-investment in a US short line rail company, as our research gave us confidence on the company's growth prospects and expect it to be a beneficiary of the 'on-shoring' / 're-shoring' trend many US businesses are pursing in the light of the US's trade wars.

While there was optimism entering 2025 around an increase in M&A activity, the story of the first half the year has been mixed. According to data from PWC , M&A volumes continue to decline, compared to 2024, however deal value has increased, implying fewer, but larger deals. Furthermore, the growing need to embed AI means that usual reasons (ie. political uncertainty, market volatility) for putting off strategic initiatives may no longer hold, as corporates race to adapt and remain relevant. Furthermore, (and again according to PWC) the backlog of sponsor-backed companies continues to grow, with the number of portfolio companies exceeding 30,000 by the end of March 2025—47% of which have been on the books since 2020. That said, distributions to LPs have increased, primarily as a result of 'NAV financing' and 'continuation vehicles'.

From a regional perspective, Europe continues to offer compelling relative value, with more attractive entry points than North America and the potential for fiscal stimulus to support demand. In particular, German industrials — under pressure from energy costs — are seeking to divest non-core assets, creating carveout opportunities for Private Equity (PE). Despite a fluid market environment, we remain steadfast in our approach to PE to our due diligence process, with continued focus on valuation discipline, financing structures, and the operational capability of managers. Encouragingly, sponsors continue to invest in internal operating teams to drive operating performance in investee companies. We expect to close on a new primary fund investment focused on this thematic in the coming weeks.

Real Estate markets continued to exhibit turbulence, with transaction volumes remaining weak despite a modest pickup. We expect that cap rate expansion has hit its cyclical peak and are particularly focused on opportunities arising from current market dynamics. As some investors seek liquidity, we are seeing real estate funds being offered at attractive discounts to their prevailing net asset value (NAV). The breadth of our relationships with real estate managers positions us well to understand the underlying pool of assets and underwrite these opportunities at attractive valuations/entry points.

Across traded markets, we continue to observe dispersion in equity and credit pricing, reflecting the divergence in macroeconomic and political conditions. Our existing credit exposures have delivered solid performance, but tighter spreads have reduced the appeal of new investments. In response, we have begun reallocating capital toward hedge fund strategies that offer asymmetric return profiles and potential resilience in risk-off environments.

Although we entered the year with some optimism around increased corporate transaction activity, we remained cautious about the pace of realisations, particularly in private equity where we expect them to remain modest. To manage through this environment, we added exposure to high total return, high cash flow investments. In particular, we see a demand/supply imbalance in the global aviation industry, with both major manufacturers (Airbus and Boeing) struggling to deliver promised aeroplanes. To this end, we invested in an aeroplane leasing strategy, which can take advantage of airlines needing to keep planes on lease for longer.

The evolving market dynamics — notably during the quarter, the One Big Beautiful Bill's reciprocation of 'unfair taxes' played on investor minds. While anecdotally many investors put their 'pens down' on deals waiting certainty, our wider perspective, meant we could focus on the job at hand – allocating capital to regions and strategies where we see the best opportunities.

Income alternatives

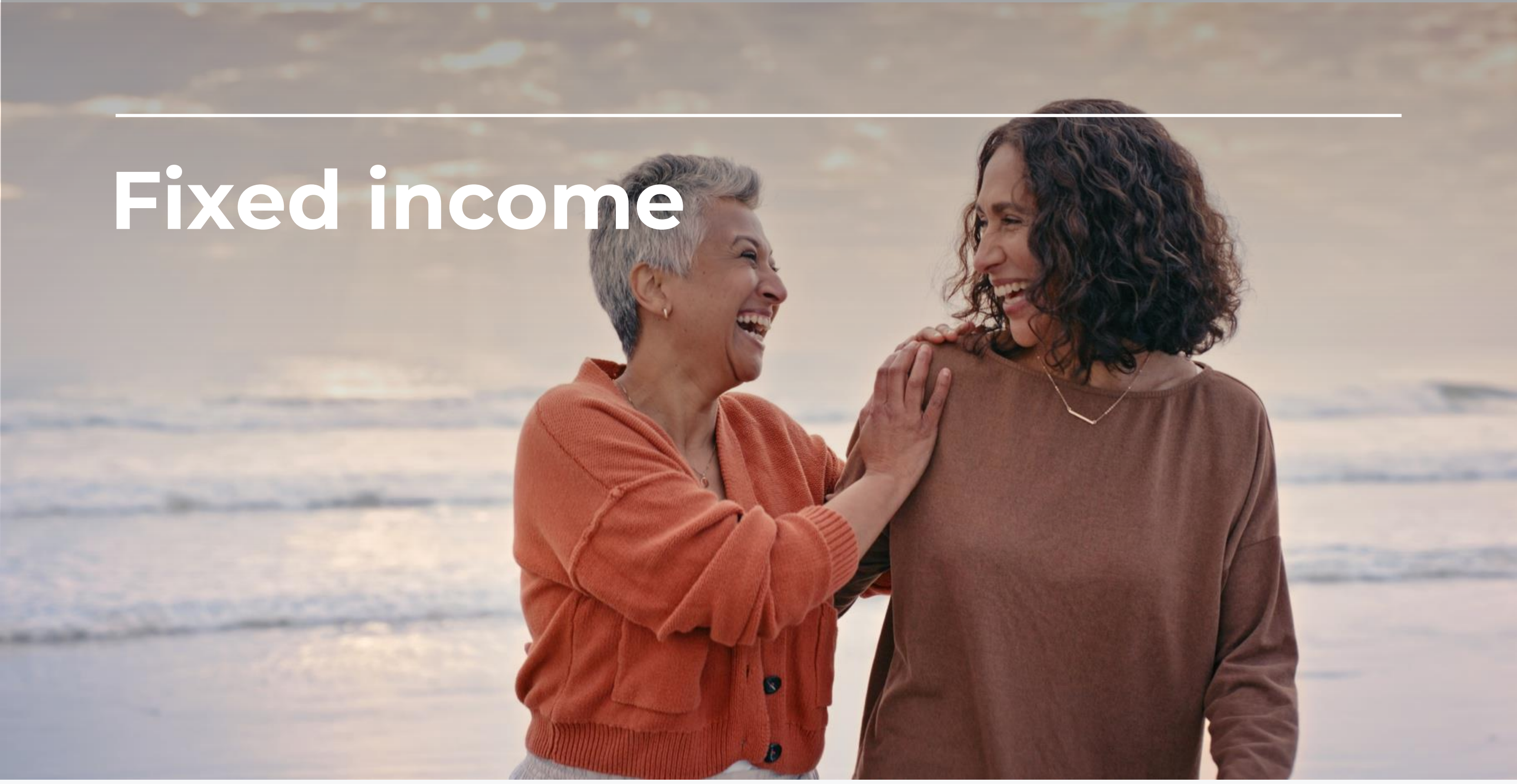
Over the last 5 years, floating rate investments have outperformed fixed rate investments with similar risks. In the last 12 months, fixed rate investments, like High Yield have done incredibly well as the market focus shifted from inflation to economic growth, or more correctly, the lack of it. Whilst our preference has been predominantly focused on floating rate investments we do maintain a small exposure to High Yield.

Outside of High Yield, liquid investments underperformed our expectations by around 1-2% for the 12 months to the end of May. Broadly syndicated loans (BSL) delivered a margin of 2-3% above cash for the year. With Investment Grade floating rate credit and premium funding delivering margins of around 1-2% above cash.

Deal flow for private debt and insurance linked strategies remains subdued, especially when compared to 2022 and 2023. M&A was reported as being high in the US during the first half of 2025, unfortunately this has not translated to Private Equity deal flow which has a direct correlation to Private Debt deal flow. Block trades in the insurance space are becoming more competitive and our managers have focused on growing their books organically through annuity sales, leading to a slower deployment than we had originally anticipated.

Slower deal flow in the private markets and a large inflow in late 2024 has seen us accumulate a 10%-15% overweight to liquid assets for the 1st half of 2025. Most of our private debt, specialty and insurance linked private assets have outperformed our liquid asset by 1-2% depending on the vintage. On the bright side, the liquid assets helped us as we rebalanced at the end of June 2025, enjoying the optionality of liquidity enabling us to make more commitments to private assets.

Our current research efforts are leaning toward higher deal flow sub sectors such as Specialty Finance and Regulatory Capital. Our current investment in Speciality Finance has been one of our strongest contributors to performance for the year. We plan on expanding our exposures to include US and European specialty finance, to help diversify our current Australian focused exposure. Regulatory capital has been a functioning market in Europe for a few decades now and in the last few years, large US banks have been significant participants. We now feel more comfortable about engaging this more diversified market.



Fixed income

Fixed income assets enjoyed a reasonably robust quarter, despite the global turmoil generated by President Trump's early April tariffs announcement. Indeed, immediately prior to the Rose Garden presentation of what was described as "reciprocal" tariffs, markets had been relatively buoyant. Sure, Deepseek had brought some of the AI linked US companies back down through the stratosphere, but from a fixed income perspective, the direction of travel can only be described as constructive.

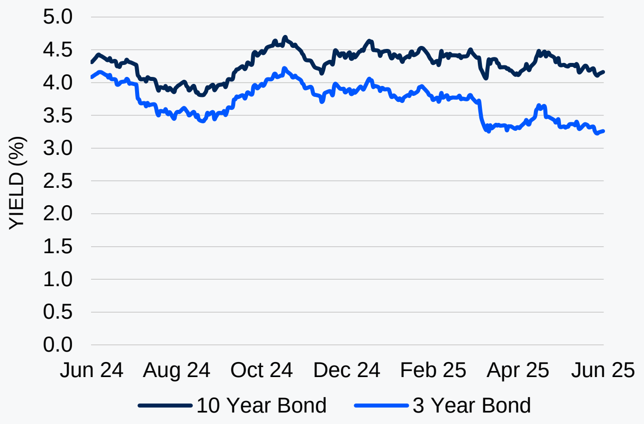
With much progress made on tackling inflation, the world had been increasingly moving towards an environment of monetary easing. Unfortunately, the US administration's penchant for tariffs has significantly increased the difficulty for central bankers, particularly the US Federal Reserve's Governor, Jerome Powell. Whilst tariffs can be seen as a one-off increase in the price level, this isn't necessarily the case. There is also scope that they trigger price and wage increase cycles, as consumers attempt to regain spending power and businesses attempt to defend margins. As such, with a elevated degree of uncertainty regarding the future prospects of inflation in the US, the Fed is unlikely to cut rates until after the North American summer, with the September meeting the next likely "live" meeting. Indeed, in a recent presentation to US lawmakers, Governor Powell described the Fed as being "well positioned to wait".

In spite of this, global fixed income delivered a respectable +1.5%[24] return for the quarter, slightly outpacing its trailing 12 month returns on an annualised basis (+5.5%). Locally, with more clarity, our own Reserve Bank had the confidence in May to cut the cash rate target (-0.25% to 3.85%) for only the second time since 2020. This allowed the Australian yield curve to shift downward in an orderly fashion. Australian fixed income returned +2.6%[26] over the quarter and a solid +6.8% over the trailing 12 months. Considering US fixed income, returns ended the quarter respectably, delivering 1.0%[25] for the period. This however does not demonstrate the volatility experienced by US treasuries over the period. Concerns that tariffs may cause stagflation (a scenario where persistent inflation combines with low growth) as well as fears about continued and growing fiscal deficits, have seen longer dated US government debt, move up meaningfully, with 30-year yields gaining more than 0.22% in the three months to the end of June.

Broadly, credit spreads also experienced a volatile quarter, for much the same reasons noted above. Concerns that disruptions to global trade emanating from Trump's "Liberation Day" tariffs would impair supply chains and therefore reduce debt serviceability for companies, saw credit spreads widen in the weeks following the announcement. Fortunately, as weeks passed, the initial shock and fear subsided and spreads returned most of the way back to where they had ended March. As a result, global High Yield assets gained by 3.3%[27] whilst global corporate bonds delivered 1.8%[28].

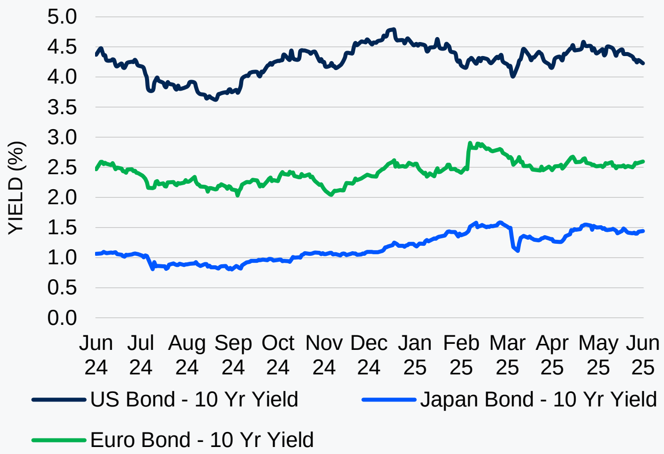
Refer to footnote's description on page 30

Figure 21: Australian government bond yields



Source: FactSet, Perpetual Private
Note: Bond prices are inversely correlated with bond yields.

Figure 22: Global government bond yields



Source: FactSet, Perpetual Private

Figure 23: Global credit markets

Source: FactSet, Perpetual Private

Fixed income – Manager insights and outlook

As expected, the RBA dropped its target cash rate to 3.85% in May 2025, with the Bank pointing to falling inflation and an uncertain global outcome. The fall in rates had the predictable effect of increasing house prices. Fortunately, the rate cuts also did what they are supposed to do, improve consumer spending. According to the ABS, consumer spending was up in May from a year prior.

As a reminder, we have maintained a constructive view on Australian Fixed Income since 2022, as outlined in our previous sector reviews and strategy updates. This recent fall in Aussie yields was not unexpected, it just took a year longer than we had originally forecast. We will now look to moderate our Australian overweight in the next few months, with timing depending on how the global economic conditions evolve.

All eyes have been on the US economy and government over the last 3 months. With US economy contracting in Q1, we will know if there is a technical recession in late July. We suspect that they may avoid it this time round. as fall in GDP was attributed to a significant jump in imports.; sometimes referred to as “tariff stocking” involving increasing inventory in front of tariff driven price increase.

Consumer spending was weak at the start of the quarter but showed some signs of recovering by May. US corporate spending was also up in the first quarter. Higher than the 2 previous quarters. Corporate spending could make up for some of the softness in US consumer spending.

A lot has been said about the Trump Always Chickens Out (TACO) Trade as Trump extended all the deadlines for making a tariff deals. Trump was not too pleased about hearing this. At the time of writing, the only major economy to sign a deal was the UK. New tariffs will put pressure on global growth and are likely to increase inflation.

Lower growth, the uncertainty around tariffs and the pricing in of some very serious geo-political events led to a fall in US yields in the front and the belly of the yield curve. Some poor auction results, likely due to falling confidence in the US as a safe haven, put pressure on the longer end of the curve.

We remain constructive on long government bonds, with part of that being a significant overweight to emerging markets. The lower yields in the belly of the curve across the globe has helped the Fund outperform. The increase in the long end of the US yield curve and the outperformance of local currency Emerging Market debt, due to a much weaker USD, have also been strong contributors.

We will look to moderate our overweight government bond and Emerging Market (EM) exposures in the next few months. It has taken longer than we expected, but our EM position is pleasingly compensating for our underweight exposure to Investment Grade credit.

Australian cash rate

The RBA cut the cash rate target by 0.25% to 3.85% at its May meeting, marking the second step in a cautious easing cycle, following the initial cut in February. The decision was driven by signs that inflation was moderating and growth was slowing.

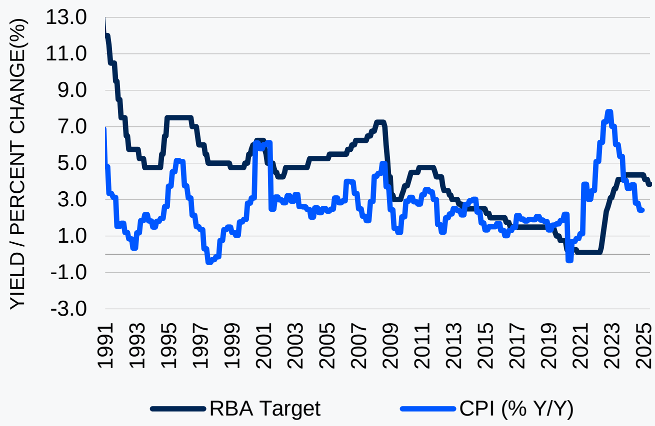
However, at its July meeting, the RBA surprised markets by holding rates steady, despite money markets pricing in a roughly 90% chance of a cut. This reflects the RBA's preference to wait for more definitive confirmation that inflation is sustainably returning to target—particularly from quarterly CPI data, which it places greater emphasis on over monthly prints. While the move disappointed expectations, the RBA's tone remained dovish, suggesting rates are still likely to fall further.

Recent data continues to support the case for easing. May's monthly headline CPI eased to 2.1% year-over-year, and trimmed mean inflation fell to 2.4%, both within the RBA's target range. Business surveys point to further disinflation, and March quarter GDP growth came in below expectations at just 0.2% quarter-over-quarter.

The unemployment rate rose to 4.3% in June, pointing to early signs that the labour market is beginning to loosen. However, the RBA continues to assess conditions as relatively tight and not overheating, noting that wage growth has not been a significant contributor to recent inflationary pressures.

The RBA has signalled a cautious and measured approach to easing. It does not intend to move aggressively or respond to market pricing alone. The current stance is best characterised as a gradual reduction in restrictiveness, not a rapid return to neutral. As with global peers, the RBA remains cautious, with heightened trade uncertainty complicating its dual mandate.

Figure 24: Long-term cash rate vs inflation



Source: FactSet, Perpetual Private.

Australian cash rate – outlook

We expect the RBA to be in the position to reduce rates into the end of the year, with one to two further reductions likely. Whilst the near-term path appears relatively clear, the pace of easing will depend on the evolution of inflation and the labour market. The RBA is unlikely to move in back-to-back meetings unless conditions deteriorate more sharply than expected.

Slowing population growth, a more tentative transition from public-led to private sector demand, and softening consumer and business activity all point to a more subdued economic outlook. If trimmed mean inflation remains below the midpoint of the target range, as recent monthly data suggests, the case for further easing will strengthen.

For now, the RBA appears comfortable with a gradual path, guided by incoming data and its dual mandate of price stability and full employment. We continue to view every Monetary Policy Committee meeting as a 'live' moving forward.

Australian dollar

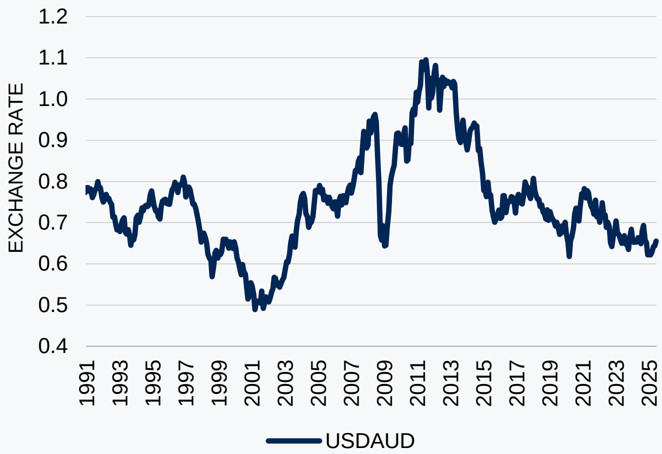
The Australian dollar (AUD) strengthened over the June quarter, appreciating 5.2% against the US dollar to close near US$0.66. The quarter began with heightened volatility, as the AUD briefly fell below US$0.60 in early April following US tariff announcements. However, our dollar rebounded steadily through May and June, supported by easing geopolitical tensions, improving risk sentiment, and broad-based weakness in the US dollar. The AUD/USD trading range for the quarter approached 10% - nearly double that seen in the March quarter.

The US dollar was the dominant driver of FX markets over the period. The US Dollar Index fell 10.8% in the first half of 2025, marking its worst start to a calendar year since 1973. The greenback depreciated against nearly all major currencies, weighed down by political uncertainty, aggressive trade policy, and growing concerns about the sustainability of US fiscal dynamics. Even elevated tensions in the Middle East failed to trigger a meaningful safe-haven bid. While the AUD remains down 1.2% against the USD over the past 12 months, the recent rebound has narrowed that gap significantly.

Australian dollar – outlook

The Australian dollar enters the second half of 2025 on firmer footing. With the immediate impact of US tariffs fading, market focus has shifted back to monetary policy and macro fundamentals. Both the Federal Reserve and the Reserve Bank of Australia are expected to cut rates by 50 basis points in H2, which should limit policy divergence and reduce pressure on the AUD.

Figure 25: Australian dollar US dollar (daily) long term



Source: FactSet, Perpetual Private.

Valuation models continue to suggest the AUD is undervalued, with purchasing power parity estimates suggesting it should be closer to US$0.72. The fading appeal of US dollar-denominated assets - driven by political risk, fiscal concerns, and speculation around Fed leadership - has prompted a rotation into alternative currencies, including the AUD. While the US dollar remains a countercyclical currency and could stabilise if global growth slows, the balance of risks appears to favour further AUD strength in the near term.

Volatility is likely to remain elevated, but dips in AUD/USD are increasingly being bought. Should global risk sentiment remain constructive and the Fed begin its easing cycle, the AUD could plausibly test US$0.70 before year-end.

1. As measured by the S&P/ASX 100 – Total Return index
2. As measured by the S&P/ASX Small Ordinaries – Total Return index
3. As measured by the S&P/ASX 300 Information Technology (Sector) - Total Return index
4. As measured by the S&P/ASX 300 Financials ex-REITs (Sector) - Total Return index
5. As measured by the S&P/ASX 300 A-REIT (Sector) - Total Return index
6. As measured by the S&P/ASX 300 Energy (Sector) - Total Return index
7. As measured by the S&P/ASX 300 Consumer Discretionary (Sector) - Total Return index
8. As measured by the S&P/ASX 300 Materials (Sector) - Total Return index
9. As measured by the MSCI Australia Growth – Net Return index
10. As measured by the MSCI Australia Value – Net Return index
11. As measured by the MSCI World Index Growth – Net Return index in AUD terms (Unhedged)
12. As measured by the MSCI World Index Value – Net Return index in AUD terms (Unhedged)
13. As measured by the DAX index – Gross Return in AUD terms (Unhedged)
14. As measured by the Nikkei 225 index – Net Return in AUD terms (Unhedged)
15. As measured by the Hang Seng index – Net Return in AUD terms (Unhedged)
16. As measured by the MSCI AC World – Information Technology – Net Return index in AUD terms (Unhedged)
17. As measured by the MSCI AC World – Communication Services – Net Return index in AUD terms (Unhedged)
18. As measured by the MSCI AC World – Industrials – Net Return index in AUD terms (Unhedged)
19. As measured by the MSCI AC World – Energy – Net Return index in AUD terms (Unhedged)
20. As measured by the MSCI AC World – Health Care – Net Return index in AUD terms (Unhedged)
21. As measured by S&P / ASX 300 A-REIT (Sector) – Total Return index
22. As measured by FTSE EPRA Nareit USA Net Return (AUD) index.
23. As measured by FTSE EPRA Nareit Germany Net Return (AUD) index
24. As measured by the Bloomberg Global Aggregate (AUD hedged) index
25. As measured by the Bloomberg US Aggregate (AUD Hedged) index
26. As measured by the AusBond Composite (0+Y) index
27. As measured by the Bloomberg Global High Yield (AUD Hedged) index
28. As measured by the ICE BofA Global Corporate (AUD Hedged) index
29. As measured by the Mean Price of Residential Dwellings, Australian Bureau of Statistics
30. As measured by the S&P/ASX 300 Communication Services (Sector) - Total Return index
31. As measured by the S&P/ASX 300 Industrials (Sector) - Total Return index
32. As measured by the S&P/ASX 300 Health Care (Sector) - Total Return index
33. As measured by the S&P/ASX 300 Utilities (Sector) - Total Return index
34. As measured by the S&P/ASX 300 Consumer Staples (Sector) - Total Return index
35. As measured by the S&P/ASX 300 Financials Ex A-REIT (Sector) - Total Return index
36. As measured by the MSCI AC World Index Small Cap – Net Return in AUD terms (Unhedged)
37. As measured by the S&P 500 index – Net Return in AUD terms (Unhedged)
38. As measured by the NASDAQ Composite index – Gross Return in AUD terms (Unhedged)
39. As measured by the CAC 40 index – Net Return in AUD terms (Unhedged)
40. As measured by the FTSE 100 index – Net Return in AUD terms (Unhedged)
41. As measured by the MSCI Emerging Markets index – Net Return in AUD terms (Unhedged)
42. As measured by the MSCI AC World – Consumer Staples – Net Return index in AUD terms (Unhedged)
43. As measured by the MSCI AC World – Real Estate – Net Return index in AUD terms (Unhedged)
44. PwC. (n.d.). *Deals industry trends*. PwC. https://www.pwc.com/gx/en/services/deals/trends.html
45. Australian Bureau of Statistics
46. FactSet: Global Composite of PMIs
47. FactSet. Data as of 30th June, 2025.

Authors

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National Investment Director, Perpetual Private

Andrew provides investment research, portfolio construction and bespoke investment advice for Perpetual Private's clients.

Andrew works closely with advisers by providing specialist investment knowledge on Perpetual's investment process and strategy implementation, focusing on delivering optimal solutions to our stakeholders and partners. This is further augmented by his provision of transparent and accessible knowledge of financial markets and asset classes both globally and locally.

Having spent 15 years in London, Andrew returned to Melbourne with a wealth of international experience to benefit Perpetual's clients and partners. Having started his career working on private equity transactions and stock market listings, he then spent time working on equity trading desks, before moving into investment management. In his role as a Portfolio Manager for Barclays Investment Solutions, Andrew managed money across multiple asset-classes on behalf of various client groups, before focusing on the charity and not-for-profit segment. With responsibility for as much as £3bn in assets, he developed a strong reputation for delivering robust investment performance linked to his comprehensive understanding of global investment markets.

Andrew is a holder of the Chartered Financial Analyst and the Chartered Alternative Investment Analyst designations

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Hugo is responsible for communicating Perpetual Private's investment strategy to both advisers and clients, bridging the work of the Investment Research team with the broader business. He supports the Head of Managed Accounts and Investment Directors by producing investment content and presentations used in adviser conversations and client meetings. Alongside this, Hugo regularly participates in client discussions, helping to explain portfolio positioning, market developments and the rationale behind investment decisions.

Prior to joining Perpetual, Hugo worked in Vancouver, Canada as a Research Analyst at a boutique wealth management firm, focusing on asset allocation across a range of client portfolios. He began his career in Sydney, with earlier roles at BT Financial Group and TP ICAP.

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