

Investor Insights

SEPTEMBER 2026 QUARTER

QUILLA

In summary

The September quarter combined solid economic growth with rising interest rates. Business surveys showed the global economy remained resilient, led by the US, where company profits grew strongly. However, renewed conflict between the US and Iran pushed oil prices sharply higher. This kept inflation elevated and pushed interest rates up around the world.

Share markets made modest gains overall but ended the quarter on a weaker note. The US share market rose 2.3%, although the gains came mainly from a small group of large technology and artificial intelligence (AI) companies. Shares in other developed markets rose slightly, while emerging markets were broadly flat. The Australian share market rose in July and August but fell around 3% in September, finishing the quarter higher by 1%.

Bond markets came under pressure. Government bond yields, the interest rates governments pay to borrow, rose sharply as investors worried about inflation and rising government debt. Australian 10-year yields reached their highest level since 2011. When yields rise, the value of existing bonds falls.

The collapse of a US-Iran agreement in July and renewed military activity drove sharp swings in energy markets, with crude oil rising almost 38% over the quarter. Positively, oil flows from the Persian Gulf recovered to near pre-conflict levels by quarter-end.

Central banks responded to persistent inflation. The US Federal Reserve (Fed) raised interest rates in September for the first time since 2023. The Reserve Bank of Australia (RBA) lifted the cash rate to 4.60%, its fourth increase this year and its highest level in 15 years. Australian headline inflation rose to 4.0% in August on higher fuel and housing costs, while underlying inflation held at 3.6%.

Company results were a bright spot. US companies reported their strongest profit growth since 2021, and AI is now showing up in company revenues. In Australia, businesses linked to global investment themes outperformed those relying on household spending.

We have increased the probability of our 'Below Trend Growth' base case. In this environment, modest growth, solid earnings and long-term investment themes support global shares. Higher interest rates, stubborn inflation and oil prices remain headwinds.

In this edition

In this edition of Investor Insights, we examine the market-moving trends shaping our outlook for the final quarter of 2026:

- **Global growth remains resilient**, led by the US. Business surveys show solid expansion in most major economies. Australia is softening as services slow and manufacturing contracts, with inflation and interest rates remaining the main headwinds.
- **Australian inflation is proving sticky**. Headline inflation rose to 4.0% in August. With underlying inflation still above target, the RBA increased the cash rate to 4.60%, signalling that interest rates are likely to stay 'higher for longer'.
- **The Australian and US earnings seasons told different stories**. Australia is increasingly a two-speed economy. Sectors tied to global themes (AI, defence, mining) are expanding profits, while businesses that rely on household spending are under pressure. In contrast, US corporate earnings and forward guidance broadly exceeded expectations, driven by technology.
- **Rising interest rates have not historically derailed share markets**. On average, US shares have delivered stronger returns following Fed rate rises compared with rate cuts.
- **The AI ecosystem offers multi-year earnings growth at reasonable prices**. Prospects differ across the supply chain, from the large cloud providers to chipmakers, hardware, power and software. While some investors fear an AI bubble, company profits and valuations do not point to one.

Complexities in a 'Below Trend Growth' environment

This quarter, markets were pulled in different directions. On the positive side, the global economy remained resilient, and long-term trends continued to support growth. These include AI, ongoing technology breakthroughs and large infrastructure projects. On the other hand, markets had to deal with sticky inflation, cost-of-living pressures, high government debt and uncertainty over US-Iran relations.

Against this backdrop, we have increased the probability of our **'Below Trend Growth'** base case scenario for the global economy compared with last quarter to 60%.

In this scenario, global growth is resilient but uneven. The US retains its economic leadership, while Australia continues to weaken and most other economies grow at a softer but positive pace. Underlying inflation remains stubborn. Oil supply disruptions, demand from the AI infrastructure build-out and rising wages are all adding to price pressures in the near term. Longer-term inflation expectations, however, remain steady.

Central banks are taking a more cautious approach. The Fed raised rates in September under its new Chair, Kevin Warsh, and is in the early stages of a new cycle of rate rises. The RBA also lifted the cash rate in September and

remains focused on inflation, even as risks to the Australian economy grow. After a sharp rise, we expect government bond yields (the interest rates governments pay to borrow) will settle at these higher levels. Higher government spending is widening budget deficits and adding to public debt.

Share markets remain supported. Long-term themes such as AI, along with pro-growth government policies, continue to support the US economy, its share market and company profits. Positive earnings growth is spreading, but risks are rising in sectors that have experienced strong share price gains. The Australian dollar ended the quarter at around 70 US cents, close to our estimate of its long-term fair value, and we expect it to stay around this level.

Mapping global financial and macroeconomic conditions

The global economy is in reasonably good health, although conditions vary widely between regions. The S&P Global Purchasing Managers' Index (PMI), a comprehensive monthly survey of business managers, has shown activity has been expanding strongly across both manufacturing and services.

Inflation, however, has remained stubborn as energy prices rose sharply over the quarter. Fighting between the US and Iran disrupted shipping through the Strait of Hormuz, which carried around one-fifth of the world's oil supply before the conflict began. Brent crude oil, the global benchmark, started July at around US\$72 a barrel. It passed US\$100 in early September and peaked at US\$109 in mid-September. Higher energy prices weigh most

on countries that import much of their oil, and they are a key reason inflation remains elevated.

With inflation proving sticky, interest rates are a headwind in most regions, as shown in Table 1.

How conditions compare across regions

Table 1 summarises our assessment of major economies across six factors that influence financial markets. Each factor is rated as supportive, balanced or challenging.

Table 1: Regional economic and market conditions

Region	Economic Growth	Monetary Policy (Interest Rates)	Fiscal Policy (Govt. Spending)	Earnings Growth	Market Valuation	Investor Sentiment
Australia	Negative	Negative	Negative	Neutral	Neutral	Neutral
United States	Positive	Negative	Positive	Positive	Neutral	Positive
Europe	Negative	Negative	Positive	Positive	Neutral	Neutral
Japan	Neutral	Negative	Positive	Positive	Neutral	Positive
China	Neutral	Positive	Positive	Positive	Positive	Neutral
India	Positive	Neutral	Neutral	Positive	Neutral	Neutral

Positive Supportive conditions

Neutral Balanced risks

Negative Challenging conditions

Source: LSEG, Bloomberg, Quilla Consulting

What the table tells us

United States: The US remains the main driver of global growth. Economic activity is strong, with both manufacturing and the much larger services sector supporting economic growth. Demand is healthy across industries, particularly those linked to AI investment. Government spending, earnings growth and investor sentiment are all supportive. The main headwind is interest rates, with the Fed now raising rates to contain inflation.

Australia: Australia is in a weaker position, with growth, interest rates and government spending all challenging. Domestic growth is expected to continue to fade. Manufacturing activity has slipped into contraction, and the services sector has slowed. The RBA's rate rises are weighing on households and the housing market. The recent Federal Budget and already high public spending also leave the Government little room to support the economy.

Europe: Economic conditions are challenging given greater sensitivity of the region to rising energy prices. Europe imports most of its energy, so higher oil and gas prices have weighed on growth and lifted inflation.

The European Central Bank (ECB) raised interest rates in September for the second time this year. Government spending and reasonable earnings growth provide support.

Japan: Growth is balanced and investor sentiment is positive as regulatory and government initiatives support the markets and economy. Tighter interest rate settings are a challenge, but government spending and earnings growth are supportive.

China: The exception on interest rates. China is the only major economy where we rate interest rate settings as supportive. Inflation is low because of a weak housing market and spare capacity in the economy, which gives its central bank room to support growth. China is also the only region where valuations are cheap on a historical basis.

India: India has the strongest economic growth of the group, and output has accelerated. As a large oil importer, however, it is exposed to higher energy prices. India has seen capital outflows to other emerging markets, such as South Korea, that supply the AI build-out.

Common themes

- **Earnings growth is a common strength.**
Solid profit growth is expected across most regions over the next 12 months.
- **Interest rates are a headwind almost everywhere.** Near-term inflation risks remain high and business surveys show costs are still elevated. Central banks are likely to stay cautious, even though inflation is expected to ease gradually into 2027.
- **Share market valuations have eased.** They have moderated as profits have grown, although pockets of concern remain in sectors where prices have risen quickly.
- **Investor sentiment is modest** outside fast-growing themes such as AI.
- **Government spending is broadly supportive outside Australia.**
Rising spending is boosting short-term growth, but it is also adding to inflation, government debt and budget deficits.

Our view

Global growth remains resilient, led by the US. This supports company profits and provides a favourable environment for global shares. Solid growth combined with inflation pressures, however, means interest rates are more likely to stay 'higher for longer'.

With Australia's economic headwinds likely to persist rather than resolve in the short term, we expect uncertainty to linger, keeping investors cautious across the local markets into next year.



Australian inflation is proving sticky

Australian inflation has been a key economic headwind, contributing to rising cost-of-living pressures and higher interest rates.

Headline inflation, measured by the Consumer Price Index (CPI), fell to 3.5% over the year to July, down from a peak of 4.6% in March as energy prices eased. It then rose to 4.0% in August. Fuel prices jumped as oil prices climbed and temporary fuel excise relief ended. Housing costs, including new homes and electricity, have remained the largest contributors.

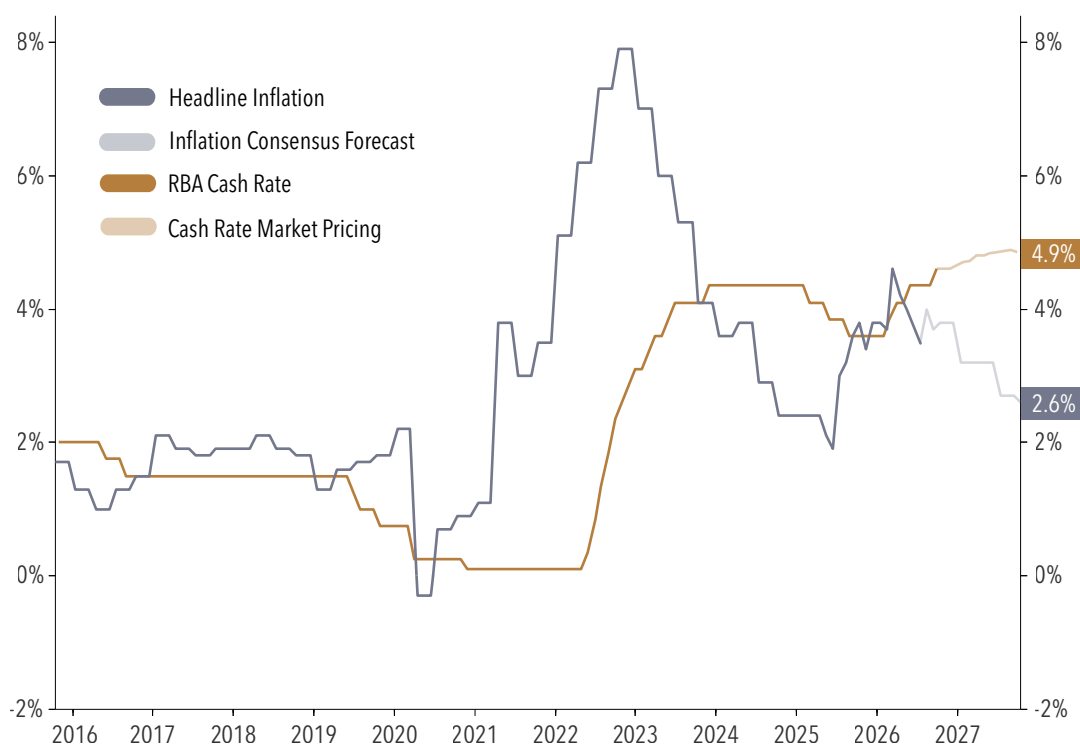
Trimmed mean inflation, which removes the most extreme price movements to show the

underlying trend, held at 3.6% for a third consecutive month. This remains above the RBA's 2-3% target range.

The RBA raises rates again

On 29 September, the RBA raised the cash rate by 0.25 percentage points to 4.60%. This was its fourth increase in 2026 and takes the cash rate to its highest level since 2011. The RBA said inflation is still too high and that it is prepared to raise rates further if needed.

Chart 1: Australian inflation forecast to fall, but the cash rate to stay elevated



Source: LSEG Datastream, Quilla Consulting

Inflation and interest rate forecasts

Analyst consensus forecasts suggest inflation will stay elevated in the near term before returning to the RBA's target range in late 2027 (Chart 1). Markets expect the cash rate to peak at 4.85%, implying one more rise, and to stay elevated well into 2027. Expectations of a rise before the end of this year eased after the August inflation data.

Signs that the economy is cooling

A weakening economy reduces inflationary pressures through softening demand. The Australian economy is showing signs of weakness across multiple measures:

- **Business conditions:** At their weakest since September 2020, led by declines in business profitability and trading conditions. Confidence remains weak, and forward orders are also subdued. The manufacturing sector is back in contraction territory and broader services activity is also slowing.
- **Capacity utilisation:** Businesses are using less of their full production capacity. This points to easing pressure on prices.
- **Jobs market:** Showing signs of cooling as unemployment rose to 4.7% in September 2026, above market forecasts for a steady 4.6% and the highest level since late 2021.

- **Consumer sentiment and spending:**

Sentiment fell to a six-month low in October 2026, with discretionary spending under pressure.

- **Housing and credit:** National house prices have fallen for six straight months, and home sales are tracking close to 20% below last year's levels. New housing loan commitments have also contracted.

Our view

A cooling economy and moderating inflation expectations suggest the RBA is getting close to the end of its interest rate hiking cycle. We expect interest rates to remain elevated. Relief is likely only if the economy weakens materially or inflation falls quickly to within the RBA's 2-3% target band.

Insights from the Australian and US earnings seasons

Australia

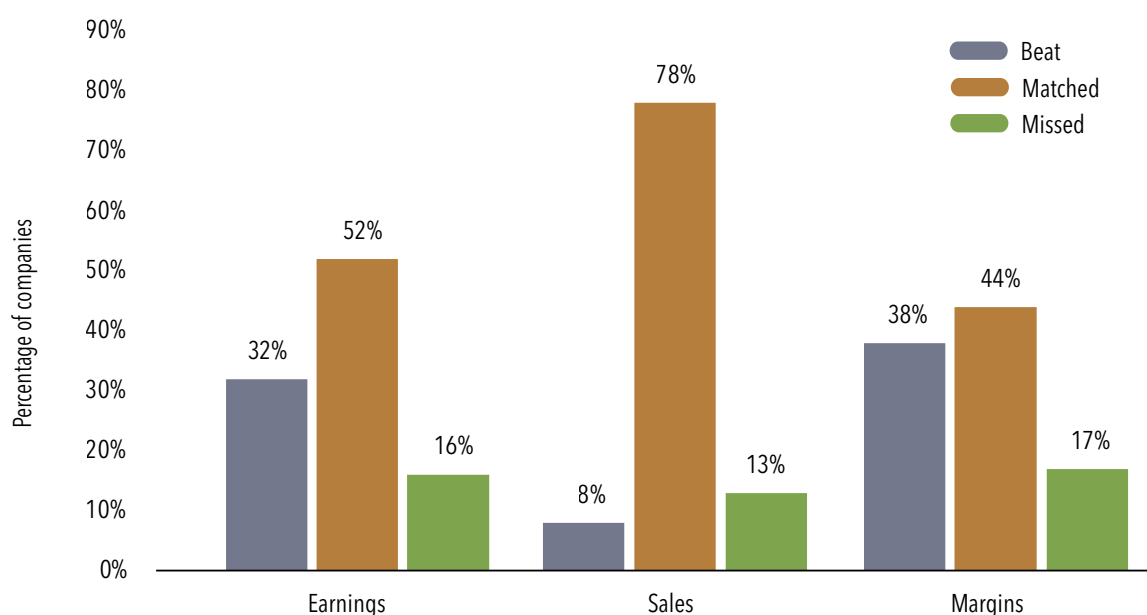
In August, most listed Australian companies reported their results for the 2026 financial year (FY26). The results showed a clear divide between businesses benefiting from global investment trends and those relying on Australian households.

Cost control, not sales, drove better results

Around one-third (32%) of companies in the ASX 300 Index, which covers Australia's 300 largest listed companies, reported earnings that beat analysts' expectations. Only 8% beat expectations on sales (Chart 2). Instead, the beats came from profit margins, the share of

each dollar of revenue a company keeps as profit, as businesses kept a tight rein on costs. Analysts also likely cut their forecasts too far after the Iran conflict began, so many results were better than feared rather than a sign of stronger demand.

Chart 2: Cost control, not sales, drove ASX earnings beats



Note: Chart shows the percentage of companies that beat, matched or missed expectations. ASX 300 results compared with analyst expectations. Beat: more than 5% above; matched: within 5%; missed: more than 5% below. Source: FactSet, Visible Alpha, Macquarie Research

AI is also starting to show up in Australian company results. Commonwealth Bank of Australia (CBA) reported \$200 million of gross benefits from AI in FY26 and expects this to double in FY27. Other companies also reported early benefits. Health insurer nib said its productivity and AI program delivered \$61 million of value in FY26, while online jobs marketplace SEEK credited its investment in AI for strong profit growth despite fewer paid job advertisements.

A two-speed economy

Overall earnings across the market grew 11.6% in FY26, but only 5.3% when resources companies are excluded. Businesses involved in AI infrastructure, defence and mining services are benefiting from global investment. Meanwhile, housing-related businesses and those selling non-essential goods are seeing weaker demand.

The major banks reported that mortgage applications fell by around 15% following the Federal Budget. Missed loan repayments, small business loan losses and credit card balances are also starting to rise.

Sticky costs and rising borrowing costs

Company managers highlighted that the costs of services, wages, insurance and construction remain stubbornly high, even as goods and energy prices ease. Company borrowing costs are also rising as older fixed-rate loans are refinanced at today's higher rates. This will keep pressure on profits even if the RBA eventually cuts rates.

Where to from here for corporate Australia

Earnings growth for the ASX 200 is expected to slow to around 7% in 2027. The market trades on a price-to-earnings (P/E) ratio of 17 times, a common market valuation measure. With only modest growth expected, this suggests Australian shares are fully valued compared with their history.

United States

US companies delivered another strong set of results. Of the companies in the S&P 500, the main index of large US companies, 86% beat profit expectations for the June quarter. Earnings rose 53% compared with a year earlier, the strongest growth since 2021.

While positive earnings growth was broad, share price gains were far narrower. The S&P 500 rose 2.3% over the third quarter, but most of the gain came from the largest technology and AI-related companies. The average company in the index fell, and smaller US companies dropped as rising interest rate concerns weighed on investor sentiment.

AI revenue is finally appearing

- **Cloud computing is booming.** Businesses are increasingly renting the computing power they need to run AI tools. Revenue from Google Cloud grew 82%, Microsoft Azure 43% and Amazon Web Services 37%.
- **Businesses are paying for AI products.** Salesforce's Agentforce AI product passed US\$1 billion in annual revenue, up more than 200%. Microsoft 365 Copilot surpassed 30 million paid seats. Alphabet's Gemini app reached 950 million monthly active users, with daily active users tripling over the past year.

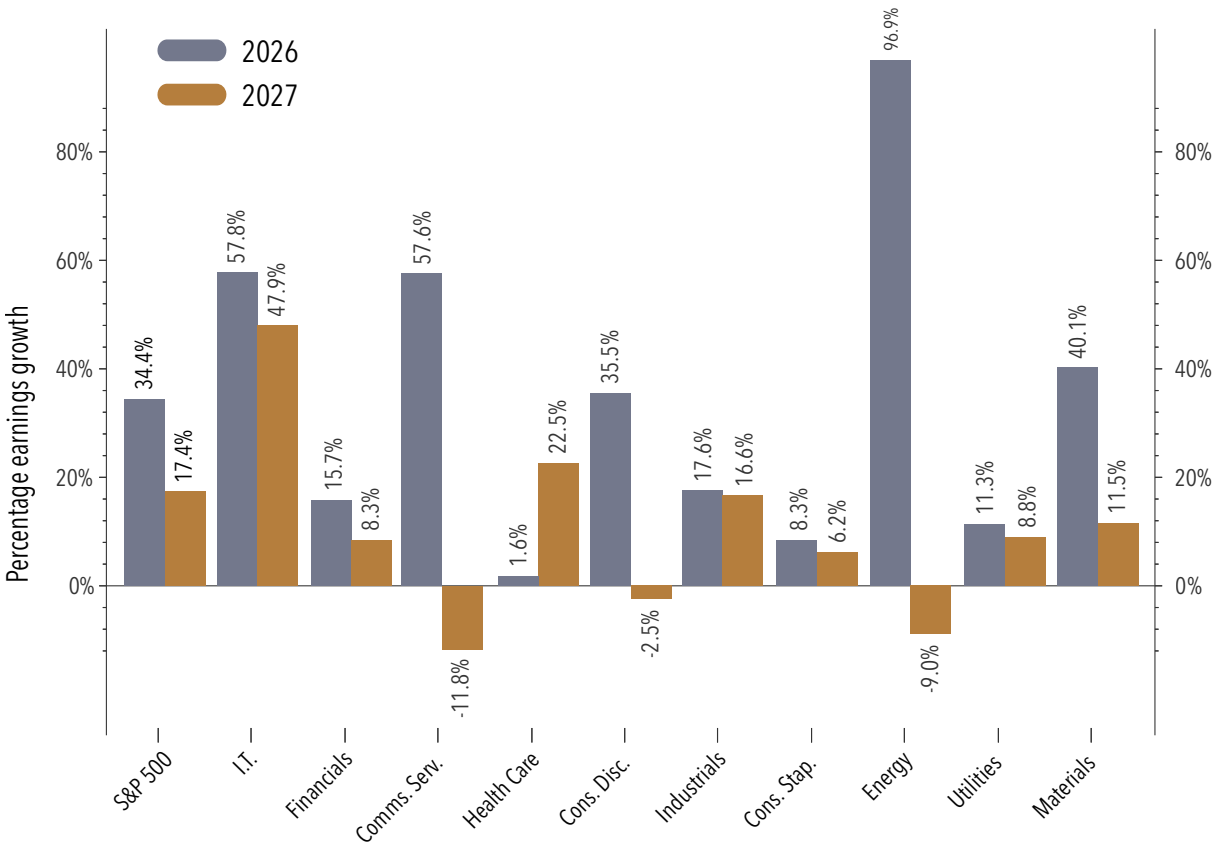
Banks and capital markets show strength

- **Strong bank profits.** US banks delivered strong earnings growth, driven by deal advisory, trading and helping companies raise money.
- **Consumer borrowing remains stable.** Overall, households are keeping up with their debts, but missed repayments are rising among lower-income households.

The outlook for earnings remains positive. Profits are forecast to slow from current levels but remain robust, with profit margins close to record highs. Chart 3 shows that strong growth

is expected across most sectors, not just technology, in both 2026 and 2027 calendar years. Overall earnings for the S&P 500 are expected to grow at a solid 18% in 2027.

Chart 3: US earnings to slow but stay solid in 2027



Source: LSEG, Quilla Consulting

Our view

Strong US corporate earnings and optimistic management forecasts reinforce our preference for global shares in growth-oriented portfolios. While year-on-year profit growth may naturally slow, healthy balance sheets, strong profit margins and broader sector participation continue to support a positive outlook.

We anticipate occasional market volatility as investors react to changing earnings forecasts or shifting enthusiasm around high-growth themes such as AI. However, we remain confident in US shares and their long-term growth drivers. Overall, we continue to favour global shares over Australian shares, though we still expect good income and modest, sector-specific earnings growth within the domestic market.

Do rising interest rates spell trouble for shares?

Rising interest rates have been a feature of global markets in recent months, prompting concerns about their impact on share prices. History shows these concerns are overstated.

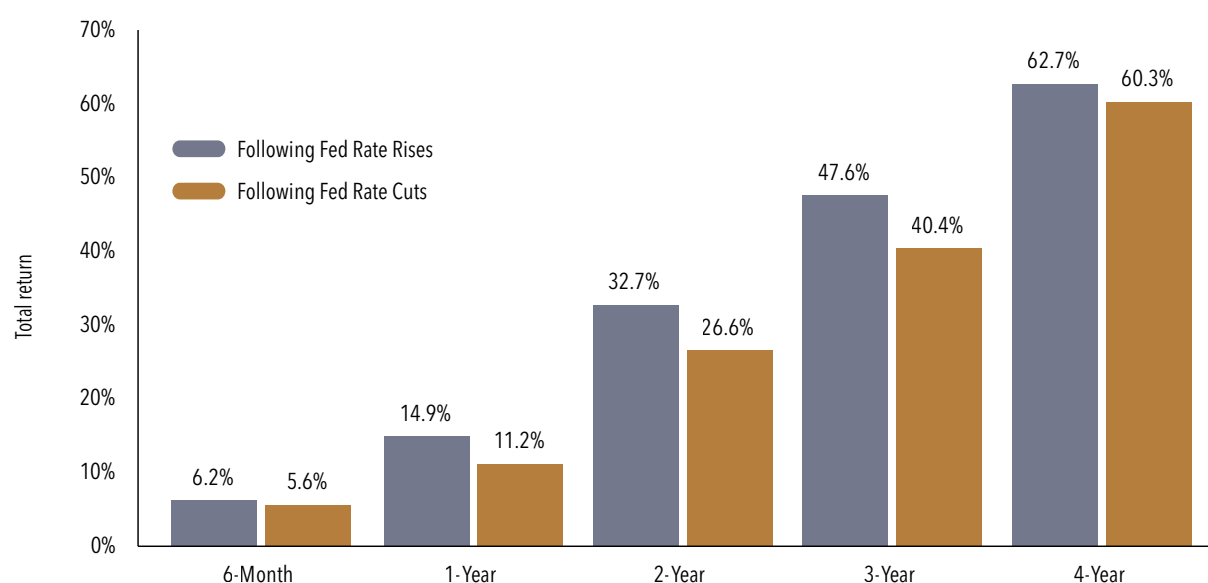
Rate rises and US share returns

On 16 September, the Fed raised its target interest rate range by 0.25 percentage points to 3.75–4.00%, its first increase since 2023. Fed officials' own projections point to one more increase this year. On average, rising rates have not held back share markets. US shares have delivered higher returns following Fed

rate rises than following rate cuts, across every time period shown in Chart 4.

The reason is straightforward. Central banks usually cut rates when the economy is weak. They usually raise rates when the economy is strong, and strong growth also supports company sales and profits.

Chart 4: US shares have been strongest during rate hikes



Source: Creative Planning, Quilla Consulting

When do higher bond yields weigh on shares?

The US 10-year government bond yield, the interest rate the US Government pays to borrow for 10 years, is currently around 5.3%. It is an important benchmark because it influences borrowing costs across the economy and is a key input into how investors value companies. Higher rates generally lead to lower valuations.

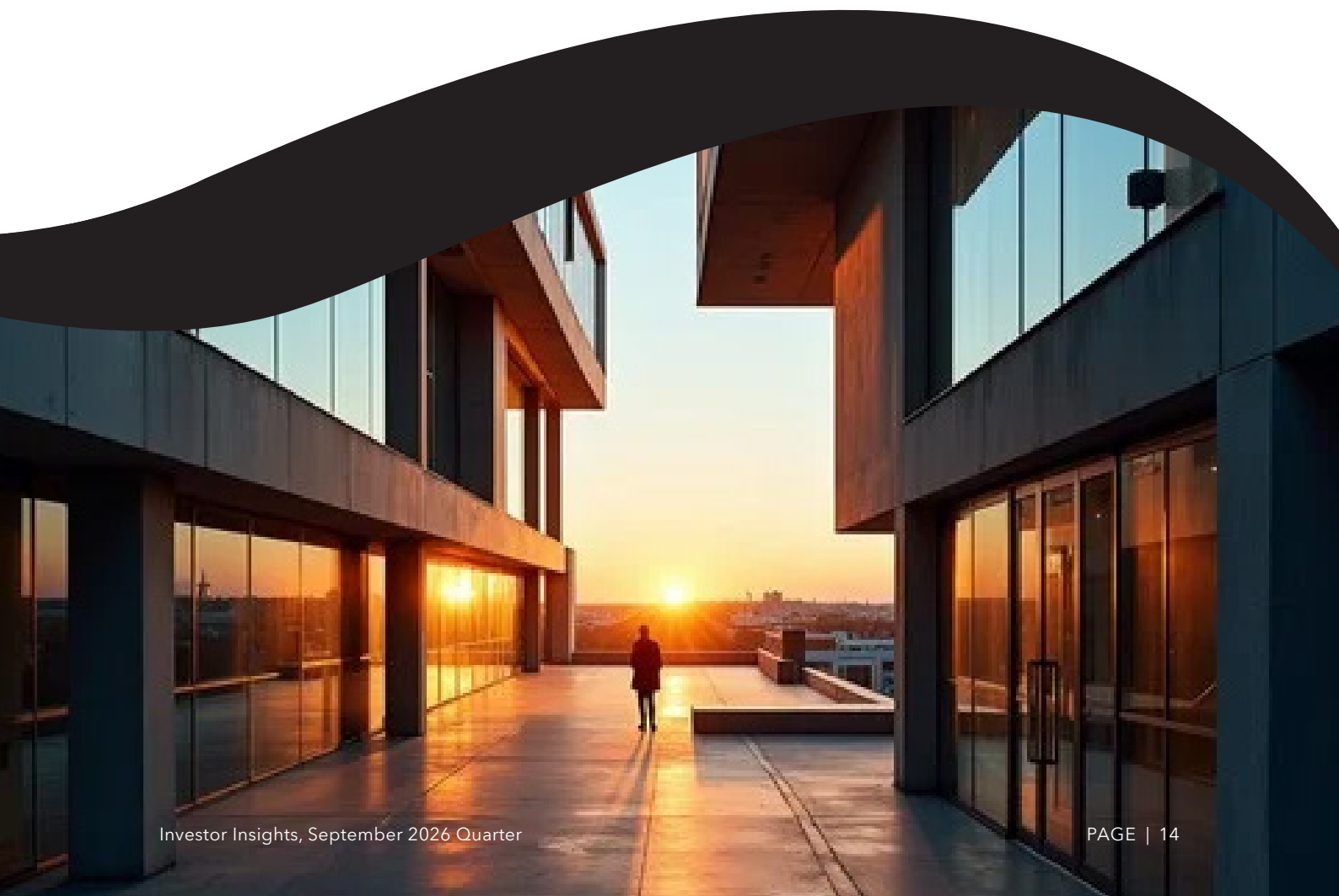
Data since 1980 suggests yields at today's level are unlikely to have a significant negative effect on share valuations overall. Historically, valuations have come under sustained pressure when yields move above 6%, which is still higher than current levels.

Higher yields did weigh on parts of the market during the quarter. In the US, sectors that are sensitive to interest rates fell, with utilities down 13% and real estate down around 6%. Similarly, in Australia, the real estate sector fell by 13%, and the consumer discretionary sector dropped by 9%.

Our view

Share prices have already adjusted to higher rates, and many sector valuations have fallen. However, a further rise in bond yields remains a key risk in our scenario analysis.

We expect shares to remain resilient through this new cycle of rate rises, but not immune to greater volatility. This view is supported by a resilient global economy and strong company earnings. We are therefore comfortable with our global share exposures.



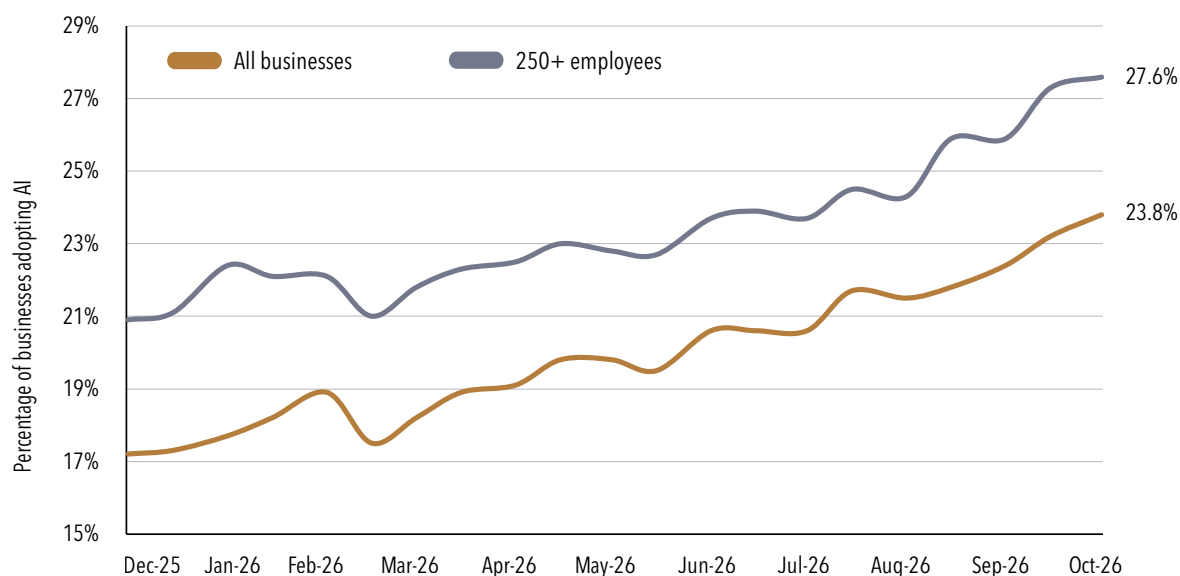
Inside the AI ecosystem

AI is a transformational technology that we expect to support economic growth, productivity and company profits. It works as a self-reinforcing cycle that begins with productivity gains, as the technology becomes capable of handling increasingly complex tasks.

These benefits drive rapid adoption by both everyday consumers and large businesses, which creates a large increase in demand for computing power. To meet this growing demand, heavy investments flow into building

new data centres and hardware infrastructure, which in turn pushes the technology forward and restarts the entire cycle of growth. Chart 5 illustrates the growing adoption of AI across small and large businesses.

Chart 5: Business AI adoption



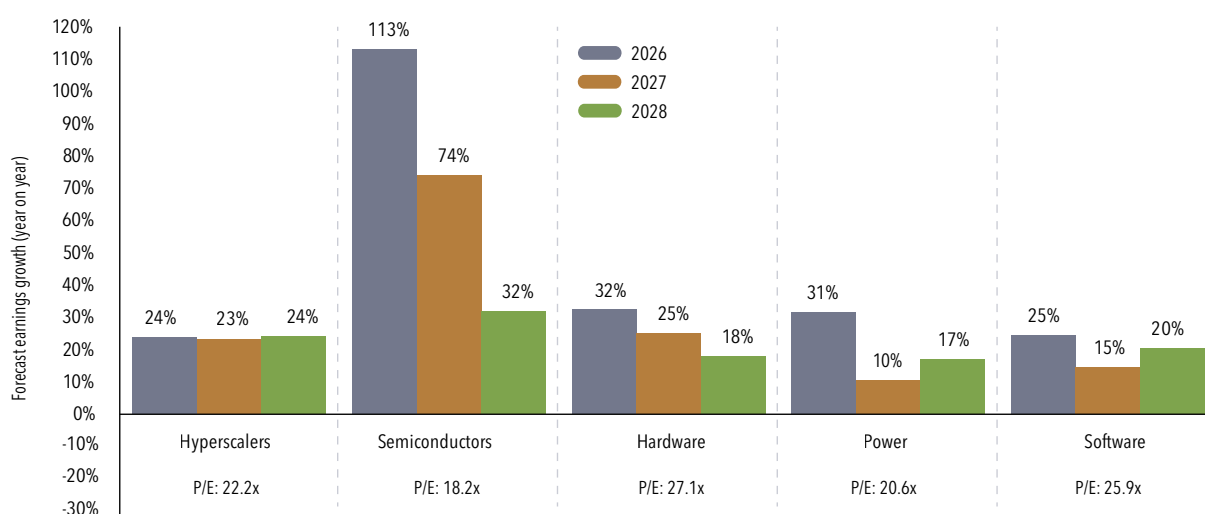
Source: US Census Bureau BTOS, Quilla Consulting

AI is not a single industry

AI relies on a chain of businesses, from the companies that build data centres to the firms that make chips, hardware, power systems and software. Each part of this chain offers different growth prospects and risks (Chart 6) that investors need to consider.

Chart 6 also shows each group's price-to-earnings (P/E) ratio, which compares a company's share price with its expected profits over the next 12 months. A higher number means investors are paying more for each dollar of profit.

Chart 6: AI-related industries – forecast earnings growth and valuations



P/E: forward price-to-earnings ratio.

Hyperscalers: equal-weight average of Amazon, Alphabet, Oracle, Microsoft and Meta, adjusted for gains on privately held investments.

Source: LSEG, Quilla Consulting

Profit growth for the most direct AI beneficiaries is expected to peak in 2026 and remain strong through to 2028. Valuations range from 18.2 to 27.1 times expected earnings. This is not overly stretched compared with 21.6 times for the S&P 500 as a whole.

- Hyperscalers (P/E 22.2x):** These are the large technology companies that provide cloud computing on a massive scale, such as Microsoft, Amazon and Alphabet (Google). They have the most consistent earnings, backed by diverse revenue and strong cash flows. Their spending drives the whole chain, giving them bargaining power over suppliers, and wider AI adoption lifts demand for their services.
- Semiconductors (P/E 18.2x):** Computer chips are the backbone of the AI build-out. This group has the strongest earnings growth, yet the lowest valuation. This reflects expectations that growth will peak, as chip demand tends to rise and fall in cycles.
- Hardware (P/E 27.1x):** Makers of servers, networking and storage equipment benefit from the build-out, but face thinner margins and more competition. At current prices, much of the good news is already reflected.
- Power (P/E 20.6x):** Data centre demand supports the long-term case, but earnings can be uneven. Project timing, delays connecting to the electricity grid and regulation cloud the outlook. Valuations are reasonable and below the broader market.
- Software (P/E 25.9x):** Software is a second-stage opportunity. Growth depends on companies turning AI into products customers will pay for, or using it to improve existing products. AI will create winners and disrupt some established players, so choosing the right companies is critical.

Are we in an AI bubble?

The rapid growth of AI, and the strong rise in the share prices of companies benefiting from it, have prompted speculation that markets are in an AI bubble. A closer look at the fundamentals, however, does not suggest this is the case. There are, however, some risks worth monitoring.

US share prices are supported by strong company profits rather than optimism alone:

- **The broader market:** the average S&P 500 company trades near its historical price-to-earnings (P/E) average, supported by broad earnings growth.
- **The largest technology companies:** the 'Magnificent 7' (Apple, Microsoft, Alphabet, Amazon, Meta, Nvidia and Tesla) are delivering earnings growth well ahead of the market, yet trade at their smallest valuation premium to the broader market in years.
- **Technology and semiconductors:** valuations remain comfortably below their peaks and below historical averages, supported by both strong earnings and revenue growth.

Several factors suggest AI investment is grounded in real business results rather than speculative hype:

- **Funded by cash, not debt:** most AI investment is paid for from the cash these companies generate.
- **Measurable returns:** US hyperscalers (companies that build and operate data centre infrastructure to deliver cloud computing) are seeing a return on their capital expenditure, with cloud revenues growing from 37% (AWS) to 82% (Google Cloud) in the second quarter.

- **Genuine demand:** AI adoption is being driven by demand, while the cost of using it continues to fall.

We are watching for signals that would change our view:

- **Funding model:** A material shift towards AI investment funded by debt.
- **Extreme valuations:** Valuations rising well beyond what fundamentals support.
- **Circular financing:** An increase in circular financing within the technology sector, where companies fund their own customers' purchases.

Our view

We remain confident in our US equity exposure. Current market performance is anchored by resilient corporate fundamentals and verifiable earnings growth rather than pure speculation. While pockets of exuberance exist, we do not believe they pose a risk to the broader market.

Demand for AI is growing, and its benefits will spread as more businesses adopt it. We expect AI to support company profits for several years, and our global share allocations, which have exposure to the AI theme, are positioned to benefit.

Looking ahead to the final quarter of 2026

Global share markets continue to be supported by solid company earnings, particularly in the US, where profit growth is being seen across a broad range of sectors. Significant investment in AI and related infrastructure is also supporting economic growth and corporate activity. For now, we expect these trends to remain supportive of markets.

However, there are still risks to the outlook. Inflation remains higher than central banks would like, energy prices are elevated, and geopolitical tensions continue in several regions. The risk of further energy price increases, particularly as the Northern Hemisphere heads into winter with lower energy stockpiles.

Closer to home, the Australian economy remains relatively weak. Higher interest rates, subdued productivity growth and policy uncertainty are weighing on households, businesses and economic confidence. We continue to favour Australian companies with greater exposure to overseas markets over those more dependent on the domestic economy.

We remain positive on equities, with a preference for global markets where strong company earnings and investment in AI are providing greater support. We also continue to see value in holding Australian government bonds as a source of portfolio diversification and income.

On balance, we are positive on the outlook for investment markets, particularly as we enter a seasonally strong period of the year for equities.



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