



SMARTER
INVESTMENT SOLUTIONS

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Investment Insights

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Key messages

- **Mapping financial and macroeconomic conditions.** Economic conditions have shifted modestly weaker since the energy price shock, but underlying global economic growth remains resilient, albeit modest. Earnings are broadly positive but monetary policy has shifted cautious.
- **Artificial Intelligence's (AI) reinforcing cycle for growth and productivity.** Lower costs and benefits of using AI tools enable more use cases which drives more investment, producing a virtuous cycle for growth.
- **Few indications of an AI market bubble.** US equity valuations are reasonable and grounded by fundamentals. While strong earnings growth underpins market returns, there are several factors that require monitoring.
- **Australian credit continues to offer relative value.** Australia's wider credit spreads provide improved risk-adjusted credit exposure relative to global credit.
- **Australian inflation and interest rates.** A cooling economy and softer than expected inflation data suggest the Reserve Bank of Australia (RBA) is likely at the end of its hiking cycle, but the cash rate is still expected to remain higher for longer.
- **US inflation and interest rates.** Driven by a persistent inflation gap to the Federal Reserve's (Fed) inflation target, we expect a continued hawkish bias in the near term.

Global economic scenarios

	Scenario 1: Risk-Off	Scenario 2: Below Trend Growth	Scenario 3: Growth Stabilisation/Acceleration
Probability	15% (Unchanged)	55% (Unchanged)	30% (Unchanged)
Detail	- Most major economies' growth slows meaningfully, leading to recession and corporate earnings contraction. - Significant re-escalation of the US-Israel war with Iran, leading to an extended closure of the Strait of Hormuz, driving energy prices higher, leading to broader inflationary pressures and a consumer slowdown, creating a stagflationary environment. Other key risk factors: - Material slowdown in AI capex. - Expected AI earnings significantly disappoint. - Significant Australian housing market deterioration. - Substantial rise in bond yields leading to material revaluation of risk assets.	Global growth is resilient but uneven. US retains economic leadership as Australia weakens. Most economies experience softer growth. Core inflation remains stubborn as oil supply disruptions, demand from the AI infrastructure buildout and rising wages place pressure on shorter-term inflation expectations. Longer-term inflation expectations however remain anchored. The global policy landscape shifts more cautious. US Federal Reserve (Fed) policy is hawkish under a new Fed Chair, with at least one hike over the next 12 months. The Reserve Bank of Australia (RBA) remains hawkish but is likely close to the end of the hiking cycle. Elevated global bond yields will remain rangebound, reflecting stubborn inflation but not growth and unemployment risks. Higher fiscal spending leads to larger budget deficits and rising debt, and a steeper yield curve. Structural themes such as AI, as well as pro-growth government policies, support the US economy, equity markets and corporate earnings. Equity market leadership broadens, but pockets of risk in high-momentum sectors builds. The Australian dollar trades around its long-term fair value.	- Global growth becomes more synchronised and improves as productivity gains support the global economy. - Inflation picks up marginally as aggregate demand lifts while productivity gains cap price rises. - Central banks hold rates steady. - Global bond yields remain rangebound, while longer dated bond yields are pushed higher by larger deficit spending. - Pro-growth policies are implemented, such as fiscal spending which supports economic growth. - Earnings are materially revised higher as sentiment improves. Earnings growth broadens across regions, sectors and market caps. - Structural themes like AI drive productivity, lifting economic growth and equity returns.



Mapping financial and macroeconomic conditions

Regional macro heatmap

Region	Economic Growth	Monetary Policy	Fiscal Policy	Earnings Growth	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

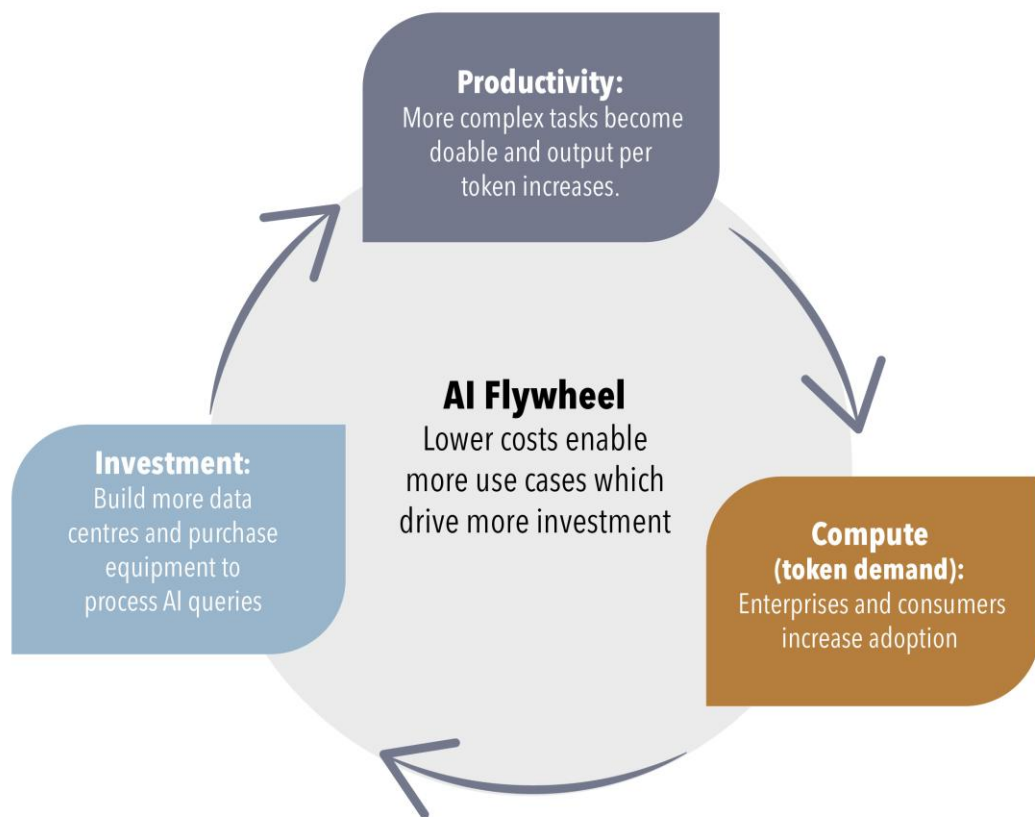
- **Economic conditions** have shifted modestly weaker since the energy price shock, especially for net petroleum importers. The US is a major positive growth driver. India has the strongest growth but is facing energy-related headwinds.
- **Monetary policy** has become more restrictive as near-term inflation risks remain elevated, but a gradual disinflationary path is expected into 2027. China is the outlier as its inflation is contained under a weak housing market and excess economic capacity.
- **Fiscal policy** is supportive apart from Australia, where the recent federal budget and already elevated government spending leaves limited fiscal flexibility.
- **Valuations** have moderated with strong earnings growth in many sectors offsetting valuation multiple expansion. Pockets of valuation concerns are centred in high momentum sectors.
- **Earnings growth** is a common supportive factor, with strong earnings growth estimates across regions expected over the following 12 months.
- **Investor sentiment** is muted outside of high-growth themes and sectors, but equity sentiment indicators continue to show that global investors are highly allocated to US equities.

Our view

Underlying global economic growth is resilient. This provides a favourable environment for global equities, while global bonds are expected to face pressure under a "higher for longer" interest rate regime.



AI's reinforcing cycle for growth and productivity



AI is a transformational technology and its build-out has been a key factor supporting economic activity and corporate earnings growth across multiple sectors.

Markets have questioned the sustainability of the current capex cycle and the ability of AI to produce tangible benefits and returns on significant outlays.

The reinforcing cycle

- As AI drives productivity, its adoption grows. This fuels the demand for computing power, necessitating further investment in advanced models.
- Challenges: infrastructure capacity (energy and chips), financing (cashflows and debt), AI regulation (AI usage and data centres) and higher input costs.
- Catalysts: rising AI use cases, falling token costs and AI's ability to accelerate new ideas and deployment quickly.

Our view

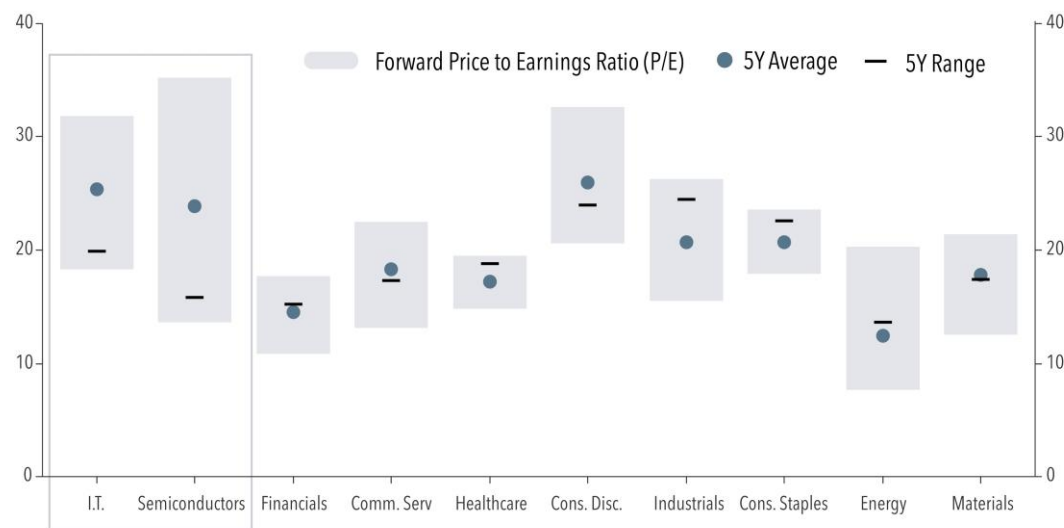
We expect AI adoption will continue to drive global equity returns and economic expansion. Robust capital expenditure forecasts and extended infrastructure build-outs support continued adoption.

Sources: UBS: The AI Economy, Quilla Consulting



Fundamentals outweigh bubble concerns

US equity sector valuations are in line with historical ranges with technology lower



Sources: LSEG, Quilla Consulting

US equity valuations are reasonable and grounded by fundamentals

- The average S&P 500 company trades near historical P/E averages, supported by ~13% forward earnings growth.
- The "Magnificent 7" is trading at its smallest valuation premium to the broader market in years, despite delivering ~40% earnings growth.
- Technology and semiconductor valuations are comfortably below their historical peaks.

Why current conditions do not signal an AI bubble

- Earnings growth (70.5%) and revenue growth (35%) support Tech valuations, not speculative hype.
- Cash flows fund the bulk of AI capital expenditures.
- US hyperscalers are generating measurable ROI with 43% cloud revenue growth in Q2.
- AI is experiencing demand-led adoption alongside falling costs.

Warning signs to monitor

- Material shift toward debt-fuelled investment.
- Valuation blowouts decoupled from fundamentals.
- Rising circular financing within the tech ecosystem.

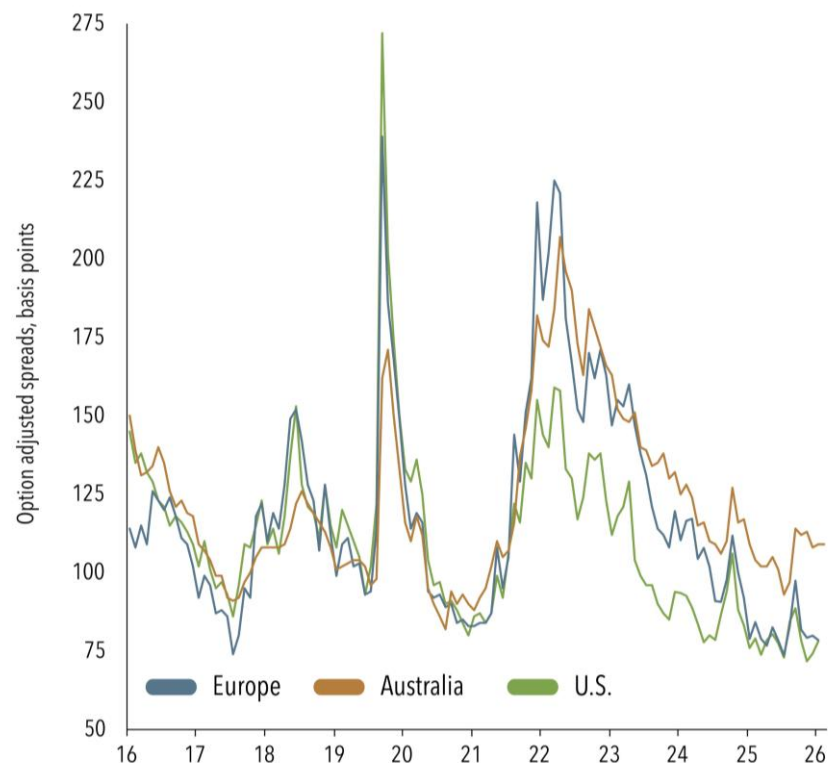
Our view

We remain confident with 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, they do not present broader market risks.



Relative value in Australian credit

Australian investment-grade credit spreads are relatively attractive



Sources: JP Morgan Asset Management, Quilla Consulting

Australian investment-grade credit spreads sit around 108 bps, wider than both the US (~73 bps) and Europe (~80 bps).

The premium has narrowed from cycle peaks, but Australian credit continues to trade at wider spreads compared to global peers.

A yield premium over global peers

- Australian spreads offer a pickup of roughly 30-35 bps over US credit and around 25 bps over Europe, supporting a stronger income profile.
- The wider spread is a result of excess demand for global credit as opposed to higher default risk for domestic credit.

Global spreads leave little cushion

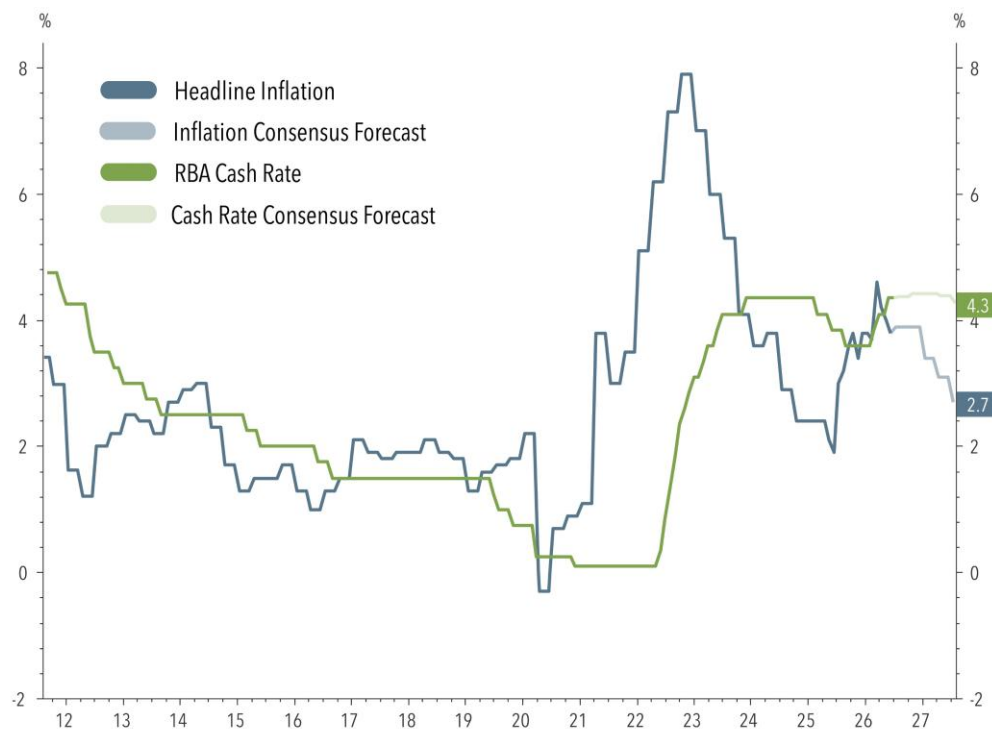
- US spreads have compressed to near historically tight levels, offering limited reward for credit risk and potentially asymmetric payoff should conditions deteriorate.
- Australia's wider starting point provides more carry to absorb any spread widening, providing improved risk-adjusted credit exposure relative to global credit.

Our view

We retain our preference for domestic credit versus global credit. We expect this allocation to continue driving portfolio value through a balance of strong nominal yield and relative capital stability.



Domestic inflationary pressures are easing



Sources: LSEG, Bloomberg, Quilla Consulting

Australian inflation and interest rates

June headline inflation fell to 3.8% year on year, slowing from peak levels of 4.6% in March, mostly on lower energy prices.

Trimmed mean CPI remained steady at 3.6% year on year but undershot consensus and the RBA's own forecast.

Forecasts suggest inflation will slow

- Estimates indicate inflation is set to remain elevated in the near term, trending to within the RBA target band in late 2027.
- The cash rate, however, is expected to remain steady in a higher for longer setting. The market retains a moderate expectation of one further hike this year.

Sources of easing inflation pressures

- The unemployment rate has trended higher to 4.4%. While the labour market remains relatively tight, it is showing signs of loosening.
- Business capacity utilisation is moderating, highlighting easing economic pressures.

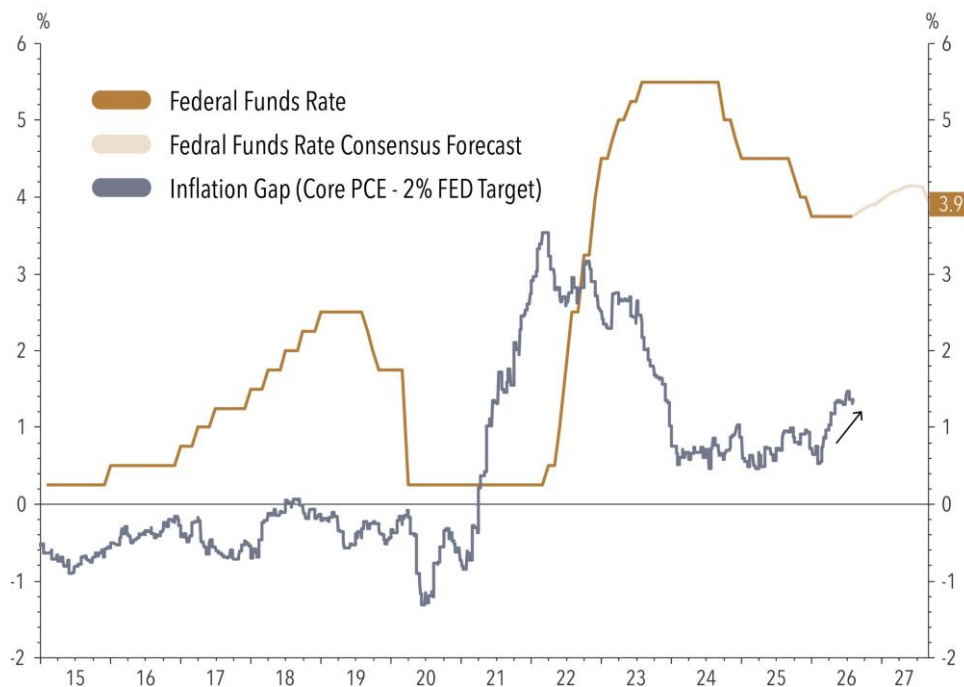
Our view

A cooling economy and softer than expected inflation data suggest the RBA is likely at the end of its hiking cycle. Given this dynamic and the potential economic risks, Australian government bonds are more attractive compared to global bonds.



US inflation and interest rates

A persistent inflation gap pressures US interest rates



Sources: LSEG, Bloomberg, Quilla Consulting

The Fed held rates at 3.5%-3.75% in July amid solid economic growth and productivity.

Three dissents favouring a 25 basis point hike underscore a hawkish undercurrent within the Federal Open Market Committee (FOMC).

Forecasts suggest further tightening

- A significant inflation gap persists (Core Personal Consumption Expenditure (PCE) minus the Fed's target of 2%), driving expectations for at least one more near-term rate hike.
- Bond markets reflect a higher for longer outlook, with the yield curve bear-steepening and 30-year yields breaching 2007 highs.

The Fed's price stability and employment mandate

- A steady labour market continues to operate close to equilibrium, providing the FOMC flexibility to focus on tackling inflation risks.

Our view

A resilient US economy and steady employment suggest the Fed's tightening cycle is not over. Driven by a persistent inflation gap, we expect a continued hawkish bias in the near term. We retain our underweight exposure to US government bonds relative to both Australian government bonds and credit allocations.



Quilla asset class views: summary

Key themes	Rationale
Modest but underweight exposure to government bonds	Retaining diversified exposure to government bonds but remaining underweight interest rate duration relative to fixed interest indices given the risk of further increases in bond yields for longer dated bonds. We are growing more constructive on Australian government bonds versus global bonds as the rate-hiking cycle nears its potential end. We maintain a bias towards Australian credit over government bonds.
Preference for investment grade credit over high yield	Yield pickup in credit compared to government bonds and lower credit risk compared to high yield. Overweight Australian credit versus US credit where spreads are at historically tight levels. Monitoring global high yield bond spreads closely for potential opportunities.
Prefer global equities compared to Australian equities	Maintain an overweight position in global equities, supported by broadening EPS growth across regions. In contrast, Australian EPS growth remains modest relative to global peers; its sustainability is constrained by domestic economic headwinds and high earnings cyclicality in key sectors.
Maintain small and mid cap exposure	The macroeconomic backdrop has become more uncertain, but a supportive government fiscal policy setting coupled with strong expected earnings growth continues to justify exposure to global small and mid-cap equities within portfolios. Within Australian equities, we maintain a reasonable allocation to small caps underpinned by relatively attractive growth profiles, earnings prospects and valuations.
Positive view on private equity / venture capital	A positive outlook due to the potential for higher long-term returns while reducing portfolio volatility and increasing diversification. Private equity/venture capital can provide exposure to the 'picks & shovels' of the AI Infrastructure build out and is less impacted by market sentiment.
Constructive view on gold	Despite a recent softening in performance, gold continues to add meaningfully to portfolio diversification. Over the medium to long term, we anticipate the price will be supported by structural forces that include central bank demand, government fiscal sustainability pressures, ongoing geopolitical volatility and strategic investor flows.
Positive outlook for emerging markets	We favour broader emerging markets due to strong economic and earnings growth, supportive fiscal policies, and exposure to AI infrastructure. Broad EM exposure remains a strong complement to our long-term strategic allocation to Indian equities.





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